"Coforge Limited
Q2 FY '24 Earnings Conference Call"
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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY24 Earnings Conference Call of Coforge Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on a touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Vikas Jadhav, VP, Investor Relations. Thank you and over to you sir.

Vikas Jadhav: Thanks Zico. Good morning to all. You would have received our Q2FY24 results by now. They have already been filed with the stock exchanges and also available on the Investor Section of our website. We have with us today our CEO – Mr. Sudhir Singh; our Chief Customer Success Officer – Mr. John Speight, Mr Ajay Kalra our CFO, and our Deputy CFO – Mr. Saurabh Goel.

We'll begin the call with opening remarks from the Management Team, and post that we'll open the floor for the questions. Before we begin, please note that some of the statements made in today's discussion relating to the future, should be construed as forward-looking statements and may involve risk and uncertainties. Please refer to the disclaimer to this effect in slide number two of company's Q2 results presentation.

With that, I would now like to hand it over to our CEO – Mr. Sudhir Singh. Over to you Sudhir.

Sudhir Singh: Good morning, good afternoon and good evening to all of you across the world, folks. Thank you for joining us today as we share our Q2'FY24 performance and the business outlook.

We meet today in the shadow of a material change in the shareholding structure of Coforge that has taken place since we met last quarter. As you are aware BPEA EQT, which was the promoter of the firm, has sold its entire stake over the course of the last three months. Consequently, Coforge has emerged as the only material Board governed professionally run Indian IT services firm in the industry. We believe that as the Indian IT services industry matures this ownership construct of professionally run firms will likely increase and we take our responsibility as being the first professionally run firm very seriously. It shall be the intent of my team to ensure that in the years to come we set a benchmark around governance and performance that will do justice to the trust that the investors have placed in us.

Moving on, I am pleased to report that in Q2, the quarter under review, Coforge has delivered another strong performance despite the challenging and uncertain macroeconomic environment. At the end of the first half of the current fiscal year, our revenue has grown 16.2% in CC terms, 18.7% in INR and 13.2% in USD terms.

In Q2, we've recorded robust sequential growth, seen a significant sequential growth in our margins, sustained our large deal signing velocity, ensured broad based growth across all verticals, continued with our net headcount increase led by both lateral and campus hiring and also continued our investments in SG&A to sustain our growth trajectory in the coming years. At Coforge we have always believed that superior execution is key to driving sustained performance. This quarter was again reflective of the execution intensity that is uniquely Coforge.

With that preamble, let me move on to the quarterly performance and the revenue analysis.

QUARTERLY PERFORMANCE – REVENUE ANALYSIS

I am pleased to report that during Q2FY24, Coforge reported revenue of $278.1 million, registering a sequential growth of 2.3% in Constant Currency (CC) terms. In USD and INR terms, the sequential growth was 2.3% and 2.5% respectively.

On a YoY basis, Q2 revenues grew by 14.1% in CC terms, 12.6% in USD terms and 16.2% in INR terms.

I shall now detail vertical-wise growth for the quarter under review.

During the quarter, our banking financial services vertical reported again, a sequential growth of 3.8% in CC terms and contributed 31.6% to the revenue mix. The insurance vertical registered a third consecutive quarter of strong growth registering a sequential growth of 2.4% in CC terms. It contributed 22.6% to the revenue mix.

The travel vertical grew 2.3%, Q-o-Q in CC terms and contributed 18.5% to the total revenue. The other verticals portfolio saw a growth of 0.6% in CC terms and contributed 27.3% to the total revenues.

During the quarter under review, top five clients contributed 23.5% to revenues while the top ten contributed 35.2% to the revenues.

During the quarter, quarter 2 that is, offshore revenue contribution saw a further pickup and stood at 52% of the total revenues versus around 51% in quarter 1 FY24.

As I have noted earlier, in previous quarters, this shift towards higher offshore revenues over the last two years has been an important structural margin support for the firm.

With that I can now move on to the margins and the operating profits discussion.

QUARTERLY PERFORMANCE – MARGINS AND OPERATING PROFITS

During the quarter, we delivered an adjusted EBITDA of $48.8 million in USD and Rs. 3,997 million in INR terms. This reflects an adjusted EBITDA margin of 17.6% for the quarter, an expansion of 160 bps sequentially. We are satisfied to see continued expansion in our gross margin, which has gone up by 180 bps QoQ and 42 bps on a YoY basis. This is in-line with our adjusted EBITDA gross margin guidance expansion of 50 bps during the year.

Our quarter two SG&A as a percentage of total revenue stood at 14.9% and has now increased by 121 bps year on year as we continue to invest in the business which was the plan right at the outset. SG&A now stands at around 15% of revenue, which was the target that we had set for ourselves.

Reported EBITDA margin stood at 15.3% and saw an expansion of 33 bps Q-o-Q. Q2 saw a one-time increase in ESOP costs, and I repeat, a one-time increase due to acceleration in ESOP costing. We expect the ESOP costs to normalize from quarter three onwards.

Consolidated PAT for quarter two stood at INR1,810 million, which was a Q-o-Q increase of 9.5%.

ORDER INTAKE

Coming to order intake, we recorded an order intake of $313 million during the quarter under review. This is the seventh consecutive quarter where the firm has reported an order intake of more than $300 million. In terms of geographic regions, America's contributed $118 million, India $138 million, and the Rest of the World, $57 million to the Q2 order intake.

