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EDITED TRANSCRIPT

Q4 2019 Genpact Ltd Earnings Call

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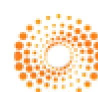

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the 2019 Fourth Quarter and Year-end Genpact Limited Earnings Conference Call. My name is Gigi, and I will be your conference moderator for today. (Operator Instructions) As a reminder, this call is being recorded for replay purposes. The replay of the call will be archived and made available on the IR section of Genpact's website.

I would now like to turn the call over to Roger Sachs, Head of Investor Relations at Genpact. Please proceed, sir.

Roger Sachs *Genpact Limited - Head of IR*

Thank you, Gigi, and good afternoon, everybody, and welcome to Genpact's fourth quarter earnings call to discuss our results for the fourth quarter and full year ended December 31, 2019. We hope you had a chance to review our earnings release, which was posted to the IR section of our website, genpact.com.

With me in New York today are Tiger Tyagarajan, our President and Chief Executive Officer; and Ed Fitzpatrick, our Chief Financial Officer. Our agenda for today will be as follows: Tiger will provide a high-level overview of our results and update you on our strategic initiatives. Ed will then discuss our financial performance in greater detail and provide our outlook for 2020. Tiger will then come back with some closing comments, and then we will take your questions. And as Gigi just mentioned, we expect our call to last roughly an hour. Some of the matters we will discuss in today's call are forward-looking. These forward-looking statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those in such forward-looking statements. Such risks and uncertainties are set forth in our press release.

In addition, during our call today, we will refer to certain non-GAAP financial measures. We believe these non-GAAP measures provide additional information to enhance the understanding of the way management views the operating performance of our business. You can find a reconciliation of these measures to GAAP in today's earnings release posted to the IR section of our website.

And with that, let me turn the call over to Tiger.

Nallicheri Vaidyanathan Tyagarajan *Genpact Limited - President, CEO & Director*

Thank you, Roger. Good afternoon, everyone, and thank you for joining us today for our 2019 Fourth Quarter and Year-end Earnings Call. Outstanding execution and continued transformation services wins capped off one of our best revenue growth years ever. This translated into a healthy adjusted EPS and operating cash flow growth for 2019. These metrics were all above the high end of our expectations. Clients' desire for transformational change is accelerating, expanding our addressable market and providing greater opportunities for us to drive profitable long-term growth. We continue to improve the rigor and agility of our portfolio evaluation process, allowing us to quickly reallocate investment and talent resources to best penetrate high-growth areas.

Here are our full year 2019 results on a constant currency basis. Total revenue increased 18%, Global Client revenue increased 12% and

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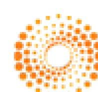

Global Client BPO revenue increased 14%. We also delivered adjusted operating income margin of 15.9%, up 10 basis points; and adjusted EPS of $2.05, up 14%.

During 2019, we were increasingly recognized by our clients and industry analysts as a preferred partner to drive transformational change. By leveraging disruptive digital technologies and real-time predictive insights, we are reimagining the way work gets done to solve critical business problems for our clients.

With the relentless pace of technological innovation, as well as competitive, macroeconomic and geopolitical pressures, corporate leaders must accelerate their decision-making process and make bold decisions based on insights derived from analytics. We believe our culture of driving change to meet these heightened expectations from the C-suite and Boards is a huge differentiator in the market and is one of the reasons we win.

During 2019, we drove Global Client growth across our chosen verticals led by growth of more than 30% in Transformation Services. Our consulting, digital and analytics Transformation Services, rooted in domain and process expertise, acts as a "tip of the spear" for many large, long-term transformational engagements. Our consistent growth performance over many years supports my long-held view that digital and analytics "comes to life" when implemented with a deep understanding of domain and process.

Highlighting the impact of Transformation Services on our business, our fastest-growing relationships are greater than 20% of revenues coming from Transformation Services. These accounts are growing at more than double the company average.

During 2019, for the second consecutive year, we signed total new bookings close to $4 billion, fed by our high-quality pipeline that remains near historic highs with steady win rates. As a comparison, during 2016 and 2017, new bookings averaged approximately $2.7 billion.

Global Client bookings had a solid growth in 2019 with proactive sole sourced deals accounting for roughly half of our new wins. Large deals continued to be a meaningful contributor to total bookings, and almost three quarters of our bookings had Transformation Services embedded in them, up from 60% range in 2018. As expected, the bookings declined in 2019, given the large deal we signed late in 2018.

Let me call out some key highlights for 2019. We continued to add iconic brands to our client list in our focused industry verticals. We closed 2 acquisitions to enhance our capabilities in critical areas: financial crimes and risk management and digital experience. Supply chain services, a strategic focus area, showed dramatic growth in inflows, pipeline, bookings and revenue during the year. We successfully launched Genome, a re-skilling and training platform for our global workforce that has been a huge hit. We continued to leverage new commercial models, reflecting the changing nature of work we do for our clients. And finally, through the last phase of the large GE deal, we significantly enhanced our strategic sourcing capability.

Expanding on some of these. During the year, we elevated our brand recognition and solidified our reputation as a thought leader, providing innovative transformative solutions for a growing roster of iconic clients. For instance, as discussed last quarter, we entered into a strategic relationship with Cardinal Health, where our deep expertise in finance and accounting and ability to leverage data analytics to provide insights will help transform their FP&A analytics function to drive timely as well as insightful decision-making. FP&A represents another ripe area for disruption and provides opportunities for growth.

