Corrected Transcript

09-May-2024

Genpact Ltd. (G)

Q1 2024 Earnings Call

CORPORATE PARTICIPANTS

Krista Bessinger
Head-Investor Relations, Genpact Ltd.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

OTHER PARTICIPANTS

Bradley Clark
Analyst, BMO Capital Markets Corp.

Maggie Nolan
Analyst, William Blair & Co. LLC

Ryan E. Potter
Analyst, Citigroup Global Markets, Inc.

Bryan C. Bergin
Analyst, TD Cowen

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Moshe Katri
Analyst, Wedbush Securities, Inc.

Surinder Thind
Analyst, Jefferies LLC

Sean Kennedy
Analyst, Mizuho Securities USA LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen. Welcome to the 2024 First Quarter Genpact Limited Earnings Conference Call. My name is Michelle and I'll be your conference moderator for today. At this time, all participants are in listen-only mode. We will conduct a question-and-answer session towards the end of this conference call. 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 Krista Bessinger, Head of Investor Relations at Genpact. Please proceed.

Krista Bessinger
Head-Investor Relations, Genpact Ltd.

Thank you, Michelle. Hi, everyone, and welcome to Genpact's Q1 2024 earnings conference call. We hope you've had a chance to read our earnings press release posted on the Investor Relations section of our website, genpact.com.

Today, we have with us BK Kalra, President and CEO; and Mike Weiner, Chief Financial Officer. BK will start with a high level overview of the quarter and then Mike will cover our financial performance in greater detail before we take your questions.

Please note that during today's call, we will make forward-looking statements including statements about our business outlook, strategies, and long-term goals. These comments are based on our plans, predictions, and expectations as of today, which may change over time. Actual results could differ materially due to a number of important risks and uncertainties including the risk factors in our 10-K and 10-Q filings with the SEC. Also during this call, we will discuss certain non-GAAP financial measures. We have reconciled those to the most directly comparable GAAP financial measures in our earnings press release. These non-GAAP measures are not intended to be a substitute for our GAAP results. And finally, this call in its entirety is being webcast from our Investor Relations website and an audio replay and a transcript will be available on our website in a few hours.

And with that, I'd like to turn it over to BK.

Balkrishan Kalra

President, Chief Executive Officer & Director, Genpact Ltd.

Thank you, Krista. Hello, everyone, and thank you for joining us today. I'll start with a brief overview of Q1 performance, our updated outlook, and then hand the call over to Mike to take you through our financial performance in more detail.

Q1 was a solid start to the year, with total revenues of $1.13 billion, up 4% year-over-year. This was above the high end of our guidance range, driven by early signs of improving execution and better than expected performance across both Digital Operations and Data-Tech-AI. Gross margin of 35% also exceeded expectations, reflecting operational efficiencies and better than expected revenue performance. Adjusted operating income margin was 16.1%, in line with guidance, reflecting investments in our top priorities.

In Q1, as most of you know, we established our 3+1 Execution Framework and it is driving promising early results. 3+1 consists of three client-facing initiatives: partnerships, Data-Tech-AI, and simplification; and one internal-facing initiative, client zero. This is about establishing Genpact as our own best credential for AI-led transformation. Let me walk you through each one of them.

First, on partnerships, in first quarter, we significantly strengthened our partnership team and achieved tier 1 partnership status, the highest level with AWS, Salesforce, and Adobe. We have also joined forces with Microsoft. By combining Genpact's leadership in finance and accounting with the Azure OpenAI technology, we are transforming finance organizations to best-in-class, leveraging data and AI solutions.

Second, on Data-Tech-AI, we are aggressively driving go-to-market engagement across data engineering, analytics, and AI with specific focus on gen AI. This drove a significant increase in client conversations in Q1 and contributed to better than expected Data-Tech-AI revenue. We are working with clients to integrate gen AI into their core business processes. Gen AI is also serving as a driver of foundational work as we help enterprises build a broader data and system architecture that is a prerequisite to succeed in the AI world.

Genpact plays a critical role. We'll bridge the gap between off-the-shelf solutions delivered by platform provider, bringing domain understanding at a keystroke level. This helps clients installing AI first, end-to-end business process with underlying data and systems in their production environments.

Clients choose us for five key reasons. One, deep domain expertise. Two, end-to-end capabilities from strategy and design all the way to delivery and transformation. Three, strong partner ecosystem. Four, client centricity. And five, full stack data technology and AI stack including our pre-built accelerator, the Cora platform. Let me give you few examples.

