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Cognizant Technology Solutions Corp.

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Cognizant Technology Solutions First Quarter 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to turn the conference over to Mr. Tyler Scott, Vice President Investor Relations. Please go ahead, sir.

Tyler J. Scott

Vice President-Investor Relations, Cognizant Technology Solutions Corp.

Thank you, operator, and good afternoon, everyone. By now, you should have received a copy of the earnings release and investor supplement for the company's first quarter 2023 results. If you have not, copies are available on our website, cognizant.com.

The speakers we have on today's call are Ravi Kumar, Chief Executive Officer; and Jan Siegmund, Chief Financial Officer.

Before we begin, I would like to remind you that some of the comments made on today's call and some of the responses to your questions may contain forward-looking statements. These statements are subject to the risk and uncertainties as described in the company's earnings release and other filings with the SEC.

Additionally, during our call today, we will reference certain non-GAAP financial measures that we believe provide useful information for our investors. Reconciliations of non-GAAP financial measures where appropriate to the corresponding GAAP measures can be found in the company's earnings release and other filings with the SEC.

With that, I'd like to now turn the call over to Ravi. Please go ahead.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

Thank you, Tyler. Good afternoon, everyone. When I spoke to you early February, I was just three weeks into my role. I explained my plan to move rapidly up the learning curve by embarking on a global listening and learning tour with associates, clients and partners. I also mentioned that I would meet with more than 100 clients and as many of our associates as possible.

In addition, I outlined three interrelated priorities making Cognizant an employer of choice in its industry; accelerate revenue growth, especially by winning large deals; and enhancing our operational discipline. I'll comment on progress of each of these areas, but first, I want to cover a few of the quarter's financial and operational highlights.

In quarter one, we delivered revenue of \$4.8 billion, a decline of 0.3% year-over-year as reported, but a growth of 1.5% in constant currency, above the high end of our guidance range. Our adjusted operating margin was 14.6%. We recorded strong quarterly bookings growth of 28% year-over-year and ended quarter one with record trailing 12-months bookings of \$25.6 billion and the trailing 12-months book-to-bill of 1.3x.

Approximately 30% of our in-quarter or quarter one bookings were large deals, which we define as total contract value of above \$50 million compared to approximately 20% for all of 2022. We were very pleased with our first quarter bookings performance, as well as the build in our pipeline, which includes a strong mix of large new opportunities. I'm especially pleased to see the continuing reduction in our attrition with trailing 12-month voluntary attrition for our technology services business, declining to 23%, down 3% points sequentially and 7% points Y-on-Y, year-on-year.

While Jan will cover our financial performance at the business segment level, given the importance of financial services on our momentum, I want to comment on the state of this business and the emerging opportunities we see in this segment. For starters, we believe our company-specific operational challenges in financial services have largely subsided, and we are beginning to stabilize the business. Our client portfolio has shown resilience, both in US and internationally, but we're also seeing the impact from softer discretionary spending and decision delays by existing and potential clients.

In the US, our banking clients are generally large institutions, and we have seen an uptick in our deal pipeline. Overall, we have seen early green shoots that we are moving this portfolio in the right direction, while navigating the macro dynamics. We are encouraged by leading indicators such as strong Q1 global bookings growth for financial services at a rate above the company average as well as an uptick in our large deal pipeline.

I'm particularly encouraged by my conversations with about two dozen of our financial services clients. I came away from these meetings with many new opportunities to pursue related to cost takeout, vendor consolidation, post-merger integration and a new wave of outsourcing in fintechs. Having said that, we still have a lot of work ahead, and we will be closely monitoring the environment to anticipate shifts in our clients' needs.

To-date, I have met either in person or virtually with C-suite executors from more than 100 of our clients representing nearly all of our industry segments and all of our major geographies. Several teams have surfaced from these candid conversations. We have a strong goodwill with our clients and they continue to recognize a culture of client centricity. This way, we are easy to work with, adventive to nurturing our client relationships and deeply understand their businesses.

They like our entrepreneurial approach to developing solutions to their challenges. They also appreciate our humility, our willingness to learn, listen and adapt. I believe the longevity and depth of our relationships have created a lot of accumulated trust.

By the way, none of our clients I spoke to mentioned about Cognizant's digital mix. I believe that's because digital and non-digital capabilities have converged to the point where the distinction between the two is less significant. Instead, the differentiator many clients have spoken about is how well positioned Cognizant is at the confluence of technology and industry domains. Given that our digital mix is no longer a true measure of the value we are providing to clients, we have decided to stop disclosing this metric.