These relationships are creating a heightened level of new inbound C-suite calls as companies want to explore engaging with us to transform their businesses. We expect to fully leverage such new skill sets from a number of these relationships that has added significant new capabilities over the last 2 years. These include highly leverageable teams in financial planning and analysis; order management and supply chain, particularly in consumer goods retail; commercial and pricing analytics; and sourcing and category management. A lot of this depth is in market and onshore.

We acquired riskCanvas early in 2019, which bolstered our already strong market offerings in financial crimes and risk management services for banks, a large opportunity for growth. Our expanded capabilities in this space are already showing results. We were selected

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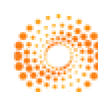

by a global bank to transform their KYC process for their wholesale banking business to better define customer risk profiles and improve regulatory compliance. Our risk domain team, along with our digital and analytics experts, are deploying a first of its kind "as-a-service" solution with a transaction-based commercial model. This unique offering leverages the riskCanvas proprietary cloud platform to collect and organize customer data, populate customer profile templates and provide risk scores. Replacing the bank's current manual processes with a streamlined digital "as-a-service" model, this solution is expected to cut processing time in half and provide an industrialized KYC process with much higher accuracy and timely regulatory reporting.

During the fourth quarter, we closed the acquisition of Rightpoint to deepen our capabilities in experience, which is becoming increasingly important to our clients. While still early days, we're already seeing the value of bringing together our process innovation and Rightpoint's experience innovation.

Supply chain management, now led by the team that joined us from Barkawi in late 2018, is allowing us to build traction in a vastly underpenetrated market. Our pipeline has expanded more than 3x during the beginning of -- since the beginning of 2019, and we recently won a new engagement with a large global consumer goods company to help transform and run their end-to-end supply chain operations. The redesigned operating model is aimed at helping the client drive better customer relationships, improve fulfillment rates, accelerate new product introductions and optimize trade promotions, thereby driving higher revenue and better working capital levels for them.

I am excited to report that we now have 3 global relationships that crossed $100 million in annual revenue, up from just one at the end of 2018. We expect many more of our relationships to hit this milestone over time.

As our solutions increasingly leverage AI, machine learning, robotic process automation and cloud-based solutions, our commercial models are becoming more outcome based. At the end of last year, more than 40% of our total revenue is from newer constructs, not just based on FTE pricing, up from the mid-30% range only a couple of years back.

Our talent has always been the most important pillar of our success. Like many of our clients, we are going through a transformation in the way we excite our workforce to re-skill and help them continuously learn. The launch of our Genome platform early last year provides the right tools and methods to upskill our 95,000-plus global team members with relevant digital transformation and other professional skills at scale. We are well on our way to achieving our first year goal of reaching 70% penetration with the amount of learning hours continuing to expand.

As we move into 2020, we continue to expect our overall demand to be robust and continue to be led by Transformation Services. Coupled with the power of our domain and process expertise, we believe we are uniquely positioned to leverage innovative new digital technologies as well as data and analytics in a focused way to solve for specific business outcomes. This allows us to drive end-to-end digital transformation for clients in unprecedented ways, delivering significant outcome improvements and superior experiences.

We have been building these solutions through a combination of internal development, partnerships, acquisitions and large targeted carve-outs from our clients. We now have an active portfolio of solutions that we manage, allowing us to leverage them for scale. Over time, we will continue to take decisions to proactively pull the plug on some of these. Recent examples of this include our mortgage origination platform, the KYC JV and the wealth management platform. This proactive culling allows us to double down on areas such as dynamic workflows in the cloud, customer experience solutions, supply chain optimization, financial crimes and risk solutions and many others that are demonstrating market traction.

With that, let me turn the call over to Ed.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Thank you, Tiger, and good afternoon, everyone. Today, I will review our full year results in detail then briefly touch upon some highlights of our fourth quarter performance as well as provide our financial outlook for 2020.

Let me begin with a review of our full year 2019 results. Total revenue was $3.52 billion, up 17% year-over-year or 18% on a constant

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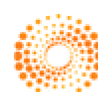

currency basis. Total growth was greater than expected with Transformation Services leading the way. Total BPO revenue, which represents approximately 84% of total revenue, increased 19% year-over-year; and total IT services revenue was up 10% year-over-year. Global Client revenue, which represented approximately 86% of total revenue, increased 11% year-over-year or 12% on a constant currency basis, at the high end of our expected range. Within Global Clients, BPO revenue increased 13% year-over-year or 14% on a constant currency basis, led by growth in Transformation Services, up more than 30%; while IT Services revenue increased 3%.

During the year, as we become a bigger transformation partner for an increasing number of Global Clients, we have meaningfully expanded the size of a number of our client relationships. During 2019, we increased the number of our Global Clients with annual revenues over $15 million to 49 from 45. This included clients with more than $25 million in annual revenue, growing to 25 from 21.

GE revenue increased 78% year-over-year, above our expectations, largely due to incremental scope added during the year related to the large deal we signed late in 2018.

Adjusted income from operations grew 18% year-over-year to $559 million. Recall that we had assumed approximately $22 million at the beginning of the year related to the India export subsidy in our adjusted operating income outlook. As it became clearer throughout the year that we would only receive approximately $4 million of that expected benefit, we put plans in motion to cover the $18 million shortfall with other items. During the fourth quarter, we were able to finalize the plans to monetize a property we owned in India which generated a gain of approximately $31 million included in other operating income. This gain was partially offset during the quarter by certain other costs, including an $11 million nonrecurring impairment charge in cost of revenues related to a European wealth management platform that we no longer plan to leverage beyond the current scope.

Adjusted operating margin of 15.9% was 10 basis points or $4 million, lower than our 16% target, primarily due to a $4 million impairment charge recorded in the fourth quarter related to certain retirement plan assets in India.

