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G.N - Q2 2021 Genpact Ltd Earnings Call

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OVERVIEW:

G reported 2Q21 total revenue of $988m and adjusted diluted EPS of $0.66. Co. expects 2021 total revenues to be $3.96-4.00b and adjusted EPS to be $2.36-2.39.

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the 2021 Second Quarter Genpact Limited Earnings Conference Call. My name is Buena, 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 go ahead.

Roger Sachs - *Genpact Limited - Head of IR*

Thank you, Buena, and good afternoon, everybody, and welcome to Genpact's second quarter call to discuss our results for the period ended June 30, 2021. We hope you had a chance to review our earnings release, which was posted to the IR section of our website, genpact.com.

Speakers on today's call are Tiger Tyagarajan, our President and CEO; Ed Fitzpatrick, our outgoing Chief Financial Officer; and Mike Weiner, who is joining us as our new Chief Financial Officer, succeeding Ed, who will be transitioning to another leadership role within Genpact.

Today's agenda will be as follows. Tiger will provide an overview of our results and update on our strategic initiatives. Ed will then walk you through our financial performance for the quarter as well as provide some thoughts on our outlook for 2021. Tiger will then come back for some closing comments, and then we'll take your questions. We expect our call will last about an hour.

Some of the matters we will discuss in today's call are forward-looking and 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 that we believe 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 second quarter 2021 earnings call.

Our second quarter performance saw Global Client revenue return to double-digit growth earlier than we anticipated driven by accelerated momentum in Transformation Services, particularly in analytics, and the strength of our Intelligent Operations business. We exceeded our expectations on the top line, bottom line cash flow.

Our strategic investments and services such as supply chain, sales and commercial and financial crimes and risk are proving to be extremely relevant for our clients, opening many new opportunities to create value in areas beyond just cost and productivity.

In the second quarter 2021, we delivered total revenue of $988 million, up 7% on a constant currency basis; Global Client revenue of $893 million, up 11% on a constant currency basis; adjusted operating income margin of 17.9%, expanding 170 basis points year-over-year; and adjusted diluted earnings per share of $0.66, up 27% year-over-year.

Before reviewing the quarter in more detail, I want to welcome Mike Weiner, who has joined Genpact as our new CFO effective August 10, succeeding Ed Fitzpatrick, who will be staying on in a market-facing client advisory role. Mike comes to us with strong public company CFO experience and brings an extensive background in the finance function, working in many large global corporations.

We expect Mike will make a significant contribution to the continued success of the company as we execute on our strategic growth agenda. We're very excited to have him on board. Mike is with us on the call today and will make a few comments later on.

During the second wave of COVID-19 in India a few months back, we were able to adapt and maintain our delivery of services to clients, resulting in no material impact to our business. This was only possible because of the unwavering support of our clients, together with our geographically distributed operations across India, extensive global delivery footprint and ability to quickly redeploy talent across areas of our business.

I'm happy to report that new cases among our India-based team have significantly declined. And we are aggressively driving a vaccination campaign in partnership with local hospitals with vaccination clinics set up at many of our operating centers. To date, more than 60% of our India workforce has at least 1 dose of the vaccine.

As we move into the second half of the year, the overall demand environment remains healthy as companies pursue digital transformations. The pipeline continues to include an increasing mix of new logos.

Global Client revenue returned to double-digit growth in the quarter. This impressive performance was seen across most of our chosen industry verticals, including consumer goods and retail, life sciences and health care, high tech and manufacturing and services.

As we had expected, banking and capital markets was impacted by the restructured relationship with one of our clients that resized its asset management business. However, we saw an expansion of our banking and capital markets pipeline, supported by opportunities in financial crimes and risk services.

Transformation Services accounted for 35% of our Global Client revenue in the quarter and grew at 30% plus, including the contribution from the Enquero acquisition. A good portion of our Transformation Service engagements continue to be annuity based.

Transformation Services continues to be powered by our analytics business that has grown at an increasing rate in each of the past 3 years. The combination of robust demand and our strategic investment has led to analytics becoming the largest component of our Transformation Service business while we continue to also grow nicely across consulting and digital.

Let me share some examples of our Transformation Service engagements and the value they are driving for our clients. For a global CPG company, changing their operating model and redesigning the user experience for its sales teams to significantly free up their capacity to drive higher growth and customer satisfaction. For an insurance company, using our AI-based cloud workflow solution, Cora, to orchestrate underwriting processes across the client's shared Microsoft Azure environment, leading to significantly faster underwriting times with better premium pricing, lower risk and higher profitability.

For a high-end consumer electronics company, leveraging our industry expertise and data, AI and machine learning-based analytics to improve demand and supply forecast accuracy. Integrating these forecasts with the planning and production processes resulted in a 20% improvement in order fulfillment, a 40% reduction in planning time and a 15% lower inventory. For a global bank, bringing our data specialists and subject matter experts together to significantly improve their data governance, leading to better timeliness and accuracy of their regulatory reporting.

We have consistently seen that starting a new client relationship with Transformation Services leads to subsequent growth. Over the past 18 months, 60% of new accounts that started with a stand-alone Transformation Services engagement led to a follow-on booking, including longer-term annuity deals. Additionally, many of these engagements provide the opportunity to leverage new and more profitable commercial models beyond traditional FTE pricing. The share of our total revenue with alternate commercial models has been consistently increasing.

Thematically, there are 3 competitive differentiators that are helping us win. First, our ability to orchestrate data and analytics in the cloud as it's becoming core to every client's transformation journey. Second, our deep expertise linking services, such as finance and accounting to supply chain or financial crimes and risk to banking operations or supply chain to sales and commercial operations. And finally, our focus on driving value for clients beyond just cost and productivity such as increased growth, lower receivables and inventory or lower losses and fraud, in each case, linking client outcomes to commercial constructs.