Novva Data Centers, a provider of state-of-the-art data centers, is using our AI solution to improve the functionality, integration, and operational efficiency of their Boston Dynamics Spot robots. Using natural language processing, hardware integration with OpenAI interfaces, these robots have been given features such as AIpowered anomaly detection, facial recognition, license plate monitoring, and the ability to have human-like interaction. These features will allow their robots to further enhance security capabilities and monitor critical infrastructure.

Or in case of Volkswagen Financial Services, we have integrated gen AI into the production systems. This enables agents to manage servicing requests with significant efficiency. The gen AI translation skills are already launched across three countries in Europe and rapidly expanding. This solution has significantly enhanced agents' ability to manage account changes, loan disbursements, addressing customer complaints while delivering a more personalized experience and improve customer satisfaction.

We are also building responsible AI centers of excellence for clients and this is a significant focus for us.

I'll give you couple examples.

The finance organization of a major IT company wanted to automate a range of operational finance activities. We ran a portion of their finance and accounting and other operational processes. Taking a page from our own best practices, we established a responsible AI center of excellence for them, bringing functional domain depth, supplementing it with data engineering capabilities, and enabling AI deployment. It is helping them put various use cases in production at speed.

We also established an AI center of excellence for a major life insurance company. For this client, we are building a platform that uses advanced AI techniques that stitches together historical information, product specifications, and future projections to enable range of decisions. The first use case will drive the end-to-end automation of pricing and renewal decisions using AI with human in the loop.

These are just few of the examples. While it is still very early days, we are seeing increased momentum in gen AI-related revenues and bookings and believe we are in a strong position to partner with enterprises to drive competitive advantage moving forward.

Third, on simplification, as part of 3+1, we simplified our field and go-to-market leadership structure in Q1, moving from highly matrixed organization to 12 units, which mirrors our client organization. This is strengthening execution and accountability with standardized scorecards, internal management reporting, sales and post-sales activity all supported by a new governance structure that tracks key performance indicator at the unit level. We are now in the process of simplifying a number of additional key elements that will allow us to scale more efficiently.

And finally, the +1 in our 3+1 Execution Framework is client zero. This is the work we are doing to establish Genpact as our own best credential for AI-led transformation. We have identified and are moving forward with more than 50 internal use cases across IT, finance, HR, legal, sales and marketing to drive growth, improve employee satisfaction, reduce costs, and improve cash flow all by leveraging the same AI tools we use on behalf of our clients. It's early days here as well, but we are excited by the progress we are making.

Now, turning to our guidance, Mike will go through the details, but I wanted to cover few important points upfront. As I mentioned earlier, we are seeing early signs of improving execution with better than expected results for quarter one. As a result, we are increasing our full year revenue guidance by 50 basis points to 2.5% to 3.5% growth on as reported basis, up from 2% to 3% previously.

Our outlook does not assume any improvement in the macro-buying environment. We are simply flowing through the revenue upside from Q1 of approximately $20 million at midpoint of the range through the full year. We are also increasing our gross margin outlook for the full year by 30 basis point to 35.3%, up from 35% previously, reflecting outperformance in Q1. Our AOI margin outlook remains unchanged at 17% for the full year as we continue to invest in our top priorities, partnerships, and gen AI to drive accelerating long-term growth.

In closing, Q1 was a solid start to the year, with revenue and gross margin above the high end of our guidance range, reflecting early signs of improving execution. We are excited by the progress we are making and believe our 3+1 Execution Framework will be key ingredient in putting us on path to reach our full potential.

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

Michael Weiner

Chief Financial Officer, Genpact Ltd.

Thank you, BK and good afternoon, everyone. Today, I'll review our first quarter results and then provide you with our thoughts on our second quarter and full year 2024 outlook.

Beginning with our first quarter results, while we continue to experience pressure in our discretionary short cycled work, demand for our long-term annuity-based services continues to be strong. Specifically, our pipeline achieved record levels fueled by strong inflows. We booked three large deals in the quarter. While this was lower than the number in the first quarter of last year, our overall total bookings level was near the level we booked in the same period last year. We also booked 30 new logos in the quarter with an average TCV of approximately $4.5 million compared to 17 new logos with an average TCV of approximately $5.6 million last year. Sole sourced deals represented approximately 40% of bookings, and win rates remain elevated at 62%.