Gross margin was lower year-over-year, primarily due to higher stock-based compensation of 20 basis points and approximately 50 basis points due to the nonrecurring charges I just mentioned. Better-than-expected revenue growth with higher onshore scope and the additional GE revenue also impacted margin.

SG&A expenses totaled $795 million compared to $694 million last year. As a percentage of revenue, SG&A expenses were down 50 basis points year-over-year, driven by operating leverage, despite a 50 basis point dilution related to higher year-over-year stock-based compensation as well as a 10 basis point impact from Rightpoint acquisition-related expenses.

Adjusted EPS of $2.05 was up 14% year-over-year compared to $1.80 in 2018. This $0.25 increase was primarily driven by higher operating income of $0.34, partially offset by lower foreign exchange remeasurement gains, higher tax expense and higher net interest expense of $0.03 each. 2019 represents the fifth consecutive year of double-digit adjusted EPS growth that produced a 15% compound annual growth rate over that period. This growth was driven by solid revenue growth and disciplined cost management that has consistently driven increased operating income and related operating margins in each of those periods, in line with our stated key strategic objectives.

Our effective tax rate was 23.7% compared to 22.3% last year driven by the expiration of Special Economic Zones benefits in India, changes to the jurisdictional mix of income and the impact of India tax law changes.

Let me now provide some additional color around our fourth quarter performance. Global Client revenue increased 7% year-over-year or 8% on a constant currency basis, largely driven by continued growth in our consumer goods retail, banking capital markets and high-tech verticals. Recall that our growth rates during the fourth quarter last year made for a tougher comparison this year.

GE revenues were up 61% year-over-year driven by the new large deal signed late last year and incremental scope of work added during the quarter.

Adjusted operating margin during the quarter was 16.9%, largely in line with the level reported during the same period last year, but

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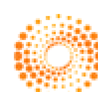

slightly lower than we expected, primarily due to the nonrecurring impairment of the India retirement plan assets in the quarter that I mentioned earlier.

Gross margin for the quarter was approximately 33% compared to 35.5% level we generated during the first 3 quarters of 2019. The decline was primarily driven by the 2 nonrecurring charges I referred to earlier that total approximately $14 million. In addition, lower margin on the incremental GE scope and lower margin on the ramp-up of a new account in our banking vertical negatively impacted gross margin levels during the quarter. The new banking account margins are expected to return to more normalized levels in the first quarter of 2020. We also expect overall GE full year 2020 gross margins to be largely aligned with GE's 2019 levels. Since 2019 was impacted by nonrecurring charges of approximately 50 basis points, we are expecting full year gross margins to be up by 50 basis points in 2020.

Total SG&A expenses were $213 million compared to $179 million in the same quarter of last year and included approximately $7.4 million of nonrecurring Rightpoint-related acquisition expenses and approximately $16 million related to stock-based compensation.

Adjusted EPS for the fourth quarter was $0.57 compared to $0.52 last year. The $0.05 increase was driven by higher operating income of $0.07 as well as $0.01 related to the impact of higher foreign exchange balance sheet remeasurement gains, partially offset by higher effective tax rate of $0.02 and increased share count of $0.01.

Our effective tax rate was 28.1% compared to 25.8% last year due to the expiration of Special Economics Zones benefits, changes in the jurisdictional mix of our income and the impact of India tax law changes.

Turning to our balance sheet and cash flows. During the year, we returned $95 million of capital to shareholders. This included approximately $65 million in the form of our regular quarterly dividend of $0.085 per share which increased by 13% in comparison to the prior year. We also repurchased approximately 766,000 shares totaling $30 million at a weighted average price of $39.16 per share during the year. Since we initiated our share buyback program in 2015, we've reduced our net outstanding shares by 17%. Over this period, we repurchased 37.4 million shares at an average price of approximately $26 per share for a total of $976 million. The weighted average annual return on these share repurchases has been approximately 18% from 2015 through the end of January this year. We currently have approximately $274 million of authorized capacity under our share repurchase program.

Cash and cash equivalents totaled $467 million compared to $368 million at the end of the fourth quarter of 2018. Our net debt-to-EBITDA ratio for the last 4 rolling quarters was 1.7. With undrawn debt capacity of $428 million and existing cash balances, we continue to have sufficient liquidity to pursue growth opportunities and execute on our capital allocation strategy.

Days sales outstanding were 86 days, which were down from 87 days sequentially and increased 3 days from the last year driven by delayed collections on certain accounts where cash was received in early January.

Despite the higher DSOs, we were able to generate $428 million of cash from operations in 2019, up 26% year-over-year, exceeding the high end of the range we expected for the year. The majority of this outperformance was driven by higher adjusted operating income.

Capital expenditures as a percentage of revenue was 3.3% in 2019, in line with our expectations.

Finally, let me update you on our outlook for 2020. We expect total revenues to be between $3.89 billion and $3.95 billion, representing year-over-year growth of 10.5% to 12.5% on a constant currency basis. We expect the Rightpoint acquisition to contribute approximately 250 basis points to total company growth in 2020. This impact is approximately 100 points higher than the contribution from acquisitions to our top line in 2019.

For Global Clients, we expect revenue growth to be in the range of 12% to 14% on a constant currency basis. We expect GE revenues to normalize and be approximately flat year-over-year. We continue -- we will continue our strategic objectives to expand our adjusted operating margin and expect to drive 10 basis points of improvement to 16%. As I mentioned earlier, we are expecting our full year gross margins to improve by approximately 50 basis points in 2020 due to the impact of nonrecurring charges incurred in 2019. We believe our

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gross margins have stabilized. The impact of large deals has driven even higher revenue growth than we expected and thus has had a greater impact on gross margins than we initially expected. Given the tremendous amount of capabilities we have been adding to our team from these iconic companies, we made the strategic decision to accept initially lower gross margins on these deals. We plan to fully leverage these skill sets well into the future.