With that said, clients want more from us. They trust us with their agenda, strategies and competitive challenges. They tell me Cognizant has earned the right to challenge their thinking and be a strategic partner who co-create solutions with them and offers insights and improving their operations.

Overall, I came away with the sense that many clients are fans of our company. What also surfaced is that most clients are grappling with largely similar challenges, although with variations by industry. The cost basis reflect the higher growth levels seen during the pandemic era, prompting an intensified focus on optimizing cost and efficiency and building greater resilience. They need to digitize workflows, enhance their customer and employee experiences and boost the efficiency of their commercial and operational teams.

In that context, I thought it would be useful to mention a few recent client wins that underscore the strategic cloud-focused work we do for clients and a skill-as-a-systems integrator. We are partnering with Microsoft to build an integration roadmap between our TriZetto health products and the Cloud for Healthcare. Our shared aim is to give payers and providers easy access to cutting-edge technology solutions, streamlined claims management and improved interoperability to deliver better patient and member experiences.

In a new win, we are working with Boehringer Ingelheim to speed the development and improve the accuracy of their life-saving therapies. We help our clients unify medicinal development processes and data into unified cloud platform and enhance the collaboration across clinical, regulatory and quality functions. We've been engaged by Volkswagen Group Ireland to reengineer its siloed contact center platform into omnichannel customer service landscape that will deliver more personalized agent and customer experiences using Salesforce Cloud and Amazon Connect.

And last week, we announced a new five-year agreement to transform and support the global technology operations of a long-term client, Nike. We will help drive customer, employee and partner experiences from Nike by leveraging hyper-automation, AI and processing reengineering. These are just a few examples. In short, our capabilities are in demand, as clients navigate an uncertain macroeconomic environment.

Let's turn to the company's three focus areas, the growth enablers and the progress we are beginning to make. The first of these is to become an employer of choice. We recognize this as a multiyear undertaking. To take the pulse of employee sentiment, I've been using every communication channel available to get unfiltered feedback from tens of thousands of associates to learn what's working well and what needs to improve.

As a part of my immersion, I spent two weeks in India visiting a half a dozen cities where we have major facilities, along with traveling to see associates in the UK, Switzerland, Canada and across the US. I've been moved by our associates warmth, enthusiasm and energy, and what I'm hearing from them is very encouraging. In this post-pandemic era, we are back to walking the corridors of our clients, mining relationships and building new ones, and we're revitalizing our ability to land and expand within existing clients, as we steadily bring on new accounts.

Across the organization, I see a rising pride in the company. Associates at all levels of our company want to partner with me to begin writing the next chapter in Cognizant's nearly 30-year history and are moving forward with renewed confidence about the future. To be an employer of choice, we need to meet the demands of a diverse workforce that spans geographies, generation and the range of work and life priorities.

Here are a few of our approaches. We have made career progression easier by expanding our internal job board process and redesigning the promotion process to increase more movement across our organization. We have intensified our focus on continuous upscaling and learning by expanding our learning library, running internal learning and development campaigns and launching a new leadership training initiative for people at all levels.

We have had three merit increases in 18 months for the majority of our associates who are in the levels up to associate director. And over the past couple of years, we've invested significantly more in compensation. In addition, we are stepping up the efforts to get our associates to return to office because doing so we believe, helps build and sustain our culture and helps associates build their social capital with colleagues.

To tap into the creativity of our more than 350,000 associates, we are launching a grassroots innovation movement, because I believe innovative ideas can come from everyone. This program called [ph] Blue Bolt (00:11:43) encourages and celebrates the thousands of flashes of inspiration that our associates have every day as they innovate for our clients.

Over the coming months, we plan to train more than 20,000 additional project leads in our innovation methods and generate over 100,000 ideas for client to use rapid prototyping and the identification of new opportunities.

The second focus area I've spoken about is accelerating revenue growth and building commercial momentum, especially by strengthening our ability to win large deals. Our Q1 bookings were a balance of renewals, expansions and new engagements, which we believe will provide revenue opportunities for us later in the year and valid to 2024. Our strong bookings growth in the quarter, including four deals with a total contract value of above \$100 million.