Total revenue of $1.13 billion was up 4% year-over-year, both on an as reported and constant currency basis. This performance was above our expectation, reflecting early signs of improved execution and better than expected performance across Digital Operations, Data, Tech and AI (sic) [Data-Tech-AI] and all segments.

As noted in our press release, we made enhancements to our Data-Tech-AI and Digital Operations revenue breakout to more accurately reflect revenue from certain solutions. We have also provided historical comparison results in our financial (sic) [supplemental] fact sheet, which were posted prior to the call. The results I will provide for Data-Tech-AI and Digital Operations below will leverage the prior methodology so that you can accurately compare the results to the guide we provided on our year-end call.

Data-Tech-AI revenue, which represents 44% of total revenue, increased 3% year-over-year on an as reported and constant currency basis. Performance was largely driven by service lines in finance and accounting, supply chain, and risk.

Digital Operations revenue, which represents 56% of total revenue, increased 4% year-over-year on an as reported and 5% on a constant currency basis, primarily reflecting deal ramps related to last year's large booking wins.

Outcome and consumption-based models expanded to approximately 19% of first quarter revenue compared to 13% of total revenue in the first quarter last year. Revenue from priority accounts grew 4% year-over-year and remained at 63% of global revenue, with 43% of first quarter bookings from priority accounts.

From a segment perspective, financial services increased 3% year-over-year, primarily driven by ramp of large deals and growth in financial crimes, partially offset by continued pressure around client discretionary tax spend. Consumer and health care increased 5% year-over-year due to large deal ramps and growth in supply chain engagements. High tech and manufacturing increased 4% year-over-year, primarily driven by ramp of new logos in both Digital Operations and Data-Tech-AI, moderately offset by partial descoping of a high tech priority client noted last year.

Adjusted operating income margin was 16.1%, down 30 basis points year-over-year, primarily due to increased investments to support growth. Gross margin for the first quarter was 35%, up 100 basis points year-over-year, primarily driven by less upfront large deal investments and lower severance costs. As a reminder, severance costs were elevated last year from workforce reductions in our short-cycled advisory work.

SG&A as percentage of revenue increased 90 basis points year-over-year to 20.8%. The year-over-year increase was largely due to higher investments to support growth that I mentioned earlier. Note we also had lower stock comp expense, which does not impact our adjusted operating income margin.

Our effective tax rate was 25.2% compared to 23.4% during the same period last year, primarily driven by lower tax deductions related to stock-based compensation and the implementation of Pillar 2 global minimum tax rates.

GAAP net income was $117 million, up 10% year over year. GAAP diluted EPS equivalent of $0.64, up 12% year-over-year. Adjusted diluted EPS of $0.73, up 7% year-over-year and outpaced revenue growth for the quarter. The increase was primarily driven by the impact of lower outstanding share count of $0.02, higher adjusted operating income of $0.01, and FX remeasurement gain compared to the same period last year of $0.01 and lower taxes of $0.01.

Compared to first quarter of 2023, we grew the number of relationships with annual revenue greater than $5 million from 175 to 187. Additionally, clients with annual revenue greater than $25 million expanded from 36 to 40, and clients with approximately $100 million of revenue remained at 5.

Turning to cash on balance sheet, during the quarter, we utilized $26 million of cash from operations compared to utilizing $34 million during the same period last year. Days sales outstanding expanded to 91 days from 83 days in 2023 due to collection delays and higher payment terms in new accounts. The overall credit quality of our portfolio continues to be very strong. Cash and cash equivalents totaled $478 million compared to $584 million at the end of the fourth quarter of 2023, reflecting the return of $57 million to shareholders and an annual incentive compensation payout that occurred in the first quarter.

At the end of the quarter, our net debt to EBITDA ratio for the prior four quarters was 1.1 time, in line with our preferred 1 to 2 times range. With undrawn debt capacity and our existing cash balances, we have ample flexibility to pursue growth opportunities and execute on our capital allocation strategy.

During the quarter, we repurchased approximately 865,000 shares at a total cost of $30 million and at a weighted average share price of $34.67 per share. Capital expenditures as percentage of revenue equated to approximately 1.8%, in line with our expectations. We remain committed to returning capital to shareholders through a regular cadence of buybacks and quarterly dividends. We continue to plan to pay out approximately 50% of our operating cash flow to shareholders during the year, including a minimum of 30% of our cash flow from operations for share repurchases.

Before I provide an update on our outlook, some quick stats on attrition. Our attrition rate for the quarter was 23%, in line with fourth quarter levels and the low end of our historic range. Adjusted for involuntary attrition and employees with less than three months of service, our attrition was 17% during the quarter.