Due to the historic seasonality we see in our business, we currently expect our adjusted operating margin for the first quarter of 2020 to be in the 14% to 15% range we have seen in the last 2 years. We also expect the ramp of operating margins to be more in line with the trajectory we have seen over the past 2 years.

Our 2020 effective tax rate is expected to be approximately 23.5% to 24.5%, up from 23.7% in 2019, driven primarily by the expiration of Special Economic Zones in India. We continue to expect our effective tax rate to stabilize in a mid-20% range as the Special Economic Zone expirations reduce over time.

Given the outlook I just provided, we are estimating adjusted earnings per share for the full year 2020 to be between $2.24 and $2.28. This increase in earnings per share of 9% to 11% includes the negative impact of higher tax rate of approximately $0.01 per share in 2020 and includes no FX remeasurement-related impact. Recall that we recorded a gain of $0.03 for FX remeasurement gains in 2019. We have assumed our ending share count as of December 31, 2019, in this estimate. We are forecasting cash flow from operations to grow by approximately 10%, largely in line with total company revenue growth. Capital expenditures as a percentage of revenues are expected to remain at approximately 3% to 3.5%. We continue to expect the free cash flow to net income ratio to be approximately 1:1, on average, over time. And finally, we just announced an increase to our quarterly dividend from $0.085 to $0.0975 per share, which equates to annualized dividend of $0.39 per share, up 15% year-over-year.

With that, let me turn the call back over to Tiger.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Thank you, Ed. We saw terrific momentum in our business in 2019 driven by disciplined strategic choices and strong execution. Our investments in our service lines, along with the successful integration of our acquisitions, particularly in digital and analytics, has positioned us well for a multiyear growth trajectory. Our large deals with iconic brands has solidified our reputation as a transformation partner of choice, leading to higher levels of inbound activity beyond our traditional buying centers.

As we enter 2020, we are seeing the experience economy rewrite the rules of digital transformation. We are extremely excited about how we have bolstered our capabilities in this area through the acquisition of Rightpoint on the heels of the addition of the TandemSeven team a few years back.

We have also been able to leverage our automation to AI platform Genpact Cora in many of our engagements and solutions, and we see it being a huge differentiator. Cora allows us to bring more standardized, repeatable offerings to the market.

Clients increasingly need predictive insights to make more informed decisions. With the acceleration of the digitization of data and the maturation of data management, our opportunity in analytics has expanded dramatically. We saw terrific growth in analytics in 2019, and we expect this trajectory to continue to be a key driver of Transformation Services growth going forward.

As noted earlier, we will continue to be maniacally focused on reallocating investment and talent resources to high-growth areas, and we'll continue to be thoughtful in our choices.

In summary, we have a growing top line primarily made up of sticky long-term global relationships with inherent operating leverage driving long-term margin expansion and the ability to tap our cash flows and balance sheet to take advantage of opportunities in our underpenetrated market. We have the right leadership team and talent base to go after this. I'm pleased with our 2020 outlook which is very much aligned with our long-term growth and profitability goals.

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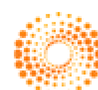

Roger Sachs ***Genpact Limited - Head of IR***

Thank you, Tiger. We'd now like to open up the call to your questions. Gigi, can you please provide the instructions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Ashwin Shirvaikar from Citi.

Ashwin Vassant Shirvaikar ***Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst***

Good quarter. Yes. So what I was hoping for was maybe a bridge to connect your 2019 performance to 2020 expectations on a revenue basis. I get the 250 basis point contribution from Rightpoint, but total contribution from acquisitions, the GE delta, how we think about that? How much is existing client growth versus new client ramp? And I might have missed the FX comment you had.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

So let me take that, Ashwin, to begin with, and Ed will add to that. I'll start with GE. GE, as I mentioned and I think Ed added, will be broadly flat as we look at '20 versus '19, which is kind of the way we thought about GE for many years until various changes happen. So that's one way to think about GE, and then that leads to Global Clients. If you back off the 250 basis points driven by acquisitions, which is about 100 basis points more than '19, then really you're talking about a Global Client growth that is just a little bit above in 2020 versus 2019, which is a great position to be in. And that -- the confidence of that is driven by, obviously, the pipeline, the wins we've had which we continue to execute on. I'd also say that all the execution during the year of the various large, complex deals that we won have gone really well. And it's important to call that out because that sets the stage for continued growth, both in those relationships as well as what it does to other relationships as far as reputation is concerned. And on FX?

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

And on FX, really expecting no rate right now. The as reported and constant currency is consistent, so it's kind of a small difference, so no change. If anything changes during the year, we'll update you.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes. And maybe the final wrapper to that -- to both our comments would be visibility to revenue kind of very similar as we look at 2020 as it was at the beginning of 2019.