While the macros and the IT spend environment continues to remain challenging, we signed three large deals in quarter 2. In addition to these three large deals, we secured a $10 million TCV cross-sell based contract in our BPS business, and we secured our first sizable transformational win in the Guidewire space for a large US Auto and Home Insurer.

Our executable order book, which reflects the total value of locked-in orders over the next 12 months, now stands at $935 million, and it is up 16.6% on a Y-o-Y basis.

Coforge also signed eight new logos during the quarter. People metrics now.

PEOPLE

At the end of the second quarter, headcount stood at 24,638 employees and saw a net addition of 414 sequentially. I think it's important to point out that in the first six months of the current fiscal, our net headcount has grown by 1,414. You will have noted that this quarter our net headcount grew 1.7% following a sequential growth of 4.3% in the previous quarter.

Utilization including trainees during the quarter stood at 80% compared to 81% in Q1 of 524. There's a slight drop on account of campus fresh graduate edition.

We continue to do campus fresh graduates addition as I said last time as well. Last 12 months, IT services attrition during the quarter stood at 13%. Employee attrition at Coforge continues to remain amongst the lowest across the Indian IT services industry. As you're aware, we fully rolled out the annual salary increments for our employees on time on the 1st of April. We had honoured all commitments and continue to do so to onboard campus and lateral hires. And we had again paid out in full on time the annual bonuses of fiscal year 23 in Q1 24 itself.

With those comments, I shall now request John Speight, Customer Success Officer, Coforge to walk us through capability and delivery highlights. John over to you.

John Speight: Thank you, Sudhir. I shall now touch upon the highlights of the quarter related to our delivery operations.

In our BFS business, we have successfully implemented a new system at a major European bank to replace their UK based legacy Mortgage Retention platform. This has reduced the turnaround time to process mortgage applications by 50%, and increased offers released by 25%.

We created a class-leading portfolio aggregation service for our largest banking technology clients. This has enabled them to target large Private Banks who manage client assets held in-house and at external custodians. For the same client we successfully migrated over $250Bn assets under management for a major US bank onto their Wealth Management hosted platform, the largest migration to-date.

In the Insurance sector, our ongoing commitment to expand our Guidewire capabilities has resulted in Coforge being selected for a multi-year deal by a major US based carrier to transform, and then support their Personal Lines business. A tier 1 speciality insurance carrier appointed us as their strategic integration partner to design, develop, and deploy more than 350 business services on Microsoft Azure over the next 18 months.

Our Insurtech AdvantageGo closed a major deal with a global specialty reinsurer to implement their new product, the Underwriting Workbench. It is a class-leading solution that consolidates all information in a "single pane of glass" to enable efficient underwriter decisioning.

For a large travel technology client, we successfully migrated more than 40 global airlines and 9000 travel agencies onto a new Passenger Name Record system hosted on Google Cloud.

The Company has received a notice from a client in the North America region regarding the client's intent to seek indemnification for third party claims and costs associated with a claimed breach of contract by the Company. The Company has responded to the client's notice, and is not a party to any litigation or other formal proceeding. Notwithstanding the receipt of such notice, the Company continues to provide services to the client on a regular basis with no impact on the revenues received from such client.

In our last earnings call I talked about Coforge being an "AI-first" organization. We continue to develop and showcase our Quasar platform, it now provides more than 100 pre-built frameworks and solutions that clients can use to develop and build their own Gen AI powered solutions. We recently used to help (1) a leading UK retailer reduce monthly losses from customer returns and (2) A tier 1 insurance carrier to increase customer retention ratios.

Continuing with the AI theme, I wanted to highlight an organization-wide program we initiated to understand the benefits that Github Copilot could deliver for our clients. We are training and implementing Copilot across development, testing, documentation, and code migration; tracking the velocity and quality improvements on engagements. In one case we were able to demonstrate a 25% productivity improvement on existing maintenance programs for a global human capital management firm.

Lastly, we continue to focus on expanding our relationship with partners who are heavily invested in AI, that is, the hyperscalers and the low-code/no-code providers such as SFDC, Pega and ServiceNow. For example, today we now have 8 solutions available on the Microsoft Azure marketplace and are currently working with GCP and AWS to host our solutions onto their equivalent marketplaces.

I would now like to hand over to Ajay for further details on financials.

Ajay Kalra: Let me provide few more details on the financials.

Total cash and cash equivalents as at September 30, 2023 was Rs 3,259 compared to Rs. 5,699mn as at March 31, 2023. This was lower by Rs 2,440mn during the period. This reduction of cash was due to payment of dividend amounting to Rs.2,322mn. We also paid Rs. 3,523mn towards acquisition of additional stakes in subsidiaries.

OCF to EBITDA for Q2 stands at 49%. Our H1 OCF/EBITDA was at 1%. Looking at our past trends, we generate most of our OCF in the second half of the year. In the first half we have significant payment like variable compensation, interest, etc. We expect the OCF/EBITDA ratio to be in the range of 65% to 70% in FY24.

The debtors at the end of the quarter stood at 64 days of sales outstanding compared to 70 days in Q2FY23. Capex for H1 is at US$ 12 million.

ESOP costs have increased this quarter due to accelerated vesting on achievement of a certain milestones. Hence could be about 30 bps higher than envisaged. However, we expect this to be lower next year.