Our portfolio of services, investments in data and process models and digital expertise are proving to be incredibly relevant for clients in this business environment. Four specific areas that we are seeing strong momentum include sales and commercial, supply chain management, financial crimes and risk and financial planning and analysis. Let me expand on each of these.

Firstly, in our sales and commercial service line, bringing together cloud-based data and analytics and operations insights to drive revenue growth for our clients. For example, helping our high-tech clients' sales teams focus on best opportunities to pursue with small and medium businesses.

Second, in supply chain services, given the disruption in the semiconductor industry, helping improve demand and supply planning by leveraging data and analytics for many integrated device manufacturing companies, foundries and Tier 1 chip manufacturers.

Third, as digital commerce becomes pervasive and industry agnostic, we see an increased need for clients to address fraud and financial crimes. Our teams of industry experts and data scientists are developing and implementing as-a-service solutions on the cloud in the areas of fraud and anti-money laundering, know your customer and transaction monitoring.

And finally, FP&A is an area ripe for disruption. And we are seeing significant opportunities to leverage our deep industry expertise, strength in finance and accounting and use of data and analytics in the cloud to provide agile forecasting and decision-making capabilities for our clients cutting across customer, supply chain, marketing and finance data.

All these areas highlight that anything that drives growth for our clients represents high-growth opportunities for us. For example, we recently announced a new strategic relationship with Coca-Cola Beverages Africa to help them drive competitive growth. Leveraging our deep process and domain depth in CPG and beverages, we are establishing a multifunction, digitally enabled shared services organization to centralize and automate finance, procurement, data management as well as other functions, creating intelligent operations that improve customer service and allow them to concentrate on their growth initiatives.

We've always believed our people are our biggest competitive advantage. Therefore, attracting, building and retaining talent continues to be a top priority for us. In the quarter, we increased our net global employee base by more than 5,000 people.

Over the years, we have earned a reputation as an organization known for building great careers. Our investments in the learning and development of our employees allow our talent to build critical new skills needed for the future. We leverage our scalable online learning platform, Genome, to reskill our workforce. Genome, in combination with our redeployment platform, Talent Match, has been an enormous success. And during the quarter, we redeployed 4,000 team members into new roles, providing them with new career opportunities.

As we discussed last quarter, we have a unique certification program in data and analytics that enables our employees to generate critical insights from our vast operating data sets, ultimately allowing us to build unique data models in specific domain areas that bring tremendous client value. 60% of our global workforce is currently enrolled in this program with about 10,000 fully trained and tested by the end of second quarter.

Our strong second quarter results prove that the powerful combination of deep domain and process expertise, coupled with our strategic investments in digital analytics and experience, provides us with a competitive differentiation. We believe Transformation Services engagements drive better, long-term partnerships with clients with better CxO connects, creating paths to different buying centers. This has led to more than half of our bookings to continue being driven by sole source deals.

With our expanding addressable market, we are bringing more Transformation Services and Intelligent Operations solutions to our clients, setting the stage to continue our long-term journey of delivering annual double-digit to low teens Global Client growth and deliberate adjusted operating margin expansion. Based on our year-to-date performance, we are now raising our 2021 full year top line, adjusted operating income margin and adjusted diluted EPS outlook.

With that, let me turn the call over to Ed for a detailed review of our second quarter results.

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

Thank you, Tiger, and good afternoon, everyone. Today, I'll review our second quarter results and provide our latest thinking regarding our full year 2021 financial outlook.

Total revenue was $988 million, up 10% year-over-year or 7% on a constant currency basis. As we saw in the first quarter, our better-than-expected performance was driven by stronger-than-anticipated Global Client growth, particularly in analytics.

Global Client revenue, which represents 90% of total revenue, increased 14% year-over-year or 11% on a constant currency basis. This growth includes an approximate 1 point contribution from revenue related to certain divested GE businesses that we began including in our Global Client portfolio as of January 1, 2021.

As Tiger mentioned earlier, we returned to double-digit Global Client top line growth ahead of our prior expectations. This was largely driven by the strong performance we delivered in Transformation Services revenue, led once again by strong analytics growth.

During the quarter, we continued to expand the size of our Global Client relationships. For example, during the 12-month period ended June 30, 2021, we grew the number of Global Client relationships with annual revenue over $5 million from 132 to 136. This included clients with more than $25 million in annual revenue, growing from 23 to 26 .

GE revenue declined 19% year-over-year driven by our delivery of committed productivity and the overall macroeconomic impact on GE's businesses. Excluding the effect of the revenue related to divested businesses I mentioned earlier, GE revenue would have declined 10% during the quarter, in line with our expectations.

Adjusted operating income margin was 17.9%, up 170 basis points from the same period last year. The year-over-year improvement was driven by gross margin expansion, operating leverage and continued lower overall operating expenses, including lower travel-related expenses.

Gross margin in the quarter was 35.9% compared to 34% during the same period last year. This 190 basis point expansion was largely due to a higher mix of Transformation Services, particularly analytics and improved utilization, partially offset by higher expenses associated with medical costs that were elevated in part due to COVID-19. It should also be noted that last year's gross margin was lower than expected due to the negative impact on client billings related to the shift to remote delivery at the onset of the pandemic.

SG&A expenses as a percentage of revenue was 20.7%, in line with last year's level. We continue to expect to increase our investments in sales and marketing and research and development during the second half of the year.