Ashwin Vassant Shirvaikar ***Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst***

Got it. That's very helpful. And then the second question, just drilling down on Rightpoint, obviously a good-sized acquisition. How much was the 4Q contribution, first of all, I guess? And then any thoughts on what the core margins are versus integration costs in terms of margin impact? Any early views on what clients have said? One pushback I do get from investors is people try to compare Rightpoint to Headstrong from years ago and not necessarily a fair comparison, but I want to hear your viewpoint.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes. I'll start with the last one because that's the easiest one. That is a completely disconnected comparison. There is no comparison at all, not even remotely. Rightpoint is a business that is focused on improving consumer experience for B2C companies, business-to-business experience for business-to-business companies and user experience in large employee bases of large enterprises. It's multi-vertical. It's working with clients to drive change from design strategy to digital execution to bring that strategy to life. And then when you combine that with our capabilities that came to us through TandemSeven and then our capabilities on process innovation, that's where we are already beginning, as I said, to see real great conversations with our existing clients and actually interesting conversations with Rightpoint's own client base. So that one is the easy one. Contribution to fourth quarter is about 150 basis points in the fourth quarter.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Yes, 1% to 1.5%.

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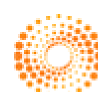

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

1% to 1.5%, 100 to 150 basis points of contribution to revenue. Margin, broadly similar to our margin at the operating margin level.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Well, I think with the integration expenses, it was a bit more dilutive. So all in, with the integration expenses, it probably caused pressure to the extent of about 15 basis points in total for the fourth quarter. As we get into next year, the impact is lesser, but it will be below company average next year because we'll continue to do the integration that we're supposed to do, right? So -- but overall, we're managing that in the 16% operating margin guidance that we gave.

Operator

Our next question comes from the line of Dave Koning from Baird.

David John Koning ***Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst***

Yes, and nice year.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Thank you, Dave. Thank you.

David John Koning ***Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst***

Yes. And I guess -- so first of all, just one more thing on Rightpoint. So it seems like, based on where you were in Q4 and then the way you guided 2020, it's probably in the ballpark of a $90 million-or-so run rate. How do you see that growing over the next couple of years between cross-selling different products to the Genpact organization and vice versa? Like is that something that might grow well faster, like 25% or something?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

So, Dave, actually, your zip code is pretty good. I would say the starting point of the zip code is right. The math is right. And one would think about Rightpoint in the same way one thinks about Transformation Services. It is new digital skills. It's new age skills. It's consulting. It's experience. Therefore, it should lead company growth, for sure, and it should get closer to the Transformation Services type of growth. That would be our expectation, combination of their capabilities brought into our client base and our capabilities taken into their client base.

David John Koning ***Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst***

Okay, great. And then just a couple of quick modeling ones. Typically, from Q4 to Q1, you fall off $40 million, $50 million or so. This quarter -- this Q1, I would assume it's going to be a little less than that, just because the incremental Rightpoint acquisition. So is it more like a $30 million, $40 million falloff sequentially? And then interest expense is the other one.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

As we look at it, we're still somewhere in the range of 2.5% to 3.5% is kind of what we've seen. I wouldn't model different than that. I'd say 2.5% to 3.5% is about the right range, David. It will help a bit, but just -- I would stick to that range, sequential decline, yes.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes. We've seen that now for historically so many years, Dave, that it's a good way to model the business.

Operator

Our next question comes from the line of Joseph Foresi from Cantor Fitzgerald.

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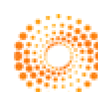

Steven Chang

This is Steven Chang coming on for Joe. So just maybe more of just any more color on Rightpoint. I'm just wondering, if possible, maybe you could quantify how much of that digital revenue growth you saw was due to integrating Rightpoint as you've seen so far and maybe how you look on that like moving forward.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Can you repeat? Yes, I didn't get the -- did you get it?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes. So if the question was how much of what we've seen so far in digital growth is because of Rightpoint, I would say by the time we close the Rightpoint acquisition, we were well into the middle of the fourth quarter. So I wouldn't say a lot of the growth of the fourth quarter came from the capabilities that came into the company through Rightpoint.

However, if the question is a broader question around how much is experience and how much have you seen experience being important for digital growth in the last couple of years, the answer is quite a lot. And the importance of that is one of the reasons that gave us the confidence to go forward and bring Rightpoint in. That confidence was built with the TandemSeven team, and that team has been with us now for more than 2 years. And we see that -- we saw that play out in banking. We saw that play out in insurance, and we started seeing that play out in a number of other verticals. That's the confidence that we have with Rightpoint as we look at 2020 and beyond.

Steven Chang

Okay, great. That's helpful. And just one more follow-up. Moving on to kind of your -- the pipeline on larger deals. Are you -- do you see any slowdown in the future? Are you expecting inflows to kind of continue at the same rate? And maybe if you could provide some color on these deals in specific verticals or any clients, especially if you could touch on maybe digital, please.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

I would say we haven't seen any change in the behavior of clients. We haven't seen any change in inflows, pipeline and closure, which is bookings, as we've gone through the year. The only thing I would call out as a question mark is the recent events around coronavirus and what does that mean. We haven't seen anything so far, but I think it's prudent for us to think about if that kind of epidemic continues to play out in a certain way, then what does that mean to global travel? What does that mean to clients' ability to travel? And what does that do to decision-making? We just want to be watchful and cautious. And obviously, we are in discussion with clients. We haven't seen anything so far.

Operator

Our next question comes from the line of Tien-Tsin Huang from JPMorgan.

Puneet Jain ***JP Morgan Chase & Co, Research Division - Computer Services and IT Consulting Analyst***

Yes. This is Puneet sitting in for Tien-Tsin. So 2019 clearly was a banner year for you in terms of ramping up multiple large deals. As we look forward and your growth begin to normalize, why is gross margins not expected to expand by more than impairment benefit of 50 basis points as some of those deals ramp up? Or is that too early, and that's more of a long-term lever for gross margin expansion?