To cite one large deal, one recent large deal, Horizon Healthcare Services selected us to manage their claims processing and counter submissions to the state and enrollment services for their 1.2 million members. In the seven-year renewal agreement, we will bring to bear advanced automation solutions for our TriZetto product suite to help Horizon expedite the claims payment process and ensure accuracy in support of their member services.

Our large deal pipeline remains healthy for the next couple of quarters. Large deal bookings that aligned with our risk appetite are essential to building commercial momentum, but they can take time to ramp up and realize revenue. We are working on strengthening and industrializing delivery to support our execution of large deals.

Moving to our third priority, operational excellence. As you may recall from my last call, I said that internal simplification would be a theme we'll carry forward to help achieve the company's full potential. Our drive for

simplification will include operating with fewer layers to deliver greater agility along with realigning the business to be closer to our clients and employees, and of course, to encourage a growth mindset.

This endeavor named NextGen is aimed at building the enterprise of the future by simplifying our business operations, optimizing our corporate functions and realigning our workforce to a post-pandemic era of hybrid and redistributed work. This shift will provide an opportunity to rationalize the workspaces across the world and especially in India's largest cities by redistributing some real estate to smaller cities where we can expand and by modernizing some existing space.

We expect the structural shift in our real estate costs to help eliminate 80,000 seats and 11 million square feet in large cities in India. This shift will also enable us to invest in collaboration spaces in smaller cities while creating structural savings for the future that we can invest in our people and growth opportunities. We expect this program to help enable us to deliver margin expansion in the range of 20 basis points to 40 basis points in 2024 while supporting a large deal pipeline.

Combined with our efforts to increase utilization, improve delivery efficiency, maintain disciplined pricing and a lower attrition, we believe we have the levers to drive modest margin expansion over the next several years while we continue to fund growth investments in 2024 and beyond. Recognizing how much work we have ahead of us, I plan to provide periodic updates about our progress in achieving these three priorities.

Let's spend a moment on the demand environment and tech trends. We are carefully monitoring what remains an uncertain macroeconomic environment and with its potential for shifts in client priorities. That said, we are optimistic about our long-term opportunity within the IT services market. The demand for solutions and business outcomes remain solid as technology becomes core to nearly every business.

The tech trend on everyone's mind is generative AI with recent breakthroughs offering the potential to fundamentally transform our clients' businesses and increase our own productivity. To that end, we are accelerating our investment in generative AI. Our AI accelerator process uses studio environments to collaborate with clients to identify priority AI use cases and rapidly implement prototype solutions for field testing. We have conducted ideation sessions with over 30 clients and are now working to industrialize solutions to their common challenges.

We believe, generative AI will revolutionize the technology services industry, creating higher rates of productivity and driving greater prominence for software and data engineering expertise. We are using AI to enhance our own creativity and productivity. We are operating pilots that use generative AI to accelerate consulting, design, engineering and operations with the long-term goal of doubling the productivity of our associates.

With that in mind, last month, we launched a Neuro IT operations, a next-generation platform that brings new levels of automation and intelligence to applications and infrastructure operations. By applying an AI-led automation-first approach, we are enabling enterprises to innovate faster and drive down cost and risk. We believe that enacting new IT operations can actually reduce operational costs by 25% to 45%, reduce mean time to delivery and mean time to detect by 30% to 50% and reduce FTEs by 15% to 30% compared with the use of traditional approaches.

Across every industry, the cloud is today the biggest transformational opportunity, and therefore, our clients need a partner that can orchestrate cloud in a heterogeneous environment. In response, we just introduced a new cloud platform called Cognizant Skygrade. This multi-hybrid cloud and edge management platform applies an industry-focused approach, designed to help clients transition to a modern cloud-native architecture, develop

modern applications that evolve with the pace of business and streamline the cloud management operations. With Skygrade, we believe we can accelerate migration and modernization programs by shortening transformation time by 20% to 40%, resulting in faster value realization while reducing ongoing run and governance costs by 15% to 25%.

To wrap up, I stand behind my initial assessment that Cognizant has the strong foundation in place on which we could accelerate growth. I am especially optimistic about the strength of our portfolio and partner ecosystem, combined with our ability to create value for our clients at the intersection of technology and industry use cases. We recognize that our renewed strength in bookings momentum is helping us replenish a softer backlog from the past nine months, and we believe we can demonstrate improved growth towards the end of this year and in 2024.