Finally, let me update you on our full year 2024 outlook and our second quarter guidance. Genpact's outlook for full year 2024 is as follows. Total revenue in the range of $4.59 billion to $4.63 billion represents year-over-year growth of approximately 2.5% to 3.5% as reported, up from the prior guidance of 2% to 3%. This includes Digital Operations revenue growth of approximately 3.6% year-over-year, and Data-Tech-AI revenue growth of approximately 2.3% year-over-year at the midpoint of the range as reported compared to the previous midpoints of 3.1% and 1.7%, respectively, on an updated classification basis.

Full year gross margin of approximately 35% (sic) [35.3%], full year adjusted income from operation margin of approximately 17%, and full year adjusted EPS in the range of $3.01 to $3.04. This represents a year-over-year growth of 1% to 2% and includes higher adjusted operating income of $0.09, positive impact related to lower share count of $0.06, partially offset by the impact of higher expected tax rate of $0.04, higher interest expense of $0.04, and a negative year-over-year FX impact of $0.02 due to the $4 million remeasurement gain recorded last year. As we've communicated in the past, to the extent we're able to deliver revenue upside over the course of the year, our bias will be to reinvest a portion of that upside back in the business to drive future revenue growth.

Our 2024 effective tax rate continues to be in the expected of 24.5% compared to 23.4% reported for full year 2023. The increase reflects the implementation of new Pillar 2 global minimum tax rates as well with lower year-over-year tax benefits related to stock-based compensation.

We continue to expect cash flow from operations to be approximately $500 million. Capital expenditures as percentage of revenue continues to be expected to be approximately 1.5% to 2% in 2024, which includes investments related to internal system upgrades.

Our outlook for the second quarter 2024 is as follows. Total revenue in the range of $1.143 billion to $1.148 billion, representing a year-over-year growth of approximately 3.4% to 3.8% as reported. This includes Digital Operations revenue growth of approximately 5.4% year-over-year and Data-Tech-AI revenue growth of 1.6% year-over-year at the midpoint of the range as reported.

Gross margin is expected to be approximately 34.8%, down 20 basis points sequentially due to the alignment of our annual compensation refresh of employees in 2Q. Adjusted operating income margin is expected to be 16.5%.

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

Krista Bessinger

Head-Investor Relations, Genpact Ltd.

Great. Thank you, Mike. We would now like to open the call for questions. Michelle, could you please give the instructions?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Puneet Jain with JPMorgan. Your line is open.

Q

Hi. This is [ph] Nina (22:27) on for Puneet. Congratulations on the results. Of course, it's still early, but now that you guys are kind of seeing some of the benefits of your new strategies such as 3+1 pay off on the P&L, is it too soon to start thinking about longer term revenue targets? I think we're currently modeling. You guys are high single digits, but I know the previous target was close to the low double so just would appreciate any color here.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. So, it's Michael. I'll kick this off and I'll turn it over to BK. Right now, we're really focused on our execution in 2024. So at this point now, I think we're comfortable with the ranges we've provided for this year. And as we get additional clarity, as we move forward in the year, we'll provide additional color on a go-forward basis.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Yeah. And if I may add, we don't see any change in the macro environment and in our model, macro environment is more big than where it was at the back half of last year. But we are enthused with our early execution and we'll continue to update as we go along.

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Bradley Clark with BMO. Your line is open.

Bradley Clark
Analyst, BMO Capital Markets Corp.

Q

Hi. This is Brad Clark on for Keith Bachman. Thanks for taking my question. I wanted to hone in on your comment on gen AI for your client. I think you said better than expected revenues and bookings in the quarter. Is there any other color that you can provide to help shape perhaps the size or depth of the business and where you're seeing [indiscernible] (24:06) traction with clients?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

So Brad, I'll say three comments. One, obviously these are early days not just for us, for our clients or overall in the industry but in the early days, we see a lot of interest from clients relative to many of the technology waves that we saw in the past.

Point number two, I think we are seeing therefore enhanced conversations and a number of those conversations convert into booking and revenue, and a number of those conversations don't convert. [indiscernible] (24:47) excitement and possibilities that we can harness and that we need to kind of handhold our clients as we go along.