Adjusted EPS was $0.66, up 27% year-over-year compared to $0.52 in 2020. This $0.14 increase was primarily driven by higher operating income of $0.13, an FX remeasurement gain of $0.02 and the impact of a lower share count of $0.01, partially offset by higher taxes of $0.02. Our effective tax rate was 24.2% compared to 21.5% last year largely driven by a more favorable mix of jurisdictional income last year and lower tax incentives in 2021, in line with our expectations.

Turning to our cash flows and balance sheet. During the second quarter, we generated $161 million of cash from operations compared to $192 million during the same period last year. The decrease is largely attributable to a higher investment in working capital, reflecting higher revenue growth in the quarter compared to the second quarter of last year when our top line performance was impacted by COVID-19.

Our days sales outstanding improved year-over-year to 83 days compared to 87 days last year largely driven by a reduction in billing cycle time and improved collection timing. Cash and cash equivalents totaled $753 million compared to $644 million at the end of the first quarter of 2021.

Our net debt-to-EBITDA ratio for the last 4 rolling quarters was 1.4x. With undrawn debt capacity of approximately $500 million and existing cash balances, we continue to have ample liquidity to pursue growth opportunities and execute on our capital allocation strategy. We continue to have a solid M&A pipeline, and we remain vigilant in searching for companies that can strengthen our capabilities in our chosen service lines.

As we have said in the past, to the extent capital is available, we will continue to repurchase our shares, particularly when the valuation is attractive in comparison to our view of the intrinsic value of the firm. During the quarter, we repurchased approximately 300,000 shares for a total cost of $13 million or an average price per share of $44.15. We also paid out $20 million in the form of a regular quarterly cash dividend of $0.1075 per share.

Since we initiated our share buyback program in 2015, we've reduced our net outstanding shares by approximately 20%. Over this period, we repurchased 44 million shares at an average price of $28.38 per share for a total of $1.3 billion. We estimate the annual return on these purchases to date is approximately 16%. At the end of the second quarter, we have approximately $490 million of authorized capacity remaining under our share repurchase program.

Capital expenditures as a percentage of revenue was less than 1% during the second quarter driven primarily by lower infrastructure spending due to our employees continuing to work remotely. We expect to increase investments during the second half of the year related to the ramp of deals signed late last year and as our global workforce slowly begins to return to the office. Given lower first half spending, we now expect capital expenditures as a percent of revenue for the full year to be towards the lower end of our prior outlook of 2% to 2.5% of revenue.

Let me now turn to an update on our full year outlook. With our strong first half performance and better visibility for the full year, we now expect total revenues to be between $3.96 billion and $4 billion, representing year-over-year constant currency growth of 5.5% to [6.5%] (corrected by company after the call) compared to our prior outlook of 5% to 6.5%.

For Global Clients, we now expect revenue growth to be in the range of 10.5% to 11.5% or 9% to 10% on a constant currency basis compared to our prior outlook of 9% to 11% or 8% to 10% on a constant currency basis. For the second half of the year, we expect Global Client revenue to continue to grow at a single-digit rate sequentially during both the third and fourth quarters, with year-over-year growth in those quarters remaining at a low double-digit rate.

There is no change to our prior GE full year outlook of an approximately 20% year-over-year decline. Excluding the effect of the approximately $40 million in revenue related to GE-divested businesses, GE full year revenue would be expected to decline 10% to 12%.

Taking into account our adjusted operating income margin performance in the first half of the year, we are expanding our adjusted operating income margin outlook for the full year to approximately 16.5%, up from our prior expectation of approximately 16%. We expect our adjusted operating income margin during the second half of the year will be lower relative to the first half as we ramp investments in sales and marketing and research and development to support our long-term growth initiatives, absorb transition costs related to deal ramps and increase travel-related activity. We also expect our gross margin to improve by 70 to 75 basis points year-over-year versus our prior expectation of a 50 basis point improvement.

Given this updated outlook, we are now estimating adjusted earnings per share for the full year 2021 to be between $2.36 and $2.39, up $0.09 from our prior estimate of $2.27 to $2.30 due to expected higher gross and adjusted operating income margins and $0.01 related to the FX remeasurement gain we recorded this quarter. We have assumed a weighted average share count of 193 million in our EPS estimate for the year.

Additionally, given our stronger-than-expected year-to-date performance, we are now forecasting our full year operating cash flow to be at least $500 million versus our prior $450 million to $500 million range. When combined with the new lower anticipated level of capital expenditures for the year, we now expect free cash flow of approximately 1.2 to 1.3x net income, above our historical level of around 1:1 ratio.

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

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

Thank you, Ed.

Before I give my closing remarks, I'd like to once again welcome Mike Weiner to our team, and I'll hand over the call to him to make a few brief comments. Mike?

Michael Weiner - *Genpact Limited - SVP and Incoming CFO*

Thank you, Tiger.

Having been on the other side of digital transformation journeys in the other businesses I was in, I'm excited to now be on this side, helping a wide range of clients undertake those journeys. I'm also thrilled to join the Genpact team and then become part of a company with excellent growth potential that owns a leading position in a large, underpenetrated market.

I'm enthused by the energy level I've seen from the global team. And I'm looking forward to partnering with everyone as we move forward on executing on our strategic initiatives to drive value for our stakeholders. I'm also looking forward to speaking with and hopefully, meeting with you all in person in the near term.

Thank you, Tiger.

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

Thank you, Mike. We all look forward to your contributions in the months and years ahead.

Our strong performance in the first half of 2021 reflects our agility and culture of embracing change, which continually allows us to move more rapidly to meet the evolving needs of our clients. Global Client revenue has recovered to double-digit growth. And we feel good about our positioning in the market and the opportunities ahead for both the balance of this year and over the medium and long term.