With that I will hand over the call back to Sudhir for his comments on outlook.

SUMMING UP AND OUTLOOK

Sudhir Singh: Thanks very much, Ajay.

As I had shared earlier, at the end of the first six months of the current fiscal we have registered a revenue growth of 16.2% in CC terms, 18.7% in INR and 13.2% in USD terms.

We believe that sustained growth is a function of both signing large deals and equally importantly ensuring that existing business is retained. Over the last six years the order executable that we announce every quarter has correlated very strongly with the actual revenue and growth that we have seen in subsequent quarters. This has happened because not only has the large deal median size and velocity gone up but also because our repeat client business at 93% is best in class for a firm our size. This ability to sign large contracts and also sustain existing book of work gives us comfort that in FY'24 and beyond we shall deliver sustained and robust growth.

Basis our performance to date, we reiterate our annual revenue growth guidance of 13% to 16% in constant currency terms for FY'24 and an Adjusted EBITDA margins similar to the FY 23 level.

With that, I conclude my prepared remarks, and I look forward to hearing your comments and addressing your questions.

Moderator: Thank you very much. We will now begin the question-and-answer session. Our first question is from the line of Abhishek Pathak from HSBC. Please go ahead, sir.

Abhishek Pathak: Yes, so Sudhir, my question was around deal activity. So most large peers have reported healthy multi-billion dollar deal wins, but they've largely been around cost takeout. And you know, they've been saying that the appetite for smaller deals and the deal velocity has become quite slow.

Now despite that, Coforge and even some peers of similar size have continued to report healthy DCV numbers. So how do we reconcile this? And for Coforge specifically, what offerings are clients willing to spend on in the current backdrop, which they are not willing to sort of pause or stop. And assuming this macro uncertainty persists, what is the nature of deal conversations you expect to have in FY '25?

Would they be materially different to what we are seeing right now? And how do we think about the nature of demand in FY '25? Thank you.

Sudhir Singh: Thank you, Abhishek. I can say straight off the bat that we do not relate to commentary that you received from some of the larger peers. We continue to see a deal velocity that continues to be very robust. We continue to see median deal size climb up. And when we look at the funnel even going forward, we feel very confident around the fact that it's the width and the probability of closure around large deals for us specifically stays very strong.

So, that's how I would characterize everything that we're seeing right now. We continue to see, if I were to actually parse out where we see large deals in the hopper going forward as well, we continue to see digital transformation as a theme that has not really played out 100% or as a theme that has petered out despite the cost constraints that are there.

Product innovation, legacy modernization, cloud migration continues to hold and deals continue to come in to organizations that are resilient and adaptable. We continue to see a very significant focus from organizations across sizes to very seriously consider challenger organizations like Coforge which have crossed the billion dollar threshold and are by no metric small, domain focused and tech focused challenger organizations.

We continue to see opportunities in Gen AI and advanced analytics. So if I were to just pull this all together, productization, legacy modernization, product innovation, cloud migration, the ability to look at challenger organizations as organizations that have both the capability and the differentiated customer centricity and hunger to satisfy enterprise client demands is what is causing us to see the number of deals that we are seeing and more importantly converting them at scale.

Moderator: Thank you. Our next question is from the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: Yes, thanks. Thanks for the opportunity. Sudhir first question, any recent conversation with the client gives you any change in view and demand outlook where some of your other peers globally like Globant has been talking a recovery in the second half of the calendar year. Are you expecting any green shoots getting emerged?

Sudhir Singh: Sandeep, in BFS we see green shoots but we are trying to balance them against the geopolitical uncertainty that prevails. Insurance within the P&C space, we do see productization and work with product vendors like Duck Creek, Bond-Pro, even Guidewire that John talked about during the call, as spaces where demand is seeing a clear uptick.

Within the Travel space, we're looking at productization, customer experience, and security as potential areas where we see emerging green shoots. Those are the sub-segment-wise views. Overall, on the macro front, the macro, I do want to reiterate continues to be challenged and demand does continue to be stressed.

Sandeep Shah: Okay, fair enough. And last quarter you said to achieve the midpoint of the growth guidance we have to grow at 2.5% compounded Q-on-Q from 2Q to 4Q. This quarter is tad lower despite the great deal wins of the first quarter. So do you expect a pick-up in the growth in the second half? Because some of your peers have been also calling out higher than normal furloughs. So how do you see the second half and when do you expect the first quarter and second quarter deal wins, first quarter particularly which was robust, to start converting into revenues?

Sudhir Singh: Our deal wins have converted into revenues. I think it would be very unfair to start comparing our performance when we've grown 16.2% at the end of the first half with the kind of challenges that the industry has. Even though we say it ourselves, is an exceptional growth.

So we wouldn't really want to go back and try to take what we've already done, complete that and contrast that with what the other peers have done. As far as we are concerned, every time we've called out large deals, we've also shown revenue growth post that.

Look at the last four quarters of results, look at the first six months results. We believe large deals have to continue to translate into revenue growth for us. Going forward, if we grow, to hit the lower end of our guidance, all we need to do is grow 1.6% sequentially for two more quarters. To get to the higher end, we have to sustain the revenue growth that we've been seeing.

We're already at more than 16% growth at the end of the first half. The macros are stressed. We believe that 13% to 16% will hold under almost every situation. And that's why we're going with the given range that we gave six months back when the year started.