With that, I'll turn the call over to Jan to provide additional details on the quarter and our outlook for 2023. Jan, over to you.

Jan Siegmund

Chief Financial Officer, Cognizant Technology Solutions Corp.

Thank you, Ravi, and good afternoon, everyone. Before I touch on the details of the first quarter, I would like to spend a moment on the NextGen program we announced today. During the second quarter, we initiated NextGen to simplify our operating model, optimize our corporate functions and realign our office space to reflect our hybrid work environment. We expect to record total estimated NextGen costs of \$400 million, approximately \$350 million in 2023 and \$50 million in 2024.

This consists of \$200 million of employee severance and other costs primarily related to non-billable and corporate personnel, which we expect to mostly incur in 2023. The personnel-related actions under this program are expected to impact approximately 3,500 associates or approximately 1% of our total workforce. We expect to realize savings from our NextGen initiative in the back half of this year.

The NextGen program also includes \$200 million of costs related to the consolidation of office space and approximately \$150 million in 2023 and \$50 million in 2024. We do not anticipate these real estate actions will begin to generate savings until 2024. By 2025, we expect to reduce our annual real estate costs by approximately \$100 million versus 2022. This reduction is net of investments to expand our real estate footprint in smaller cities, primarily in India, in support of our hybrid work strategy.

Our full year operating margin outlook includes the anticipated impact of these actions. As Ravi mentioned, we expect this program to help enable us to deliver 20 basis points to 40 basis points of margin expansion in 2024, in addition to funding revenue growth opportunities. This 2024 expectation assumes no further deterioration of the economic environment.

Beyond 2024, we are focused on driving structural cost improvements to fund investments to support revenue growth, our people and modernization of facilities while driving consistent, modest margin expansion.

Now moving on to the details for the quarter. We were pleased to deliver revenue above the high-end of our guidance range, strong free cash flow and healthy large deal bookings, which has helped us to begin to replenish our backlog following muted bookings growth throughout 2022.

First quarter revenue was \$4.8 billion, representing a decline of 30 basis points year-over-year or growth of plus 1.5% in constant currency. Year-over-year growth includes approximately 100 basis points of growth from our

recent acquisitions. As Ravi mentioned, we were pleased with our bookings performance in the first quarter, including the mix shift towards larger deals.

We also exited the quarter with a strong pipeline of larger opportunities across industries. At the same time, we also saw pressure in smaller contracts, which we believe is a result of a softer discretionary spending being driven by the macro environment. This environment has a near-term impact on our revenue in the second quarter, which I will touch on in my guidance commentary.

Moving on to segment results for the first quarter where all growth rates provided will be year-over-year in constant currency. Within Financial Services, revenue declined 1%. Revenue pressure within our North American portfolio was partially offset by growth in our global growth markets which was driven by public sector and insurance clients.

In the first quarter, bookings growth within Financial Services outpaced the total company, and we are seeing an improving pipeline of opportunities over the next 12 months. While we have begun to see signs of stabilization, we are still rebuilding our backlog as we continue to navigate an uncertain macro environment. We believe this uncertainty has impacted the pace of client decision-making and put pressure on discretionary budgets. It has also resulted in new pipeline opportunities around cost savings, efficiency and vendor consolidation, which we are actively pursuing.

Health Sciences revenue grew 4%, consistent with last quarter. Growth was driven by increased demand from healthcare payer clients for our integrated software solutions.

Products and Resources revenue grew 1%, reflecting inorganic contribution from recently completed acquisitions and continued strength among logistics, utility and travel and hospitality customers. This was partially offset by pressure from retail, consumer goods and manufacturing customers, which we believe reflects the economic environment.

Communications, Media and Technology revenue grew 4%, reflecting slower growth among our largest technology clients and muted growth among communications and media clients. Similar to our other segments, we believe the macroeconomic environment is impacting the pace of decision-making and discretionary spending among our CMT clients.

Continuing with our year-over-year growth in constant currency from a geographic perspective in Q1, North America revenue declined 1%. This performance reflected declines within Financial Services and Products and Resources, partially offset by growth in Health Sciences. Our global growth markets, or GGM, which includes all revenue outside of North America, grew approximately 7%. Growth was again led by the UK, which grew 14% and included strong double-digit growth within Financial Services, including public sector clients and CMT.