I'm very pleased to share that this past week, we published our 2020 Sustainability Report, which is available on our website, improving our disclosure by moving from a once in 2 years to an annual reporting cadence. This increased frequency is aligned with our unwavering commitment to our initiatives around diversity, equity and inclusion, climate impact, governance and community support that help us achieve our long-term financial goals.

I wanted to point out a few metrics to demonstrate our focus: global gender diversity of 41%, a 28% reduction in Scope 1 and Scope 2 emissions since 2016, learning hours completed by our employees in 2020 exceeding 10 million hours and our global corporate social responsibility initiatives impacted nearly 25 million lives.

We were also recently named to the Forbes Best Employers for Women 2021 list, reflecting our efforts in our pursuit of an inclusive and gender equitable workplace. Additionally, we were named to Fast Company's 100 Best Workplaces for Innovators. And our pharmacovigilance team was named to their Innovative Team of the Year list for the COVID-19 work we did with the U.K. Medicines and Healthcare Products Regulatory Agency.

Before closing, I want to thank Ed for partnering with me as our CFO over these last 7 years, during which he has successfully led the finance organization to support our profitable growth strategy and along the way, achieved many milestones. We are very fortunate to have Ed stay on to work closely with Mike to ensure a seamless transition and to take on his new client advisory role, in which he will leverage his extensive expertise as a CFO to benefit many of our strategic clients.

With that, let me turn the call back to Roger.

Roger Sachs - *Genpact Limited - Head of IR*

Thank you, Tiger.

We would now like to open up our call for your questions. Buena, can you please provide the instructions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question is from Tien-Tsin Huang of JPMorgan.

Tien-Tsin Huang - *JPMorgan Chase & Co, Research Division - Senior Analyst*

All the best to you, Ed, in the -- in your next role. I'm sure it will be fun. So I won't let -- I can't let you go without asking a margin question just for good time's sake.

Just on the gross margin, I heard you -- you're taking it up a little bit here. I know you're running a higher utilization. I'm sure transformation mix is helping as well. So just trying to get a sense of what's structural here that can sustain versus what might be temporary here as we look in the short and the midterm?

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

Yes. Year-to-date, we're actually a little better than the 75 -- 70%, 75% (sic) [70, 75], Tien-Tsin, as you've seen in the numbers. We did have a little bit of an impact on gross margin this quarter related to some of the health care costs that were in part due to the COVID pandemic that's been hitting us globally.

So I think part of that, year-to-date, we're a little bit better. We feel like we're not going to plan on that staying at that elevated level for the rest of the year, but we feel like at this point, the 50 basis points, we ought to be able to hit that and more. And that's why we raised it by 70 to 75 basis point year-over-year improvement.

I think some of the benefit that we also saw in Transformation Services, particularly with analytics, continued in the quarter. So the drop wasn't really necessarily related to that mix, which we talked about in the first quarter. That was still pretty good.

The dip this quarter is more due to the health care-related costs. So feel good about that, but that mix, we're not expecting that to continue for the balance of the year. We're not forecasting that. Seeing good progress, both -- not just in TS, but also in gross margins in Intelligent Operations as well as our initiatives to drive productivities for our clients to pass that benefit along to them as well helps us improve our gross margin.

So all of that being the case, we felt that the improvement that we'll see for the balance of the year should still be an improvement, but maybe not quite as good as what we saw in the first half. But we'll see how it plays out.

Tiger, anything else to add to that?

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

No, I think you covered it all. And Tien-Tsin, the only thing I would say is, clearly, the buoyancy that we've seen for 3 consecutive years in the analytics business is playing out, and those are all high value-added services.

And the other thing that I would say is as we continue to drive better than company average growth, Global Client growth in things like FP&A, supply chain, financial crimes, sales and commercial, these are all, as I said, services that pivot to driving value beyond cost and productivity for our clients. And as we do that and connect those commercials to that value being driven, I can see us undertake a long-term journey on gross margins.

Tien-Tsin Huang - *JPMorgan Chase & Co, Research Division - Senior Analyst*

That's great to hear. If you don't mind, just one quick big picture question for you, Tiger. Just going through this earnings season, demand seems to be quite good in a lot of different places, of course, on the digital side. I mean how would you characterize the demand environment if you were to compare it to past cycles? It's so tricky coming out of the pandemic here. But at the same time, the digital transformation part is very, very clear. So how would you compare it or maybe characterize it to past cycles? I mean -- and how much longevity do you see in it?

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

Clearly, Tien-Tsin, we definitely see longevity being lasting for quite some time because this is pretty secular in terms of the desire to embrace digital in order to unlock, really, 2 things. Cost and automation and all that is a given. But the 2 things that people are now trying to unlock is experience and insights in order to take decisions. And that's why analytics. And all of that is growth.

So if you ask me, the big difference in what we are seeing now versus any cycles of the past is growth-driven agendas. And the second thing that I would say is very pervasive. And the third I would say is many more new clients, new logos who have not done this before.

And that does pose one challenge, which we talked about in the past as well, which is those new relationships who have not done it before, and they are complex, large deals, sometimes take longer to close. But I see this as a secular change that is going to last.

Operator

Your next question is from Keith Bachman of Bank of Montreal.

Keith Frances Bachman - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Yes. I had a couple to follow-on Tien-Tsin, if I could. Just on the last comment, Tiger, as you think about that large pipeline with new logos and perhaps lumpy deals to use different words, but is there a margin implication as you think about that over the next year or so as those large new deals, new clients come in? Is there anything on the margin side that we should be thinking about related to that type of pipeline?