Sandeep Shah: Okay, fair enough. And last question in terms of margins, to achieve the adjusted EBITDA margin being at flat, the ask rate is still at 135bps, 140 bps, which we want to improvement in the next two quarters. So what levers which will help us to pull out such a big margin in quarter after quarter in the second half? And is it fair to assume the ESOP cost on a full year basis would be close to 1.1% versus 0.7% last year?

Sudhir Singh: I'll let Ajay take the second question. As far as the first question is concerned, Sandeep, we are not planning to do anything this year which is very different from what we have done in the last three years. Second half, margins will see a significant growth. Q3 to Q2 sequentially, we will see a very significant growth.

We have already seen a 160 bps sequential growth. We expect the growth again to be very significant around 100 bps or higher, Q3 over Q2. So there's nothing this year by way of a new lever that we plan to flex in order to get to the guidance that we've given. Trajectory will continue.

The one point that I do want to add is last year at around this time when the firm was heading into the second half, we were looking at hedge losses. This year, given the currency movements, we are looking at hedge gains. So that's why we feel confident, as I said at the outset, of getting back around the same adjusted EBITDA margin levels as last year. Ajay, over to you for the ESOP question.

Ajay Karla: Thank you, Sudhir. Sandeep, as I had mentioned in my opening remarks, the cost would be approximately 30 basis points higher than we have envisaged in FY24. You are right, it will be around in the range of 1% to 1.1% for the full year, for the financial year '24.

Moderator: Thank you. Our next question is from the line of Manik Taneja from Axis Capital. Please go ahead sir.

Manik Taneja: I thank you for the opportunity. I had a question with regards to our offshore revenue mix which has seen a significant increase post COVID and we continue to step up the pedal over there. How should we be thinking about this metric going forward? That's question number one and the second question was with regards to the outlook on the travel and transportation vertical. We've had some commentary from global companies in terms of some cost pressures or demand cooling off. How do you see this translated to business outlook for us from a 20 to 18 months standpoint?

Sudhir Singh: Manik, let me take your questions in order. The first question was around offshore revenue. When we hit 48 odd percent, this question was popping up and we were, we tried to be very conservative and said that we don't expect it to climb materially. But it continues to climb. Going forward, we expect the climb to be far more gradual, but we still believe given what's happened over the last four quarters, the number will continue to climb. But it will be climbing far more slowly than it has over the last 8 to 12 quarters.

As far as travel and transportation is concerned, the commentary that you talked about is commentary that we empathize with, we relate to some extent. Travel transport, we are seeing pockets of spend coming up. They are centered around security. Spend is centered around digitization. They are centered around productization and they are also centered around spend being directed towards customer experience-based projects. Having said that, there are initial signs of, I wouldn't say stress, but of a normalization in spend going forward. We would expect our travel vertical going forward in the next 12 months to 18 months to continue to grow in line with the broader firm's growth but not to outpace it.

Manik Taneja: Sure, and one last one, if you could also talk about the Board reinforcement, board ownership change that has happened at the company.

Sudhir Singh: I'm sorry, I lost you, Manik, would you please repeat that question?

Manik Taneja: Sure, Sudhir. I just wanted to understand your thoughts around the reinforcement of the Board post ownership change.

Sudhir Singh: Yes, Manik, as I said at the outset, the leadership team, the Board, believes it's a privilege, it's a very serious responsibility for us to have emerged as the first professionally run Board Governed IT Services organization.

Today during the Board Meeting two of the Directors from Barings Private Equity Asia have stepped down. We've called it out as part of our result pack as well. Going forward, the Board is working, the NRC of the Board is working, towards reconstituting the Board and we would expect that process to get consummated or largely be in shape over the next one quarter to two quarters. And we will update you post the next Board meeting.

Manik Taneja: Sure. Thank you and all the best for the future.

Sudhir Singh: Thank you, Manik.

Moderator: Thank you. Our next question is from the line of Ravi Menon from Macquarie. Please go ahead.

Ravi Menon: Hi, thank you. So you've shown pretty broad-based growth across all verticals. Can you explain BFS where I think most peers have struggled but you actually shown pretty good growth?

Sudhir Singh: That's right, Ravi. As we said, there are green shoots, even though the macros are stressed. Digital transformation spend has not necessarily gone away. The play around product innovation, the play around legacy modernization, the acceptance of challenger organizations like Coforge, at a $1 billion close to 55% of our revenue comes from financial services, has really picked up. So we are seeing growth from some of the areas that I talked about. We are seeing growth also because of our ability to penetrate increasingly at scale into Tier 1 financial services organizations as a very credible challenger. And we also continue to see growth across BFS in areas like advanced analytics.

John, would you like to add to that?

John Speight: Yes, I would actually. There's a few things on this, and it's been feedback from some of our Tier 1 banking clients. When we've been working with many of these clients it's been very focused in very specific areas. We haven't spread ourselves across the whole enterprise, we've focused on very-very key business aligned areas and many of those are in the non-discretionary spend areas. So we're heavily involved in a number of Tier 1s around payments processing as you may be well aware there's some major changes going on at the moment.

There's also in the regulatory and the compliance space, two areas where we're heavily involved in the transformations going on at banks. So the combination of us being very, very focused and therefore very, very competent in key areas along with it being within the non-discretionary and transformation areas, has meant we've been able to grow where others have struggled.

Sudhir Singh: Thank you, Ravi.