Now, moving on to margins. In Q1, both our GAAP and adjusted operating margins were 14.6%, as there were no non-GAAP adjustments in the quarter. On a year-over-year basis, both GAAP and adjusted operating margin declined by 40 basis points. This primarily reflects gross margin pressure from increased compensation costs, partially offset by tailwinds from the depreciation of the Indian rupee, lower SG&A expenses and the benefit of 2022 pricing actions.

Our GAAP tax rate in the quarter was 21.4%. The adjusted tax rate in the quarter was 22.5%. Our effective tax rate included a discrete benefit from a settlement of prior year tax audits. Year one, diluted GAAP EPS was \$1.14 and adjusted EPS was \$1.11, up 7% and 3% year-over-year, respectively.

Now, turning to the balance sheet. We ended the quarter with cash and short-term investments of \$2.5 billion, or net cash of \$1.8 billion. DSO of 73 days was down one day sequentially and increased one day year-over-year. Free cash flow in Q1 was \$631 million, representing approximately 110% of net income. This compares to free cash flow of \$186 million in the prior year period, which represented approximately 35% of net income. The increase in free cash flow was driven by strong collections.

During the quarter, we repurchased 3.2 million shares for \$200 million under our share repurchase program and returned \$150 million to shareholders through our regular dividend.

We also closed two acquisitions in the quarter, Mobica, which helps bolster our IoT software engineering capabilities; and the professional and application management services business of OneSource Virtual, a Workday partner. Over the last six months, we have deployed approximately \$800 million of capital across four acquisitions.

Before we move to our outlook, I would like to spend a moment to discuss the change in our attrition disclosure. As you heard Ravi mentioned, we are now disclosing voluntary attrition tech services on a trailing 12-month basis, which we believe is most relevant to our business. This new metric includes all employees, except those in our intuitive operations automation practice, and replaces our prior disclosure.

Now turning to our forward outlook. For the second quarter, we expect revenue in the range of \$4.83 billion to \$4.88 billion, representing a year-over-year decline of 1.6% to minus 0.6%, or a decline of minus 1% to flat in constant currency. Our guidance assumes currency will have a negative 60 basis points impact as well as an inorganic contribution of approximately 100 basis points.

We are also providing initial full year 2023 revenue and operating margin guidance. Our focus for the remainder of the year is to continue to replenish our backlog to successive quarters of strong bookings performance, which we believe would improve revenue momentum towards the end of this year and as we enter 2024.

For the full year, we are guiding revenue in the range of \$19.2 billion to \$19.6 billion, representing a decline of minus 1.2% to growth of plus 0.8%, or a decline of minus 1% to growth of plus 1% in constant currency. Inorganic contribution is expected to be approximately 100 basis points. This assumes no major deterioration in the demand environment, and our assumption that large deals we have signed and expect to sign in Q2 begin to ramp more meaningfully in the second half of the year.

Moving on to the adjusted operating margin. We are guiding operating margin to be in the range of 14.2% to 14.7%. Our margin outlook is impacted by several factors. First, we expect the macroeconomic environment will impact pricing, which was a key lever for us in 2022 to help offset the elevated wage inflation.

Second, we are achieving a faster pace of large deals than we initially anticipated. These larger deals generally have a dilutive impact in the first year. Finally, as mentioned, the NextGen program is not expected to drive meaningful savings until the back half of this year. For real estate, we anticipate initial savings in 2024 and a full run rate in 2025.

Our operating margin guidance also assumes a sequential decline in Q2 as a result of the merit cycle that took effect from April 1. As a reminder, this is our second merit cycle for the majority of our employees in the last six months. We anticipate 2023 interest income of approximately \$85 million, reflecting the higher interest rate environment, and an adjusted tax rate in the range of 24% to 26%.

In 2023, we expect to deploy approximately \$800 million on share repurchases, including the activity in Q1. This assumes repurchase activity above our long-term capital allocation framework and will reduce our weighted average share count by approximately 2.5% in 2023.

Based on the share repurchase activity, we anticipate full year average shares outstanding of approximately 506 million. This leads to our full year adjusted earnings per share guidance of \$4.11 to \$4.34, which reflects our wider-than-typical operating margin guidance.

Finally, we are targeting free cash flow conversion of approximately 90% of net income, which assumes the negative impact from the changes in the US tax law that we discussed in February. We now estimate the negative year-over-year impact of \$540 million from this change, which is slightly down from our prior estimate. This includes approximately \$300 million in deferred payments relating to 2022.