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Yes. I think as I said in my prepared remarks, we believe that the margins have stabilized. But as you heard Tiger say, too, the pipeline is still pretty robust. And the level of large deals in the pipeline have not decreased, right? So we're pleased with that level. And to the extent that we do more large deals, kind of if margins stay in and around this range, we'll all be very happy because we'll be able to drive through incremental operating margin as well as income and free cash flow, right? So our view is to the extent that the services that we provide for our clients provide higher value, absolutely, we should see appreciation in gross margins. For right now, our view is stable. Seems like the right place to be given the pipeline and the extent of large deals that are there. So for now, we're -- we think it's reasonable to assume flat. And as we make progress on that, we'll update it.

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Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes. And Puneet, 2 other things to add to what I just said. If you go back to the commentary on Global Client growth, after you remove the impact of Rightpoint, Global Client growth is actually just a tad bit better in 2020 versus 2019, which means the ramps continue. And we're going to -- based on our pipeline and inflows, we will have more deals that come in that need to continue to ramp. And our deals, as you know, take time to ramp. So therefore, I think we would not be able to use that ramp to get the steady-state gross margin in year 2020 itself. Obviously, over time, that should play itself through.

The second one is on Transformation Services, particularly if you peel off into digital, most commentary from most peer group companies will tell you that digital takes time to deliver on margins as you scale. And that scaling effort is not a single or 2-year effort, it's a multiyear effort. And we are still in that journey of scaling. So I think if you put those 2 together, longer-term margin trajectory should be positive. I don't think we expect to see that in 2020.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Yes. Puneet, as you've seen us manage, too, we're really looking at driving EPS growth, driving free cash flow growth for the value of the firm. To drive the value of the firm, we do that by driving operating margin, right? So the operating margin is where we've been so maniacally focused as well and making sure we're currently improving. You'll see some geography where maybe gross -- we might make a call, I think, gross margin will be a bit lower on the deal. But if we're able to drive operating margins up, we'll take that. We'll take that every day. And in fact, you heard us talk about a lot of what we've done in some of these gross margins being lower, the onshore skill sets that you heard Tiger talk about that we're more than happy to do. It's effectively building out new service lines, if you will, where we'd be developing that in our R&D line, right? So these are calls that we've made consciously and strategically, and we're happy with them.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes, absolutely.

Puneet Jain ***JP Morgan Chase & Co, Research Division - Computer Services and IT Consulting Analyst***

Got it. And Ed, can you also talk about potential impact from the recent India budget on your tax rate and subsidies or any other line item in operations? And will that also impact, in any way, your ability to move cash in or out of India?

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Sure. A couple -- there's a few different things happening. Some just recently announced some kind of a little bit -- announced a little bit earlier. The first one is the tax rate that India has announced in the elections that companies are able to take going forward with the reduction of the overall corporate tax rate is somewhere in the mid-30s to mid-20%, 25% range or thereabouts. That was one of the reasons why you saw actually our tax rate increase this year because we had to revalue our deferred tax assets at that lower rate, so the tax increase that you saw happen a little bit higher than what we expected even in the quarter was due to the revaluation of those deferred tax assets at that lower tax rate. So a good thing for the company to stem tax increases going forward, for us, actually led to a bit of a write-down of the assets, which seems counterintuitive, but it makes sense.

On the other tax provision that talks about dividends-related tax and being able to get cash allowed the cash to be more fungible. That's certainly a positive. At least, it gives more flexibility or less -- you're penalized less if you want to take cash out of the jurisdiction potentially. So that's a potential positive, but we've been able to manage that without much impact over the years, but it's certainly another potential positive in terms of flexibility it gives us.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

And that's -- as you know, that's still on the table to be passed by Parliament, if I remember right. So we'll have to wait and see ultimately what happens, but it gives us more flexibility if that's the way it turns out.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

That's right.

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Operator

Our next question comes from the line of Maggie Nolan from William Blair.

Margaret Marie Niesen Nolan ***William Blair & Company L.L.C., Research Division - Analyst***

So you've obviously still got some flexibility in the balance sheet to do some acquisitions in 2020, but you're already coming into the year with a pretty decent inorganic contribution. So I'm just wondering can you update us on your appetite for M&A in the coming year and what you're looking for.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Yes. So I'll start it off, and Ed can add. Our appetite, Maggie, has never been driven by how much growth contribution it would have or should have. We've always driven our M&A from our strategic choices, and we still have a set of strategic choices where we would love to find the right target to bring in, just as we've done over the last 4 to 5 years around certain specific digital capabilities, analytics capabilities, certain domain capabilities across the various geographies. So we do have a pretty good M&A pipeline. As you know, a number of those, while they are in the pipeline, never ultimately get done because of a variety of reasons, including, in our business, a match of cultures and so on. So I wouldn't necessarily say that our M&A decisions are based on what contribution to growth do we expect from acquisitions. We have the firepower available to do the right acquisition if we find one, and our M&A team continues to look for the right ones and engage in those conversations? Ed?

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Yes. That's a good point. I'd just add 2 other things. We're at 1.7 net debt to EBITDA, so feel pretty good about our flexibility do more, as we see appropriate. But again, it's all based upon what we think makes sense not for growth. Because it's been around 1% to 1.5%. Rightpoint was bigger, right? We said it's about 2.5%, and it was bigger. But also, kind of I was happy to do it because it was probably one of the more profitable companies that we've acquired, right? They're coming in with largely aligned operating margin. They could be a little bit lower in the first couple of years because of the integration-related expenses, but we love the product. We love the profit margins they're driving. So at the end of the day, the EPS impact of this business is going to be accretive, $0.02, $0.03. And we love that, right? And that will grow over time. So that one was bigger, and we kind of like the fact that it was bigger.