Ravi Menon: One more follow-up, if I may. Your BPS business also has held up pretty well. I know that you only have probably a small exposure to what we just spoke about in the fall, but can you speak about what are the areas that are growing well in your BPS business?

Sudhir Singh: In the BPS business, Ravi, the overriding premise behind doing the SLK acquisition two years back was because it was a banking only focus BPS business and the our premise was that we would be able to extend that business more actively into Insurance and Travel verticals, which has happened. We were also convinced that we could take the BPS capabilities across the other financial services clients of Coforce, and that again has happened.

Today when we talked in the commentary section about new wins, we talked about three large deals, but equally importantly, we talked about a $10 million BPS deal. The fact that we've been able to get new leaders, both at the front end and at the back end over the last two years after the acquisition was consummated, the fact that the team has seen very significant investments come in. The fact that it is possibly an exceptionally stable, not just management team, but a business with possibly the lowest attrition across any BPO player. And the fact that our AI and analytics business have been able to work very closely with the BPO team to make a difference has really helped.

John, any other comments on that?

John Speight: Yes, one comment I'd like to make there is the fact that we've combined automation and technology with our BPS. We haven't just focused on people on seats. We've actually focused on how we deliver value to our customers and that resonated very, very well.

Moderator: Thank you. Our next question is from the line of Shraddha Agarwal. Please go ahead, ma'am. From Asian Market Securities.

Shraddha Agarwal: Congrats, Sudhir, on a steady quarter. Two questions from my side. Can you highlight more on the three large deals that we've done, as in what is the proportion of net new deal contribution and any highlight on which sectors have you won these deals wins?

And the second question is to you, Saurabh. I mean, when you said that adjusted for hedge losses, EBITDA margin would have seen an expansion of 200 bps. But when I look at the hedge loss number in absolute term, it seems to be flat on a Q-on-Q basis. So how does the margin expansion of 200 bps come through then?\

Sudhir Singh: Thanks, Shraddha, for both the questions. Saurabh, would you like to take both questions, color around the three large deals and the hedge loss question?

Saurabh Goel: Yes. So, three large deals came in. One was from the BFS space, which was a new account. And this was an account which we were kind of going after for the last six months. So it's within the BPS space, so within banking. So that is one. It's a new logo, 100% new revenue.

Then the other two large deals came in. One from the travel vertical within the EMEA space and one was a renewal.

Sudhir Singh: Yes, and as Saurabh said, out of the two travel deals, one was with one of the leading Middle Eastern airlines and the other one was with another, possibly the leading European airline. So that's where the two travel deals came from. And as Saurabh said again, Shraddha, what was interesting about the BFS win was that we've opened a new client in BFS last quarter, despite everything that's talked about around the uncertain macros, with a large deal. So it's not an incremental scoop.

Saurabh, would you like to address your again, the hedge loss question as well?

Saurabh Goel: So hedge losses in the current quarter were flat as compared to the previous quarter. Next quarter going forward, these hedge losses will convert to hedge gains. So we will, assuming the currency remains at the current levels, we at least assume there will be a 50 bps flip on the margins just because of hedge losses getting converted to hedge gains. So that's where we are today. So currently we are at almost INR10 crores of hedge losses in quarter 2, which at current levels will get converted, if I just do mark-to-market, close to INR3-odd crores of hedge gains. So there will be a fillip of INR13-odd crores going forward as we move to Q3 and probably even more in Q4.

Shraddha Agarwal: Got it, Saurabh. Yes, got it. And the last bit from you, Sudhir, on the, so I mean, some of our larger peers have been indicating stress in their existing work of business because of discretionary projects being on hold by certain accounts. So do we see a similar situation for our discretionary book or how do we see our existing work of business altogether?

Sudhir Singh: Shraddha, I believe they are right. The macros are stressed. But we have also always maintained that for robust growth to happen as a firm and as a team, we should not just be signing large deals. That is vitally important, but we should be focusing equally strongly on retaining the existing book of business. Otherwise, the good fancy stuff gets done, large deals are announced, and when you look back subsequent quarters, you don't find revenue going up. And that's largely because the quiet drip that keeps happening around delivery because of client dissatisfaction or a lack of client delight, more than negates whatever good comes from signing large deals. So what has worked for us is the fact that our repeat business for a firm our size is possibly one of the highest at 93%.

Just summarizing the answer, yes, everyone's right when they talk about the macros being stress. But are we able to retain our business? I think the answer is yes. And that answer is also borne by the fact that not only have we been calling out over the last four quarters large deals, but we've been backing that up with actual revenue growth and material growth subsequently.

Shraddha Agarwal: Thank you, Sudhir, and all the best.

Sudhir Singh: Thank you.

Moderator: Thank you. Our next question is from the line of Rishi Jhunjhunwala from IIFL Institutional Equities. Please go ahead.

Rishi Jhunjhunwala: Yes, thanks for the opportunity. A couple of questions. You know, one, a couple of levers that you've talked about in terms of margins over the medium term. One was the initiatives around reduction in ARC (Average Resource Cost). And second is increasing the offshore mix towards closer to 55% versus 52% where we are today. So just wanted to understand on both these metrics how much -- so of course offshore mix we can see, but on the ARC, how much we have progressed and by when do we expect how much expansion coming through that?

And on the offshore side, any timelines in terms of by when do you expect to reach that 55%-plus number?