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

Yes -- no, let me just kick it off. It's a good question, and then Ed will add to this. So I think the word "lumpy" is a good word. We've used it before. These are -- particularly the larger deals tend to be very lumpy. And therefore, any response on quarter-by-quarter is not that relevant for us as a business. And therefore, when we think about margins as well as growth, we got to think about at least in the cycle of a year, if not more.

Part of the reason Ed talked about the second half of the year is not just the investments in sales and marketing and R&D, but also the ramps. In the early stage of those ramps, it does -- particularly the lumpier deals, does create a margin drag that then you got to work out of as you get into the next year. But you're talking -- when you talk longer cycles of 12, 18 months, those tend to even out, and that's why we think that we are on a secular gross margin change.

Ed?

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

Yes. I think, Keith, as you've seen us do -- it was probably 2 or 3 years ago, we had a massive bookings of how many large deals, 3 or 4 really big, large deals, and we were able to manage that without having to take margins backwards. We still progressed as we had on our 10 to 20 basis point operating margin improvement drive that we've been on.

So I think given the large -- the meaningful amount of leverage that we're able to bring with this business year-to-year, we've been able to manage that. If we have so many large deals that we have to take it back, we'd certainly update you, but we haven't had to do that so far. And I suspect that won't be the case. And if it is, it probably means growth might be taken to the next level because of this. We've got a bit of large deals, but I think we've been able to manage it even in a pretty crazy year, 2 or 3 years back.

Keith Frances Bachman - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Okay. Great.

And if I could just ask my follow-up before Roger throws me off is, Tiger, on the supply side, are you seeing constraints associated with either, A, availability or B, cost to meet what you see as pretty strong demand?

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

No. I think, Keith, it will be fair to say that the war for talent is on back to prepandemic levels for sure. That's for sure. Our attrition numbers, which is a good metric to watch, is up versus last year, exactly as we had expected but as -- is at the lower end of the range that we were prepandemic.

Having said that, if I now pass that into specific cohorts -- let's pick data engineering. Let's pick cloud. Let's pick analytics, data science. I mean these are very hot topics, as you know, in the marketplace. And when you have such red-hot topics in the marketplace of demand, you obviously have a very hot talent market. Which is why for us, it's always been about not just hiring talent but actually building talent for the long term.

And we are very good at that. We've done that for 20 years in different areas. And I just described one of the areas we talked about, which is analytics. We are in a very significant path to internally build very strong talent from our workforce on analytics.

So back to your question, hot talent market, intense competition for talent. I think we have a good brand position. We have a good career path that we give people. We reskill people very well. So we feel good. We are at the lower end of the range that we used to be prepandemic, but there are hot spots that are very, very hot.

Keith Frances Bachman - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Okay.

And Ed, all the best in your transition.

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

Thanks, Keith.

Operator

Your next question is from David -- Dave Koning of Baird.

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

Congrats. And yes, we'll miss you, Ed.

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

Thanks, Dave.

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

Yes. So I guess, first of all, just looking at sequential growth was the best in 2 years or so, really one of your best sequential quarters in many years. And is any of that either related to some of the transformation deals being kind -- running kind of hot, some onetime benefits? Or is some of it just economic catch-up with some of your clients? Or is this just sales momentum? Like maybe kind of go through what's driving all this?

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

Yes. I would say, Dave, that one quarter is not something that we would hang our hat on. Just in the nature of our business, it's a long-cycle business. It takes time to close a deal. It takes time to ramp a deal. So just looking at one quarter, sometimes it's a little bit of timing here or there.

There's nothing unique that I would call out in the quarter that is so special that I would call out. Transformation Services is very good. Within that, analytics was very, very good. One of the best analytics quarters we've ever had. One of the best analytics half years we've ever had. At the same time, consulting and digital also played very well.

The other thing that played out was -- and we are seeing this consistently every time we start with Transformation Services, it leads to follow-on work. And then subsequently, many of them do convert to Intelligent Operations, which is longer annuity deals.

So I just think our focus, investments, the front-end sales team, the Transformation Services team, it's all come together nicely, and we hope to continue. Now I wouldn't single out the fact that it is the best quarter in 2 years and say, does that mean it's a new benchmark? I wouldn't necessarily go there because it's just one quarter.

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

Got you. Okay.

And I guess the second one, just on margins. Ed has done such a nice job for many years in a row, kind of 10, 20 bps a year. And this year is going to be well above that. Do we think of kind of the second half being a little more the sustainable number to grow off of or the full year number to grow off of? Like I guess I'm just wondering, are we running pretty high just for this year that next year, just assume it's down a little bit just as we normalize attrition and other stuff? Or how should we think of that?

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

Yes, Dave. No, as we look at the first half results, really, really terrific, right, over 17% margin. That's wonderful. Obviously, the guidance we gave for the second half of the year contemplates us ramping up investments, right?

Maybe we're a little behind in some of the investments. And the plan is to absolutely make those investments so that we could drive that sustainable growth that you heard Tiger talk about, right? And that double-digit plus GC growth is what we're looking to sustain for over the medium and long term, right? Not -- it's not just a 1-year thing.

So I think from that perspective, we are going to make investments. But from a normalized basis, Tiger has been pretty clear that this is kind of the new baseline, right? Around 16.5% is where -- the outlook we've given for the full year is our baseline that we would use to set.

We're not going to talk about 2022, but we're also not going to tell you our new baseline is 15-point whatever the second half of the year has to be to get to 16.5%. So 16.5% is where we expect our -- will be baseline to make it clear.