Margaret Marie Niesen Nolan ***William Blair & Company L.L.C., Research Division - Analyst***

Okay, great. And then you had a strong quarter in Q4. Clearly, the core BPM business is doing well. It did have slightly weaker performance out of Global Client IT. So I'm just wondering if there are any dynamics there that we should be keeping an eye on and what your expectation is for both Global Client IT and GE IT in 2020 and any kind of quarterly considerations there, too.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

So I'll address the GE IT one very quickly, Maggie. Overall, we are assuming, as I said, flat GE. Specifically within that, IT, et cetera is dependent so much on GE's own budgets to a single client, et cetera. So predicting that in a very specific way is more difficult. I think Global Clients is a better conversation because it's a portfolio.

On Global Client IT, over the years, we've talked about making our choices in IT and narrowing them down to the areas where we think we have a real strength in connecting it to our process and domain and industry understanding, and we've been undertaking that journey for many years. As a result of which, we are now back to growth versus having quite a few years where we were declining. As we continue to undertake that journey, we are finding material pieces of our IT business that are getting closer and closer to our digital business. And in fact, the lines of differentiation between those 2 are blurring.

So as we go forward, we expect some portions of the IT business to actually start mirroring some of our digital business growth. And as that keeps expanding, the portions of our IT business that are more unconnected to all those will become smaller and smaller and less material and have less material impact on the overall company. And that's already beginning to show itself in the numbers if you look at the numbers today versus 5 years back. Ed, anything else to add?

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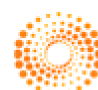

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

I would just say, as a result of this, you've heard me say we're talking about IT separately. It seems unusual because of how this has all been kind of coming together, particularly over the past year or 2. So as we move forward, our plan is to not talk about IT separately given how that has come together. So we'll cover it on this call. But going forward, you shouldn't expect us to cover it.

And then, Maggie, to answer your specific question, the fourth quarter, I think part of was a couple of things. We had some larger impacts and a good IT -- or a good comparison year-over-year because we had some fourth quarter, and GE was part of that. So that was part of the year-over-year shrinkage. In the full year, actually, we did -- we had -- some of the large deals had some IT associated with it, and that wound down a bit as we got into the fourth quarter. So just to answer your specific question.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

And some capital markets-related, banking-related customers. And you've heard that commentary from most of our peer group. I mean, that, obviously -- to the extent that we have some portion of our business there, that also got impacted.

Operator

Our next question is from the line of Justin Donati from Wells Fargo.

Justin Micahel Donati ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

I just had one. Can you talk about how many Transformation Service professionals you have and if you're having any issues finding talent?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

No. It's an interesting question, Justin. We don't count headcount based on specific number of Transformation Services professionals because that's a combination of people who are deep in a particular industry. Some of them, by the way, come from our operating teams across the globe. And now we have 100-plus operating centers across the globe. Some of them are subject-matter experts in specific services and domain: finance, supply chain, risk, financial crimes and so on. And then a number of them come from our digital teams who are kind of pods of capabilities: AI, machine learning, the experience group. And a number of them sometimes are deep inside our Transformation Services engagement. Think about them as consultants. And other times, they're actually solutioning a very large managed services deal which is not a plain engagement. So we -- I don't think we'll be able to specifically answer the question you're asking, which is headcount in Transformation Services. We don't monitor and manage Transformation Services as a specific separate headcount.

Justin Micahel Donati ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

Got it. And then if I could sneak one more in. Are you seeing a greater percentage of revenue coming from transaction and outcome-based work? Are you getting better margins in that area?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

So the simple answer to your question is we should and we will. But it takes time, particularly because in those outcome-based contracts, depending on the nature of the contracts, some of them are transaction-based pricing. If it's transaction-based pricing, then we start getting better margins pretty early, particularly as we start driving digital technologies and driving productivity, automation and so on. Some of them are fixed price. And again, as we drive productivity, we should, but that takes some time. And then we have truly outcome-based contracts, where if you drive better -- if you reduce fraud, if you increase revenue, if you improve our on-time fulfillment and supply chain, those take significant time. You've got to hit milestones, so those then don't show up as better margins immediately. They take time to show up.

Operator

Our next question comes from the line of Bryan Bergin from Cowen.

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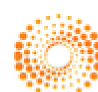

Bryan C. Bergin ***Cowen and Company, LLC, Research Division - Director***

I was curious, I wanted to ask, first, consulting and Transformation Services. Can you just give us some color on how you're thinking about managing resource utilization as you move past the year-end, particularly as you're adding this Rightpoint consulting workforce as they come on here in 4Q? Just talk about your confidence in making sure to avoid any potential air pockets on resource utilization as you're moving through the early parts of 2020.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

Yes. It's a great -- because I was going to answer that on the last question that Justin was asking, kind of added on. That wasn't exactly aligned with what his question was, but -- because you do remember coming into -- I think it was 2018, we had that -- we kind of got ahead of ourselves in the hiring, and I think I used words that were less than complementary of how we managed it, but I said we're getting after it. And the company has gotten after the meaningful way. I think a lot of brute force as we got through 2018, and we saw those margins improved, and we saw further improvement as we gotten into '19. And we now have the system, I think, largely in place where we're measuring those resources and measuring utilization. And we've improved utilization significantly. That is no longer an issue for us. So now those margins have come up significantly as we expected, and we're continuing to drive utilization metrics and drive those metrics positively up to improve margins. So that is definitely a positive for us as we move forward in terms of our ability to improve margins and utilize those resources, not just utilize them better, but get visibility to the skill sets of the folks we have so we can deploy them on the right jobs at the right time. So that is happening. I would say we've been impressed with how Rightpoint is managing their own resources using a similar system that we've deployed, so we're kind of in lockstep in terms of the way that we're thinking about managing those resources.