And last point, I think what we have seen in booking and revenues is still a very, very small portion. So we have set up our systems to see that on a consistent basis. And as it solidifies, as it progresses at some point in time, we will share more light on that.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. BK, if I may just elaborate on those comments, right, while we're not providing any quantitative benefit, to the question, I think it's very interesting where today we sit between the client and the hyperscaling large enterprise technology companies. And the vast majority of all of our client conversations are how can we help in the middle of those two things. And we think that's going to be a real driver for us for future growth.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Yeah.

Bradley Clark
Analyst, BMO Capital Markets Corp.

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Maggie Nolan with William Blair. Your line is open.

Maggie Nolan
Analyst, William Blair & Co. LLC

Q

Hi. Thank you. Can you dissect for me in a little bit more detail where the outperformance came from in Q1? Is there anything about that that's one-time or non-recurring or timing considerations that we should keep in mind as we think about how Q2 might shape up in comparison to Q1?

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

No. I think it's from that perspective. It's Mike answering the question. Hey, Maggie. How are you?

So in the first quarter, right, if you think about our business, our two revenue disaggregation units, our Digital Operations revenue, right, it was we had better than expected execution, particularly regarding the deal ramps of the large deals that we implemented in the third and fourth quarter of last year. We continue to execute really well on that.

As far as our Data-Tech-AI business versus our expectations, project work, particularly in finance and accounting supply chain, really drove a lot of that outperformance.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

And if I can add, Mike, look where it is all coming from in early days is all about our 3+1 Framework, Maggie.

So, take an example of partnerships. In partnerships, as one of the key attributes in 3+1, we invested in really strong talent, including a leader and a team in there and started engaging with the technology partners. And what we see in more detail, the inflows are roughly 2.5 to 3x relative to the corresponding period last year.

Or if I go into like Mike was saying, in Data-Tech-AI, how our employees are also embracing this pivot. There are more and more conversations happening with the clients on data and AI. And some of it you already seen our results in Data-Tech-AI. So clearly, the investments that we are making, the pivot that we are embracing is showing some early results as well as the cadence of governance and execution that we have put in place.

Maggie Nolan
Analyst, William Blair & Co. LLC

Q

Thank you. That's great to hear. When you think about all those changes that you are making within the organization now that some of that is underway, particularly on the sales team, can you talk a little bit about reception of those changes, culture? Have there been any changes in voluntary attrition within the group? Thanks for taking my question.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Yeah. Thanks, Maggie. And what I can tell you is that overall, there is a level of excitement in the team. Excitement because everybody is clamoring to deliver better results, point number one, and they see their efforts pay off, though I think we all are aware that they are a little bit more coming in from easier comps, I would say that.

Two, I think with these routines and rituals and there are a few routines and rituals that are getting etched for now and in the future, those routines and rituals are yielding results and a number of our colleagues are seeing the results of their hard work pay off. So I will say that there's lot of excitement [ph] about that (29:13), I can feel in a palpable manner.

We also hired north of 50 leaders at a senior level in last 90 days, got in first quarter and more focus on data, technology, AI also in partnerships. And all of that support is enabling our existing staff to progress further with clients.

Maggie Nolan
Analyst, William Blair & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question comes from Ryan Potter with Citigroup. Your line is open.

Ryan E. Potter
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Thanks for taking my question. It was nice to see the solid execution and the return to sequential growth that's implied in the 2Q outlook you have here. Was wondering if you'd comment on the visibility that you have into this 2Q outcome and remainder of the year. Are you expecting sequential growth for the remainder of the year past 2Q and what kind of assumptions have you made around things like discretionary spending, which I know sometimes can have more an impact on Data-Tech-AI?

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. So this is Mike. Let me kind of kick that off and I'll turn it over to BK. We're not really looking to provide additional color on really how we're seeing it out greater than this year in 2024. But what I will talk about is really our second half in terms of what our guidance is really based on, particularly with regard to revenue, which I think you're alluding to.

It's a prudent guide, to be completely frank with you, right? We have not anticipated any real change in the macro environment, particularly from the second half 2023 and through first quarter 2024, right? We have the large deals that we did flowing through and yes, arguably off of a poor comp, but that's really what's reflected in our second half revenue round.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Yeah. And I think the only add that I have, Ryan, is for the second quarter guide, clearly sitting on May 9, we have better visibility to what will happen in next 55 days. And on the second half, Mike, in any case, responded to that question.

Ryan E. Potter
Analyst, Citigroup Global Markets, Inc.