Sudhir Singh: Rishi, I'll give it a good shot and then I'll request Ajay also to chime in if he has other comments. 55% offshore is what we're heading towards, but I don't believe it's going to be a very rapid, upward line towards 55%. So it's a little difficult to call out how many quarters this will take, though we do think that's where we are likely to track to and get to.

As far as ARC is concerned, we are not happy with the progress that we have made on ARC. Second half is when we expect to be very aggressive around ARC reductions. I called this out earlier also. We were possibly one of the few, if not the only tech services firm that on the 1st of April gave 100% of the increments. We gave very high variable payouts as well. So when I look at ARC, are we at the midpoint of the year on ARC where we wanted to be at the beginning of the year?

The answer is no. But are we equally committed that we will deliver on the ARC promise before the end of the year? The answer again is a very strong yes. So long story short, we are not happy with the cost out that has happened so far. We are now going to be heads down, working on making sure that the ARC drops more significantly in the second half going forward.

Ajay, would you like to add to that?

Ajay Kalra: Sure, Sudhir. As you mentioned, Sudhir, we are working on the ARC and we are focused to drive it down, though it has not happened till now, however, there are actions that we are taking and we believe that by the end of the year, we will be at the targets that we had set out ourselves for and that's another key word that we have for the margin improvements for the second half.

Rishi Jhunjhunwala: Understood. And second question is just on your other vertical outside of BFS and transportation. So I guess you had in the past talked about splitting it up sometime in the near future, but just among the two or three key verticals within that, can you give some color in terms of how the momentum is building there?

Sudhir Singh: Yes. Retail, Rishi, seems to be doing well. Much smaller base but material growth that we've seen. Public sector has already scaled up. It's almost about 7% to 8%, roughly about 7% of our aggregate revenues and that business continues to be robust. We do expect it to go up.

You're absolutely right about the fact that we have committed to carving out a new vertical and calling out those numbers. We will start doing that starting next year because end of the year might be a logical time to start making changes to the reporting structure.

Rishi Jhunjhunwala: All right, thank you. All the best.

Sudhir Singh: Thank you.

Moderator: Thank you. Our next question is from the line of Saurabh Sadhwani from Sahasrar Capital. Please go ahead.

Saurabh Sadhwani: Hi. So despite the furloughs in Q3, you expect a margin expansion of 100 basis points. So I understand that partially it's due to the hedge gains expected, but what are the other levers?

Sudhir Singh: So let me just be very clear. In Q3, we expect revenue growth to be tepid because all of us, all four of us out here are not standing and talking about the fact that we will not see significant furloughs. We will, like any other organization. Revenue growth will be tepid, margin expansion will be significant, which is a point that Saurabh made, 100 bps, possibly higher, around 100 bps at least. One driver, as you rightly said, because of the hedge gain, the reversal on the hedge front that we talked about. Second driver, what we just talked about, the ARC initiative that Ajay and I were talking about. We expect that going forward to be also a significant event. Did I miss anything? Ajay, Saurabh.

Saurabh Goel: Yes, so I think we also every year either towards the end of September or beginning of October do a client event. So that will again add almost 40-odd bps into the margins next quarter. So I think as we move from Q2 to Q3, one is hedge losses converted to hedge gains. Second is the impact of a client event which happened in Q2, which was an annual event, which will again give the margins for next quarter.

Third thing is ARC initiative has seen slow movement but whatever actions have been taken, some benefit of that will start flowing in from Q3 onwards. So that benefit will start coming in. So I think those benefits will offset the impact of the furloughs and hence we will see at least 100 bps-plus margin improvement. So that's how we're looking at it.

Sudhir Singh: Right, and Saurabh, just to build on what your namesake Saurabh talked about, what we normally did was our annual client event used to happen in quarter 3 of a year. As Saurabh said, we did that in quarter 2 and that for a firm of our size, that is a material spend. We would like to invite some of you to attend it in the future. We like to think we throw a very good event. Because that event happened in Q2 and the costs have been fully booked by Ajay, Saurabh and their teams, that is not going to be a cost impact in Q3 and hence the 40 bps of upside that he was talking about.

Saurabh Sadhwani: Okay, okay. Thank you, thank you.

Sudhir Singh: Thanks, Saurabh.

Moderator: Thank you. Our next question is from the line of Abhishek Kumar from JM Financial. Please go ahead, sir.

Abhishek Kumar: Yes, hi. Thanks, good morning. Sudhir, my question is on the events, BFS, from what I hear, what we hear from most of the players is that most of the deals out in the market are kind of vendor consolidation, cost takeout deals. At the same time, we continue to win new logos in the BFS space. So I just want to understand who are we winning against? Are we kind of consolidating local subcontractors or are we winning against some of the larger peers in this space?

Sudhir Singh: Abhishek, in the real world, other than analyst reports, mid-tiers don't compete with mid-tiers. So firms of our size, if I look at 19 out of our top 20 clients, our biggest competitor there is a scale IT player. Could be anyone from Accenture to Deloitte to the TCSs of the world. These wins are coming against those players. They always have, and I suspect they always will.

Very rarely, if at all, do you have a mid-tier competing with a mid-tier at scale in an enterprise IT companies. So that's the ground reality. John, would you like to add to that, beyond the smile?