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

Yes, yes. And David, if you think about when we began the year, we said expect us to invest in sales and sales and marketing and R&D and expect that to happen through the year. The reality is that in our business, when you ramp costs up, the impact of that is most felt towards the latter part of the year. And on top of that, if you think about what happened in the second quarter around COVID-19 in India, that created challenges in our ability to ramp some of that sales and marketing R&D costs.

Now we're going to continue that journey as we continue in the second half of the year. And therefore, the right way to think about it is the full year margin as the margin to work off rather than the second half margin. But the second half margin is because of the first half margin, a little bit of some of that sales and marketing and R&D has shifted.

Operator

Your next question is from Maggie Nolan of William Blair.

Theodore Riley Starck-King - *William Blair & Company L.L.C., Research Division - Associate*

This is Ted on for Maggie. Tiger, you mentioned at the beginning of the call that the pipeline has increased some new logos. So in terms of the composition of the pipeline, what proportion are first-time outsourcers? And how does that compare to prior to the pandemic or even just kind of over the last couple of years?

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

Yes. So Ted, I don't think we have those specific numbers. All I can say is that the last couple of quarters, we've called out that there are many more new logo, first-time outsourcers who have jumped into the fray.

And in my prepared remarks, what I was trying to say is the pipeline continues to show that, and it continues to be the case. Again, I think it's a reflection of there is a rising tide that is lifting all companies in all industries to really say we need to change to grab the opportunity to transform, to leverage new technologies, to leverage data and analytics in order to drive growth as well as cost and productivity, et cetera, to actually fuel that growth.

So I wouldn't call out anything different this quarter versus the last couple of quarters. It's just a continuation of what I've been saying, which is as compared to 5 years back, 3 years back, the number of first-time outsourcers is more than before.

Theodore Riley Starck-King - *William Blair & Company L.L.C., Research Division - Associate*

Okay. That's helpful. And then one for follow-up, I wanted to ask about M&A. Are there certain capabilities that you're targeting in terms of just overall offerings that you'd like to add to the services portfolio?

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

Actually, it will be very nicely intersecting with some of the things that I called out in my prepared remarks. I mean if you look at some of the services that are higher value add, more pivoted to driving client value beyond cost, let's take financial crimes and risk. Let's take, for example, sales and commercial, supply chain, FP&A, I mean, those are the kind of areas from a service line perspective that would continue to be our areas of thinking about the right capabilities to add.

And then when we think about analytics or digital, cloud, we've done 2 acquisitions in the last 4 years around experience. So yes, we have a very strong experience team. We finished the acquisition of Enquero at the end of last year around data analytics and digital engineering on the cloud. And that's worked out to be a really, really great team to add to the company. So those kind of areas will continue to get our focus and attention, both from organic build as well as from M&A.

Theodore Riley Starck-King - *William Blair & Company L.L.C., Research Division - Associate*

All right. Great. And all the best, Ed.

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

Thank you.

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

Thanks, Ted. Thanks much.

Operator

Your next question is from Ashwin Shirvaikar of Citi.

Ashwin Vassant Shirvaikar - *Citigroup Inc., Research Division - MD & Lead Analyst*

Ed, it's been great working with you. And Mike, welcome.

I guess, Tiger, let me start with just building off of that last M&A question. The 4 areas you highlighted, it seems that each of them has benefited from a good-sized acquisition you did, whether it's Barkawi or Rightpoint or Enquero. Curious if that informs your view on future M&A in terms of do you feel the need to perhaps keep adding service lines, double down on what you have? Because I would imagine that there's plenty to be done even in these areas. Just consider something like supply chain given what's going on in the world, that's a huge opportunity. Can you talk a little bit about that? Will you perhaps even consider scaling up M&A as a driver of growth?

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

Yes. So Ashwin, great question. And I want to start by saying our first step in those journeys was a strategic decision that supply chain or financial crimes or data engineering, et cetera, are the right spaces for us at the right time to go into, to expand, to build capabilities and so on. So the first step in that journey is a choice that has nothing to do with M&A. It's got to do with which areas do we have the best opportunity to grow and to add value to clients and to expand and to create a differentiated value proposition.

And then the decision gets to, okay, if that's what we want to do, then which ones do we build our own capabilities, which ones do we partner and which capabilities do we actually acquire? So you then have 3 choices.

Obviously, acquisitions, there -- it's no surprise. It's probably the most capital intensive, obviously. At the same time, it actually gets you to the races faster. And all I'm trying to say is that we did not say now that we've got Barkawi, supply chain will be a big growth vector. We said supply chain is going to be one of our chosen areas. Therefore, let's look for something to fuel that. And we know exactly what we wanted. And then we found Barkawi, and that's been such a great home run.

So the choice areas that we've had through our strategy exercise seem to have stood the test getting into the pandemic and through the pandemic. All the choices that are read out were choices that we made well before the pandemic. And you rightly pointed out, for example, supply chain is such a hot topic at the moment and is undergoing so much change. But there's so much more to do.

Are there other new service lines that we should look at? We typically take a once a year exercise at what new service lines to look at. Not every year do we need to add service lines. If we have enough runway in our existing service lines, then we feel very good about our existing service lines.

Ashwin Vassant Shirvaikar - *Citigroup Inc., Research Division - MD & Lead Analyst*

Got it. Got it. No, that's very useful. The other thing was you mentioned -- I think you said more first-time outsourcers than ever before. And I wanted to ask, as you ramp these, do you find -- you seek out any change in contract terms from your existing set of clients? Are the contract lens different? Do they ramp faster? Are these -- do they have a much higher proportion of shorter-term analytics-type work associated with the attach on that? What's different about these first-time outsourcers?