Q

Got it. And then just quickly on productivity commitments from clients, can you provide some more color, I guess, on trends you've been seeing there? Like has the macro or increased interest in AI [ph] with the (31:40) clients asking for higher levels of productivity than in the past in your core services?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

So there is a lot of interest from clients on AI, but there has not been any increase in productivity expectations that we see in all of our client conversations and renewals, in new signings. And reality is, Ryan, that we always baked in a lot of productivity based on AI tools. Now, gen AI is new. Now what we see is interest from clients to learn more about the how. That certainly has changed but not be [ph] quantitative (32:27) side of house.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. We've also seen – we talked about in our prepared remarks a nice amount of growth in our alternative commercial models, right, moving away from FTE-related pricing, which all supports the implementation of a lot of this new technology.

Ryan E. Potter
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thanks.

Operator: Thank you. Our next question comes from Bryan Bergin with TD Cowen. Your line is open.

Bryan C. Bergin
Analyst, TD Cowen

Q

Hey, guys. Good afternoon. Thank you. I wanted to ask a follow-up question on the go-to-market changes that Maggie had asked. Specifically, are the changes to your sales and go-to-market organizations, are those fully implemented as you exited the first quarter or do you have incremental kind of changes that you're now pursuing in 2Q and as you go through the balance of this year?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Thanks, Bryan. So, look, I think we have made a number of changes and we'll continue to evolve as we progress through the year, as 3+1 takes hold as well as we continue to engage the clients and learn more on their needs. So it's a continuous evolution and there's nothing new. I think what we did was a surge of changes that we have driven. But fundamentally, and as an example, in simplification, we moved from a matrixed organization to finite 12-unit that truly faced the clients and brought in a lot of decision-making to those 12 units. And those changes happened in Q1. But as we continue to progress, I think we will continue to improve it on the edges. Now, as well as bringing in new talent that pushes the agenda of data and technology and AI further.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. And thus far, the execution's been wonderful. We had a nice growth in terms of our inflows and our bookings, but more to come.

Bryan C. Bergin
Analyst, TD Cowen

Q

Okay. Very good on that. And then just pivoting to gross margin here, so just first, a clarification on the 1Q. I thought I heard you say you had less large deal upfront investments. If I'm right on that, what does that do, too?

And then can you just talk about the drivers as you go through the balance of this year, the cadence of gross margin? Understand you took the outlook for gross margin up a bit here for the year, but the Q2 downticks, I think, first before you build in a second half recovery. So just help us with the moving parts as you go through the year for gross margin.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Sure. So our gross margin, I believe, in the first quarter was up about 100 basis points, right? I think what you're referring to is prior year comps with lower severance and less large deal investments than we had in the prior year as well as lower stock expense that really drove that increase.

And as far as we have increased our gross margin, as we continue to move through the year, we're flowing through the revenue that we had in terms of better than expected revenue in the first quarter. And we have enhanced operating leverage, which are flowing through in terms of the gross margin for the remaining part of the year in our guide.

Bryan C. Bergin
Analyst, TD Cowen

Q

All right. Thank you.

Operator: Thank you. Our next question comes from Bryan Keane with Deutsche Bank. Your line is open.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys. Congrats on this solid execution here. I guess my question, BK, 62% win rate. That seems elevated to me. What would you point to? Is it the pitch or go-to-market strategy that's pushing up the win rates?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Yeah. Thanks, Bryan. If you look at even last year, where we ended, win rates were in the range of 60% and I completely agree with you that they are really high win rates. And what is driven by is two factors. One, there is a lot of small deals and medium-sized deals where we do a lot of sole source. And that is helping us improve our win rates. And two, even then, as we have onboarded many clients, there are follow-on larger deals that we are doing. And some of these follow-on deals that we do, they happen to be sole source and therefore, our win rates improve because they have already seen [indiscernible] (36:55) ratio, they have already seen the performance that [ph] we're driving the accounts (36:57).

Having said that, I would say that, yes, they are very high win rates and I'd rather have a bigger pipe. And we have a record level of pipeline as I speak today. But it won't hurt to increase the pipeline further and that's where our effort is. And even if some of the win rates goes down, I'll be less bothered by that.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. And then my follow-up is just looking – you increased gross margin, but not operating margin or just operating margin. Maybe what is the cause of that? In second quarter, the margin guide is 16.5%. It's a little lower than we had in our models so just thinking about the puts and takes there as well. Thanks.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. Let me first address your first question really with regard to, yeah. I think what you're asking is our gross margin up and we're holding our AOI relatively constant from our initial guide, right?