John Speight: Not too much, but Yes, I mean, we are winning against the Tier 1s significantly. And I think, it's down to the fact that we're able to execute so well. We've got a recent case in Australia where we won against a Tier 1 and took part of the business and because the ability to actually execute so well we're actually taking more-and-more business. That's just a classic example of what we're achieving.

Abhishek Kumar: Okay. Second question is maybe on the smaller deals. You know, a significant part of our deal wins still constitute of smaller deals. Just wanted some color on the kind of deals which we are winning here, these are largely renewal or we are also getting a net new deal? And any change in the type of deals here and the pipeline that we have in the smaller deals too.

Sudhir Singh: So Abhishek, to the point that John made earlier, the smaller deals are one on the back of execution. No client asks a vendor that is delivering well ever to leave. That's an axiom in our industry. That's where most of the growth comes from. The headlines come from large deals, the growth comes from delivery. While we're signing large and small deals, it would be very unfair to start characterizing them into three or four buckets. These deals are contextual - depending on the client, depending on where they are on their tech journey, depending on where they are on the budget spends. They are of all kinds. I know, it's fashionable these days to try to bucket them into cost consolidation or something else. They include cost consolidation deals. They include a lot of productization deals, they still include innovation deals. As to your question around NN, as I said, one of the three large deals that we signed during the quarter was signing a new client with a $20 million plus contract John, would you like to add more color to that?

John Speight: Not too much, Sudhir. I keep coming back, and you mentioned the execution and quality. And what we're finding is a lot of the CxOs that we're dealing with are actually turning around and saying, you're different because of the quality of your execution. And what is helping us is, as we're seeing in the public sector at the moment, so in the UK, is where those CxOs, they tend to move around every few years into other parts of the public sector.

And they're actually reaching out to us as soon as they get into those new organizations to say, how can we get you into our organization? And that's helping us develop. But it's all on the back of execution.

Abhishek Kumar: Great, that's helpful. One maybe last clarification. Sudhir mentioned, you expect Q3 to be stepped, then in that case, that will really increase the ask rate for Q4 significantly. So in that context, I just wanted to understand, are we seeing that kind of pickup as we stand today? Or maybe in other words, are you still confident of achieving, even the upper half of the guided band?

Sudhir Singh: Difficult to say, Abhishek. What we are absolutely crystal clear on is that the guidance that we gave at the beginning of the year - which was very aggressive guidance - 13% to 16% growth, is the guidance we will deliver on. Q3 is going to be soft. It will be soft for the industry. Furloughs this year have been very aggressive. We believe, and we've always said this, that we have a very strong fix given the execution that John talked about on two quarters here on.

We at least internally know the broad number we will land at in Q3. Anyway, almost one month out of three is gone. Even on Q4 we have a clear fix. Q4 should see a material upside compared to Q3. Tepid of course is a qualitative term, so our intent is to make sure that Q3 is not terribly tepid.

Abhishek Kumar: Sure. That's helpful. Thanks and all the best.

Sudhir Singh: Thank you.

Moderator: Thank you. Our next question is from the line of Rahul Jain from Dolat Capital. Please go ahead, sir.

Rahul Jain: Yes. Hi, thanks for the opportunity. Just one question that since of course you mentioned some of the things that will benefit the profitability near term and for this year but as a measure to protect margin or do cost optimization, is there an active program given that there is a potential risk of growth slowdown at some point, or you are saying that, since the momentum for you is continuing, you are looking more on the cost optimization, but more on the growth side of the business?

Sudhir Singh: Well, we always look at cost optimization, but we do not do cost optimization on the back of cost outs that impact our employees. We believe that is counterproductive and those kind of optimizations are attempted by firms that are not confident of growth. We are crystal clear, we are a growth firm. We will deliver growth, not just in FY '24, where the guidance is 13% to 16%, but in FY '25, '26, '27 and there on. So, are we focused on cost optimization? The answer is a definite yes. But please also remember, we possibly are the only IT services firm that on the 1st of April this year gave 100% increments, gave exceptionally high variable payouts compared to the previous year. Cost optimization, will we do it? The answer is, yes. Will we do it at the expense of things that in the long term will hit the growth trajectory of the firm? The answer is no.

Rahul Jain: Sure, that's very encouraging, thanks.

Sudhir Singh: Thank you, Rahul.

Moderator: Thank you. Our next question is from the line of Vibhor Singhal from Nuvama Equities. Please go ahead.

Vibhor Singhal: Yes, hi. Thanks for taking my question. I'm sorry, I joined the call late, so I don't know. I hope the question has been answered. So, Sudhir, my just one question is on the margin guidance. I think for long we have kind of guided margins on the adjusted basis. But at the end of the day, the ESOP cost that we give, the ESOP cost that we adjust the margins for is a part of the business and it's part of the compensation that we get to do.

So any roadmap or any outlook as to when we could actually look at providing a margin guidance on a reported basis. Because the gap between the two, is quite big, even for this quarter, for multiple quarters. And eventually that cost just translates down to the profit numbers and eventually the profitability of the company. So any color on as to, when we could probably move to more of a reported basis margin guidance, which could help get better understanding than the report of the company?

Sudhir Singh: That's a fair question, Vibhor. Ajay had pointed out earlier in the call that this year there has been a spike in quarter 2. We expect the cost to normalize quarter 3 onwards. And next year, as Ajay had said, we expect the ESOP cost to come down. Ajay, correct me if I'm wrong, by about 30 bps, 40 bps, from wherever we're likely to land up in fiscal year '24. We've taken note of your suggestion and we will work on that and then revert to you in the future around giving reported EBITDA guidance as well.