Bryan C. Bergin ***Cowen and Company, LLC, Research Division - Director***

Okay. All right. Good. And then just on bookings, how should we translate the $3.9 billion of bookings being comparable to, let's say, in 2018? I heard the GE comments about, obviously, the new work that you had won back in late '18. But otherwise, anything to call out in the nature of bookings, average duration? Any metrics you can share there?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

No. Nothing, other than in the prepared remarks, I had said that if you look at 2 years, '16, '17, and compare them to '18, '19. And the reason why 2 years is the way we would look at it is because it becomes very lumpy and episodic whether a booking gets done in the last week of December or the first week of January. And that is really beyond all our control when you're talking about $100 million deal. So to that extent, we prefer to look at in all our modeling, we look at 2-year cohort of bookings. And if you look at that, the previous 2 years, $2.7 billion average; the last 2 years, $4 billion average. Within that $4 billion average, 2018, having a higher proportion of GE than 2019, therefore, by definition, Global Clients being higher in '19 versus '18. All that is good metrics to look at, and that's one of the reasons why our guidance and outlook for 2020 is what it is.

Edward J. Fitzpatrick ***Genpact Limited - Senior VP & CFO***

And what we said, Brian, too, is we do think over time that it should align with our overall growth of the firm, right? As we look back, we were looking at it today or yesterday and saw that it was largely aligned with the company. You look past -- you could do your own CAGR, I mean, the past 5 years, it's been in the low double-digit range which kind of aligns with total company growth.

Operator

Our next question comes from the line of Mayank Tandon from Needham.

Mayank Tandon ***Needham & Company, LLC, Research Division - Senior Analyst***

Tiger, just given some of the industry sources, it would suggest that the market is probably the healthiest it's been in a long time, maybe ever. So what are the constraints to growth? In other words, why can't you grow faster? Would just love to hear about what might be limiting your growth potential, just given the health of the market backdrop.

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

So Mayank, I'll start by saying we love the growths that we have seen, not just in '19, but actually pretty consistently in Global Clients over 4 or 5 years. So -- and the question that you're asking is -- and that Global Client growth, by itself, if you leave the volatility that we've

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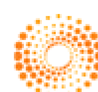

seen over 5, 7 years with GE, has been very, very good. And if you take Global Client BPM, it's been pretty industry-leading. Why can't it be higher? I'll start by saying execution is at the forefront of continuing to drive that growth. Reputation is incredibly important when we build multi-decade relationships. That allows us to drive growth with that relationship, and these are relationships where we get growth even after 10 years. And it allows us then to get phone conversations between clients who then want to engage with us because they heard something from someone else. So I will start and end with execution and the importance of execution. And there is a point at which the ability to execute complex deals, to execute complex solutions in a global delivery environment across multiple markets that we typically deal with in many of these client situations becomes a constraint that you have to think about and make sure that you don't do something that then hurts your reputation. And we are very conscious of that. We've been conscious of that from the day we became an independent company in 2005. It's one of the guiding principles of the company. Net Promoter Score is the way we measure it.

Mayank Tandon ***Needham & Company, LLC, Research Division - Senior Analyst***

Right. That makes sense. On a related basis, I was wondering, given the shift to more digital-type work, analytics, all the newer technologies that you mentioned that are clearly impacting the BPM and analytics space, are you seeing a change in the typical productivity gains that you see -- or the headwinds you see in any given year as you pass on the productivity benefits to your end clients?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

Mayank, yes. I wouldn't call it headwinds. Passing on productivity benefits to clients using new technologies is a good thing, and we feel proud about that. I think our clients think that we are really good at that, have always been. Now we have new technologies to do that, so we don't think about it as headwinds. But obviously, our growth has to take into account that, and it does take into account that.

So the way to think about it is if traditional ways of driving productivity used to drive 3% to 4% annual productivity in the same kind of work, then, today, that should be 7% to 8% on the average across all the work that we do. Now some of that becomes 20% in some cases, and some of that is nothing because there's nothing new we can do because everything has been done. So obviously, it changes depending on the type of work. And that takes into account the final growth that we deliver. So to deliver 12%, 13% growth, it means total growth has to be of the order of magnitude of 20%.

Operator

Our next question comes from the line of Moshe Katri from Wedbush Securities.

Our next question comes from the line of Justin Donati from Wells Fargo Securities.

Justin Micahel Donati ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

Just wondering, does the 2020 guidance embed anything for potentially taking market share in some social media content from competitors who are exiting that business?

Nallicheri Vaidyanathan Tyagarajan ***Genpact Limited - President, CEO & Director***

So Justin, we -- I'll start by saying that content, moderation, trust and safety as a service line a couple of years back we chose as a very important service line and a strategic service line for us, and we've been investing -- we've been creating capabilities. We have a set of great relationships there. So we obviously have planned for continued growth in that service line, having seen growth over the last few years in that service line. And we have a fantastic team with a great reputation in the marketplace with the clients that we serve.

Do some of the things that have happened in the marketplace provide opportunities? The answer is yes. But is that the only opportunity there? The answer is no. It is a space that is changing rapidly. It's providing a lot of opportunities across a range of clients. So we've, of course, factored in growth in that service line as part of our strategy, but it's not dependent on one event.

Operator

At this time, I'm showing no further questions. I would like to turn the call back over to Roger Sachs for closing remarks.

Roger Sachs ***Genpact Limited - Head of IR***

Thank you, everybody, for joining us today, and we look forward to speaking to you again next quarter.

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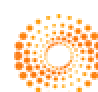

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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