So in our prepared remarks, to the extent we continue to execute on better revenue performance, what we're going to do is essentially focus that on increasing our investments, our timed investments in our business. So if you kind of think about the model on a go-forward basis that's really driving this, better revenue that we flow through in the first quarter. We'll have the operating leverage on growth that we have on a go-forward basis and as client zero for the company, we continue to execute on our own efficiencies. What we're going to do with all three of those positive is we're going to deploy those back in the business and focus really on generative AI investments for this year.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

And then just the second quarter in particular?

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

I'm sorry? It's relatively the same. It's relatively the same thing for the second quarter. In terms of I think your question is why it's 16.5%, right, I think it's really – I can't really comment on your model. But it really results in if you look at our seasonal pattern, it's pretty much in line.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Thanks for the color.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Thank you, Bryan.

Operator: Thank you. Our next question comes from Moshe Katri with Wedbush. Your line is open.

Moshe Katri
Analyst, Wedbush Securities, Inc.

Q

Hey, thanks. Congrats on strong execution. I have a couple. First, as the model continues to shift towards outcome-based pricing or what you call, I guess, non-FTE-based pricing, how should we think about the model at Genpact changing in terms of profitability, head count, et cetera? And then the follow-up is more about discretionary work. Which part of the revenue today is considered discretionary at Genpact? Thanks a lot.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

So let me kick it off and I'll hand it over to be BK, right? So what we have seen thus far in terms of our alternative commercial or non-FTE-related pricing, we've actually seen the contrary in terms of the average margin on that work that we do is higher than the average of the company as a whole, right? Yeah and we continue to believe that there'll be an enhanced decoupling between revenue and FTE-related costs.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Yeah. Exactly to the point that you're making, Mike. We are increasingly seeing that decoupling and we are pushing that decoupling of FTE to revenue. And I would again say we are at the early stages of that and we are putting certain architecture infrastructure in place to over a period of time build more momentum there. And clearly more of our investments are also going, Moshe, in building IP and building repeatable assets that we can deploy over and above, say, software of our partners. And we are again at early stages of that. As more and more data and IP takes hold, more disassociation of revenue with FTE will happen and that's where our endeavor is.

Moshe Katri
Analyst, Wedbush Securities, Inc.

Q

And the discretionary [ph] state (41:13) of the business?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Say that again. Your voice broke up here, Moshe.

Moshe Katri
Analyst, Wedbush Securities, Inc.

Q

How about the discretionary part [ph] of revenue (41:22) in general?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

Oh discretionary part. So I think – and the question on discretionary is that what portion of our business is associated with discretionary. Just wanting to clarify because your voice is a little bit muffled.

Moshe Katri
Analyst, Wedbush Securities, Inc.

Q

Yes, correct. Yes, that's correct.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

So in Data-Tech-AI, Moshe, what we have is also a lot of consulting and portions of projects that we do. Over 70% of our revenues is annuity and so bulk of our Digital Ops and a large portion and a significant portion even in Data-Tech-AI is annuity for us. They are long-term contracts. But as we think of the end-to-end capabilities, one of the reasons why clients buy from us is strategy, design to run and transform. That strategy and design portion of it has componentry, which is tied to discretionary. And owing to better execution, our pipeline is looking better, but we don't see it is because budgets have been released. It is more because we are becoming more agile in the marketplace, if that answers the question.

Moshe Katri
Analyst, Wedbush Securities, Inc.

Q

Thanks [indiscernible] (42:48).

Operator: Thank you. [Operator Instructions] Our next question comes from Surinder Thind with Jefferies. Your line is open.

Surinder Thind
Analyst, Jefferies LLC

Q

Thank you. Just a follow-up on the non-FTE revenues and the mix shifts over the past year. How should we think about that on a go-forward basis? Because the shift is pretty significant in the past year. So were there a few projects, a few clients that drove that? And is this something that's going to be maybe lumpy go-forward or where do you kind of see the endgame for this?

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

So I'll take that and Mike, feel free to add. Look, Surinder, our endeavor is to push that agenda more, be it in large deals and we have succeeded in few large deals or in renewals or in smaller and medium-sized deals. And even if the entire large deal or a medium-sized deal is non-FTE, I think there are portions of it that we are inserting is point number one.

Point number two, I already spoke about IP and data, and these are early days. So clearly, where is the endgame? It is too early to tell. What we are exceptionally clear that we want to break this association of FTE with revenues and have revenue growth disproportionately relative to the FTE head count. And I think we are putting architectural, infrastructural limits around that and we'll continue to report progress. Mike?