Vibhor Singhal: That's very interesting. Thanks a lot. Thanks, Sudhir. That's it from my side. I think most of the questions have already been answered. I wish you all the best.

Sudhir Singh: Thank you, Vibhor. Thanks a lot.

Moderator: Thank you. Our next question is from the line of Ashish Das from Mirae Asset Capital Market. Please go ahead.

Ashish Das: Hi, good morning and thanks for the opportunity. So, Sudhir, I just want to understand. Usually we say that Q2 used to be a strong quarter in terms of revenue growth for a year. Now, this quarter we have the growth is moderated compared to Q1 and so just wanted to understand your view, why this it happened this time that Q2 growth is not so strong?

Sudhir Singh: Well, Q2 growth of 2.3% has still meant that at the end of the first half, we're growing 16.2% over the first half last year in CC terms, Ashish. That 2.3% growth follows 2.7%, 3.7% and 4.7% growth. So if you look at the last four quarters, sequential growth has been between 2.3% to 4.7%. If you were to ask me, why is there been a slight deceleration, the answer is the same that we heard on the call repeatedly. The macros are tough and that's why we are at the number that we are at right now.

At the same time, it's important to reiterate what we said at the beginning of the year. We will deliver on it. That guidance we have maintained and we will continue to maintain. Even at the end of Q3, you will not from hear me, Ajay, John, Saurabh something different. We will deliver on the guidance given at the beginning of the year, which was an aggressive guidance. That's how I would respond to that question.

Ashish Das: Okay. And my second question is, I can see that top accounts, I'd say top five, top 10, got declined quarter-on-quarter. Is there anything to read there?

Sudhir Singh: No, Ashish, I won't read much there because last quarter the top five accounts, if I remember right, went up 12.5% sequentially. Saurabh keep me honest on this, but was it about 12.5%?. That was a massive spike. The growth has normalized. Top account relationships are solid. Growth on a secular long-term basis will continue to be solid.

Ashish Das: Okay, good. Thank you.

Sudhir Singh: Thank you.

Moderator: Thank you. Our next question is from the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: Yes, sir. Just a clarification. Sir, you mentioned and quantified about the hedge gains in the Q3 and Q4. Sorry, I missed it. If you can repeat the same it would be helpful?

Saurabh Goel: Okay, so I mentioned that in current quarter, we had a hedge loss of INR10.5 crores which if the currency stays at the current levels, don't move much, we should be seeing a hedge gain of INR3 crores in the next quarter and it will only expand in Q4. So that's what I said.

Sandeep Shah: Okay, perfect. So that may drive 50 bps- 60 bps kind of a Q1-Q2 tailwind…

Saurabh Goel: Easily.

Sandeep Shah: Okay. Perfect.

Saurabh Goel: 50 odd bps, assuming the currency stays at the current levels, it should be a 50 bps same.

Sandeep Shah: Okay, so Sudhir in that scenario, that plus no client event, which will have a tailwind of 30 bps, 40 bps, margin up move could be higher than 100 bps in the Q3 itself, right?

Sudhir Singh: Well, I hope you're right. That's the intent. It's a valid question, Sandeep. That's going to be our intent. A lot of it will also play into currency movements as well. Hence, we've said broadly about 100 bps. We will attempt to try to make it beyond 100 bps sequentially.

Saurabh Goel: And Sandeep, what will happen is we all know there'll be furloughs in the next quarter. So benefit of this, a part might get set off against the furlough impact but three levers, one the loss is getting converted to hedge gains, second is the client event and bit of actions that were taken in Q2 around ARC, some benefit will start flowing in that will get set off against the furlough impact that's coming in, but net-net, we're still looking at 100 bps at least, and then looking at beyond that. So that's how I will table the overall basis quarter for.

Sudhir Singh: Thanks, Ajay, you were trying to say something. Would you like to add to that?

Ajay Kalra: Hello, Sandeep, I was just trying to mention the point about the furloughs, because that's going to offset the gains that we are going to have so, And…

Sandeep Shah: Ajay sir, is it correct to assume ESOP cost may decline by 30 bps- 40 bps by FY '25?

Ajay Kalra: Yes, they will decline if no further ESOPs are given on the current level, they will decline at around 30 odd bps next year.

Sudhir Singh: There is a high probability, as Ajay just said, Sandeep, that it will decline by about 30 bps.

Sandeep Shah: Okay, thanks. Thanks a lot and all the best.

Sudhir Singh: Thank you.

Moderator: Thank you. Ladies and gentlemen, that was the last question of our question and answer session. I now hand the conference over to Mr. Sudhir Singh, CEO, Coforge Limited, for closing comments.

Sudhir Singh: Ladies and gentlemen, thank you very much for your time. I realize it's early morning in India and late evening in the States. Thank you very much for your time, for your interest, for the commentary and for the insights that you leave us with. I just wanted to point out that over the last few quarters, we have also started doing this investor call over video. We are not much to look at (laughs!) but if you do want to join the video link going forward, we would really appreciate seeing you as we answer your questions. We will make sure that the video transcript is also uploaded immediately after this conversation on our website. Thank you once again and we look forward to seeing you next quarter.

Moderator: Thank you. On behalf of Coforge Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.

Note: - This transcript has been edited for readability purpose.

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