And I do want to sneak in a quick side question to Ed. With the $6 million in other income, what was that?

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

Yes. So let me answer the first one, and then I'll turn it over to Ed. I think the advantage that the people who are coming in now have, clearly, Ashwin, is that they can leapfrog. They can leapfrog in the backs of other people who've undertaken these journeys, learned lessons, et cetera. And they can also leapfrog using new technologies that can be leveraged. So all of that is happening.

The fact that these people are doing it now means that they can use new technologies straight out of the gate, and that's exactly what our solution set that we take to the market. And actually, it's one of the attractions for a number of them to jump in.

A number of them do start with not necessarily operations outsourcing, but often start with a change agenda that drives change in their operations, that drives analytical insights with their data, that establishes, for example, the ability to pull data from different systems, use AI and machine learning to clean the data up, move that to the cloud, build data models on the cloud and for example, have better demand and supply forecasting in order to drive better inventory and all the examples that I just gave on the call. Subsequently leading to a conversation that says, "Actually, why don't you guys manage supply chain for me?"

So to your question, more learnings on the back of which these discussions happen. Therefore, speed is often -- once the contract is signed, speed is actually often faster because you can ride off the learnings of others. So I know that I attempted to answer part of your question, but I would say all of those play out in these now.

Having said all that, the reality is because they are coming here for the first time, it takes longer sometimes to close these. It takes longer to get to a final contract and then starting the journey. But the solution itself -- by the way, the commercial contract often has much more value components attached to it. Alternate commercial models where it's a risk sharing and a reward sharing and a gain share between us and the client, all of that is much more in these journeys.

Ashwin Vassant Shirvaikar - *Citigroup Inc., Research Division - MD & Lead Analyst*

Understood.

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

Ed, do you want to take the second question?

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

Yes. The other income was a combination of items, all positive this quarter. Not always positive. But we typically have sublease income in there, that's about $1 million on a run rate basis each quarter. We also have the deferred compensation plan. The return on the portfolio goes there. And that's actually been positive. It's been negative in prior periods, but that's a couple of million bucks. And then we have -- there's a recovery on an indemnified item that related to taxes, related to a pre-GE item. The offset of that is in tax expense. So it was just a recovery on that tax item. Like that was the majority of the items that are included there.

Ashwin Vassant Shirvaikar - *Citigroup Inc., Research Division - MD & Lead Analyst*

Okay. Sounds like a grab bag of stuff, not one big thing.

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

Yes, yes.

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

Yes.

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

Typically, you'll see that in the $1 million to $2 million range, but a little higher this quarter because it was -- all those are positive.

Operator

Your next question is from Bryan Bergin of Cowen.

Bryan C. Bergin - *Cowen and Company, LLC, Research Division - MD & Analyst*

Mike, welcome.

I wanted to follow-up here on the margin outperformance. So just to clarify, was there any meaningful shift in the timing of some of the S&M and R&D expenditures relative to the plan that now are all pushed into the second half? And can you specify what some of those bigger items are that you're directing it to? I'm curious if this is like scaling the sales force or if it's more like marketing events and things like that?

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

Yes. So I'll start off and then, Ed, just add to it.

It is -- I mean, clearly, when you have 3 to 4 months of the kind of COVID-19 impact that we had in India, some of that sales and R&D spend around resourcing had to be pushed into the end of the second quarter and into the third and fourth quarter. So that was much more of a timing of hiring and onboarding, and that expense just got -- and that was versus plan. Our plan was to start a little earlier. And we couldn't execute to that through the COVID-19 situation that we dealt with in India. Other than that, there's nothing else.

And most of it is in the nature of adding capabilities. Those capabilities end up, therefore, getting aligned to customers, getting aligned to specific services, building out some of those services, the models that I talked about, the data models and that's on the R&D side of bringing those teams together, building those data models, creating the benchmarks.

Benchmarks is a big thing in a number of the services that we have, and that's what clients want from us. And that's one of the reasons actually we end up winning, which is the benchmark that we have around some of the core service offerings that we have.

Ed, you want to add to what I said?

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

Yes.

It was -- we talked about it as well. First half, we'd assume that, that would ramp a bit quicker. So it is -- there is a little bit of a catch-up there, if you will, in the second half, Bryan. So -- and then as a result, obviously, looking at how much of that goes into the following year, we're obviously very conscious of run rates and the like. So it will be some combination of resources as well as other spend that's outside of adding people.

Bryan C. Bergin - *Cowen and Company, LLC, Research Division - MD & Analyst*

Okay. Makes sense. And then you recently announced plans to expand operations in Germany, I think, for local clients. Curious how fast you plan to scale that region. And also are you considering any potential new geographies to break into?

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

No. I think Germany has been on the cards for quite some time, Bryan. And I mean it's no surprise, it's one of the largest economies in the world. We now have capabilities through supply chain, the Barkawi acquisition, which has a strong presence in Munich, in Germany with a set of German clients.

I think bringing all that together has been a culmination of work that we've done actually over the last 12, 15 months between our front-end team, our strategy team, Transformation Services team and our capability teams. And we now have the team in place. We are in the process of hiring a leader, et cetera. So we feel good that this is a good time to actually expand into more clients that have a significant presence and headquarters in Germany, and that was the plan. And we've done that, for example, in Japan over many years to great success. And that's what we're trying to replicate in Germany.

Bryan C. Bergin - *Cowen and Company, LLC, Research Division - MD & Analyst*

Okay. Sounds good.

Ed, good luck filling the sales pipeline.

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

Thank you.

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

Bryan, good one. Thanks.