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. I'll just kind of build on that, right? So historically, historically over the last two years, I would say we disproportionately saw on renewals our ability to get these models implemented. But I think one of the interesting thing regarding our generative AI conversations we're having with clients, initially they're much more receptable to moving to those models than they were historically. So the generative AI narrative, right, is acting as a catalyst for those discussions as well as just our pivot to have more IP-related assets that have to drive that decoupling.

Surinder Thind
Analyst, Jefferies LLC

Q

That's helpful. And then when I think about just guidance in general, I look back to last year and obviously, the environment's been challenging. It's been hard to predict client behavior. Fast-forward to this year, you guys are out executing the guide. How should I think about the overall quality of the guide or any methodology changes that you guys have made? Is it just you guys are being maybe a bit more conservative this year? Any color there would be helpful for how you've been adapting to maybe the lower levels of visibility in this environment.

Michael Weiner
Chief Financial Officer, Genpact Ltd.

A

Yeah. So nothing has changed from what we told you about it a quarter or so ago in terms of our methodology on a go-forward basis. Obviously, we get smarter every quarter that we go.

Listen, I will say it's prudent from that perspective and that prudence here really relates to our assessment that the macro environment, particularly that affects some of our more discretionary shorter duration work, has not improved, right, in our models from the second half of last year through the first quarter this year.

To the extent that changes, yeah, potentially we could see additional benefits to it. But for now, I think the prudent way to move forward is using the information that we have best of our ability and making a conservative view from that perspective.

Keep in mind, as BK alluded to, over 70% of our business is somewhat annuitized and we have very good visibility at any given point on how that's going to perform for the remaining piece of the year on a rolling 12-month basis. So it really comes down to the 25% roughly cohort of our business that's short-term discretionary in nature. And again, what we're doing is we're tying that to our assertion of where the macro business environment's going to be for that period of time. As it changes, we'll update our guidance accordingly.

Surinder Thind
Analyst, Jefferies LLC

Q

Thank you.

Operator: Thank you. Our next question comes from Sean Kennedy with Mizuho. Your line is open.

Sean Kennedy
Analyst, Mizuho Securities USA LLC

Q

Hi, everyone. Nice job on the quarter and thank you for taking my questions. Can you touch on how the demand environment for new business progressed throughout the quarter both for the shorter duration discretionary deals and the larger ones as well? It seems like the outperformance in the quarter was more Genpact's specific execution versus the macroeconomic environment. Thank you.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

A

So, Sean, what I would say, yes, I think the execution and early signs are good. However, I'll also say that our pipeline is at a record level across all the segments, across Data-Tech-AI and across Digital Ops. And now, we can also attribute a lot of that to our increased agility, again, acting more proactively with our partnership and with technology partners. And we are getting more and more invites from our technology partners as well.

As I speak to clients or even partners, what Michael's enunciated earlier, that with understanding of hands on the keyboard and the assets in strategy and design and how we run and transform, we are able to capture the knowledge at our very keystroke level, which a lot of technology partners coming top-down are not able to. And that is the true execution that is needed by clients and therefore, there's a reaffirmation and we are seeing as we engage more actively with clients to reflect that in our pipelines.

Now, I would again continue to maintain [ph] EBITDA (49:20) many ways in which we see where the macro environment is, where the budgets are, have we seen any significant or any meaningful improvement there, the answer is no. It continues to be as it was at second half of last year. So that is what is sitting in our prudent guide.

Sean Kennedy
Analyst, Mizuho Securities USA LLC

Q

Great. Thank you. Good luck with the rest of the year.

Operator: Thank you. I'm showing no further questions at this time. I'd like to turn the call back over to the company for closing remarks.

Balkrishan Kalra
President, Chief Executive Officer & Director, Genpact Ltd.

Well, thank you so much, Michelle. And what I would say is Q1 was a solid start to the year with revenues and gross margin above high end of our guidance range, early signs of improving execution. And we are excited with the progress we are making with our 3+1 Execution Framework. And yes, we are pleased with the beat and flow, I would say, with this prudent guide. And I do want to take this opportunity to thank all of our employees for embracing the pivot, all of our clients for choosing Genpact, and all the shareholders for ongoing support. And I do want to thank you all and we'll come back to you next quarter.

Operator: Thank you for your participation. This does conclude the program. You may now disconnect. Good day.