Operator

Your next question is from Mayank Tandon at Needham.

Kyle David Peterson - *Needham & Company, LLC, Research Division - Associate*

It's actually Kyle Peterson on for Mayank. I just wanted to touch on the demand environment, particularly kind of what you guys are seeing in different verticals. Are there any verticals that are jumping out as really kind of being fast adopters for you guys? I know you mentioned there's some restructuring with a large asset management client. But how is like demand in BFSI outside of that client right now?

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

Yes, outside of that client, actually, demand is good. As I mentioned in my prepared remarks, if you take that particular client out of the equation, our pipeline has grown really nicely.

And one of the big drivers, not the only driver, is the whole financial crimes, risk, KYC, AML, that whole ecosystem. We've got actually very good traction with fintechs as they scale. And clearly, one of the big areas when they scale that they need help in is the same area, which is financial crimes, risk, et cetera.

And then when you see the intersection of online marketing and e-commerce and the traction that, that's getting in the marketplace, the connection of that to payment platforms and the requirement of those people to build similar financial crimes risk kind of capabilities and bring that to bear, I think all of those are becoming big drivers of our growth engine, apart from the fact that almost every bank on earth is trying to figure out a way to make themselves more digital.

And that's the other traction that we're getting. As banks more and more become digital, not just at the front end, but connecting that to the middle and back end, I think we are seeing really good traction in customer service, in portfolio management, in collections. And we have very good capabilities now that we're taking to them and solutions that incorporate AI-based, machine learning-based chat interactions, omnichannel interactions. And all of that is helping fill up the banking pipeline.

Kyle David Peterson - *Needham & Company, LLC, Research Division - Associate*

Got it. That's really helpful. And then just one quick follow-up with regards to like the Delta variant and some of those concerns. It seems like you guys definitely have the delivery side of the house in order to be able to kind of withstand any of this. But have you guys noticed any change in the pace of client discussions or client sentiment or really anything on the other side of the equation, given like some of the COVID case counts in recent weeks?

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

No, nothing that I would call out as -- I mean, obviously, as specific areas go back into lockdown -- an example would be Australia. When Australia went back into lockdown, the ability for our teams to interact with our clients in Australia, which had opened up very nicely, had to go back to remote. And in all those situations, the decisions, et cetera, are very local.

If you now look at the U.S. or the U.K., it's very clear that client meetings are beginning to pick up. People are meeting each other in a client situation. But it's not the same as it was in the prepandemic case. It's not large groups of people lining up for client meetings in offices that are full, et cetera. It's very measured. It's very slow.

Our operating teams continue to be in most parts of the world other than China and a few thousand people there in the Philippines still operating in a remote environment. Until all of those places get to the point where whether it's a Delta variant or whatever variant and then vaccinations, all get to the point of being really safe to get back to working in much more of a hybrid mode.

Kyle David Peterson - *Needham & Company, LLC, Research Division - Associate*

Got it. That's really helpful color.

And best of luck, Ed.

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

Thank you.

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

Thank you.

Operator

Your next question is from Bryan Keane of Deutsche Bank.

Bryan Connell Keane - *Deutsche Bank AG, Research Division - Research Analyst*

Guys, I know we're running long here. So let me just ask one quick one. Tiger, when you look at the conversion rate of the pipeline, how do you measure how you guys are doing versus the market? I'm just thinking about market share gains because everybody is doing well on IT services, talking about digital and analytics. And that's doing well across the board. How do you know if you guys are getting your fair share?

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

Bryan, you've -- I mean you've asked a very tough question. It's very tough to figure out specific market shares in our industry, you know that. So the best way for us is to look at 3 or 4 things.

In the verticals of our choice, are we seeing everything that comes to market in terms of an opportunity? Are we able to have the right conversations in clients that we already have access to? And are we able to create solutions that actually makes it attractive for the client to often work with us in a sole source manner? And then are we able to target clients that we have defined as a new account to target because we know that it's the right thing to do for that client? And then are we able to convince the client to work with us or work in a competitive environment where, ultimately, we win.

So that's one. Are we able to get to those clients, both existing and new clients? And the second is, in those competitive situations, how is our win rate working out? So those are 2 things we track.

And finally, we track cycle time and aging of the pipeline. And if I look at the last one, if we think about aging in the regular deal flow, that aging seems to be going at exactly the kind of rate that we've always seen prepandemic, et cetera. So it's actually pretty good.

When you look at the larger deals, the aging there is back to what it was in some of the slower prepandemic time, but it's no worse than that. So it's a combination of are we in the conversations in our target clients and existing clients? Is our win rate constant and steady? And what's the aging of our pipeline? Those are the kind of metrics that we look at. Unfortunately, there's no report that we can look at and say, "This is our exact market share in our specific services and our specific verticals."

Bryan Connell Keane - *Deutsche Bank AG, Research Division - Research Analyst*

And is there room for that win rate to go up in your eyes, Tiger, that you -- that you're sure you're getting?

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

So we have a pretty good win rate in many of the focus areas that we have. I would say the bigger opportunity continues to be, how do we open new client conversations? How do we expand the buying centers? How do we connect the dots between the various services? And I talked about this, that some of the best value these days gets created. When you connect those service lines, supply chain and finance, and when data crosses over is when some of the best value gets created for clients. So it's really that versus win rate. I think we have a pretty good win rate in most of these competitive situations.

Operator

And no further questions. I would like to turn the call over to the presenters for additional remarks.

Roger Sachs - *Genpact Limited - Head of IR*

Thank you, everybody, for joining us today. And as always, we look forward to speaking with you next quarter. Thanks again.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