With that, we will open the call for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from Lisa Ellis with MoffettNathanson. Please proceed with your question.

Lisa Ellis

Analyst, MoffettNathanson LLC

Q

Terrific. Thanks for taking my question. Good nice uptick here on the bookings side. I just wanted to talk about this dynamic a little bit, maybe understand it a little bit more. Is it something that has been a little bit of a struggle with Cognizant over the last few years? You're showing 9%, I think, bookings growth year-on-year, but that was a book-to-bill of like 1.3x, which is – implies a bit of a disconnect in sort of how bookings translate to revenues. Can you just talk a little bit – I know you mentioned you're refilling the backlog and you're expecting to come in later in the year. Can you just help us a little bit again with how we should think about that dynamic, the translation of bookings into revenue and the timing and maybe what's going on with the backlog or with the underlying base of revenue? Thank you.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Thank you, Lisa. I'm going to – this is Ravi here. I'm going to start off and then ask Jan to add. We recorded very strong bookings, 28% year-on-year and 12-month trailing bookings of \$25.6 billion. And you're right, book-to-bill ratio is at 1.3x.

I think the way to see it is, it has multiple factors associated with it. First and foremost, how much of it is renewable? How much of it is new? How much of it is expansion? While we don't give those numbers out, we had healthy expansion and new business in comparison to the past. We had four large deals more than total contract value of \$100 million. Just to give you an order of magnitude. Last year, same quarter, we did not have any large deals. Large deals come with a little bit of – it comes with a runway where a lot of it is at the end of the cycle or rather at the back of the cycle. Short deals, small deals come with immediate short-fuse demand, which gives you revenue on the short run. Large deals give you revenue on the medium to long run, while in the short run, they take a little time to ramp up.

So in summary, how this translates to revenue in the short and the medium and the long run is dependent on what percentage of it is large deals, what percentage of it is small deals. You would appreciate small deals are actually a little softer for us because we've – we know that the discretionary spend is softening in an economic environment we are in. So the large deals gives us the opportunity to accrue revenues at the back end of this year and the next year, while we build the pipe for the future. Our pipeline is looking strong as well.

Jan Siegmund

Chief Financial Officer, Cognizant Technology Solutions Corp.

A

Lisa, the 9% trailing 12-months bookings growth is really entirely driven by the very strong bookings growth in the quarter. In this quarter, as you know, we had three quarters of flat bookings that contributed to this overall trailing 12-months result. And so the revenue growth, in this case, will be picking up. We expect to model in our revenue guidance some revenue impact from these larger deals picking and starting and ramping up in the second quarter – in the second half of this fiscal year and then have a full year impact next year.

So for the second quarter, impacting our guidance is also the anticipation that we see softness in the small-scale bookings. So the second quarter, in a sense, is kind of a transition quarter, I would say, because we have the high bookings growth, hopefully, continued momentum in bookings as we go through the year. But we do have a short-term revenue impact from the decline of these shorter and smaller deals that are impacted by the economy, by discretionary spend. So that's kind of how I think best to understand the relationship between bookings and revenue growth.

Lisa Ellis

Analyst, MoffettNathanson LLC

Q

Thank you. And then maybe for my follow-up. Ravi, this one is for you. I know you mentioned you've been out talking to 100-plus clients and have now been at Cognizant for 3.5 months or so. Can you just articulate, when you're talking out there with clients, how you see Cognizant, like, really uniquely differentiated in the market when you're – with what you're hearing back from them, what you're hearing from associates, et cetera?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Thank you, Lisa. No, I've met more than 100 clients in my first 100 days across all geographies, and traveled extensively to meet them and my associates. I would say, just to keep the high-level observations, I think our clients love the confluence of technology and industry demand which Cognizant really comes with.

Cognizant, if you go back to the history of Cognizant, it was bought at a time when there was a tail end of the Y2K boom, and it was born to be application outsourcing wave, which was starting off. And Cognizant built the capability on a confluence of industry and domain. And industry and domain, the confluence is very important now than ever before, because we all know that we are living in a golden era of technology, where the core of every business in every industry is transitioning to a technology-led core or a technology immersed core. So I would say, we have to progressively make sure that the confluence of technology or industry, we actually demonstrate the differentiation in every industry we represent. Our biggest exposure is healthcare, life sciences, financial services, which is where I think we have really doubled down on this confluence and we now have to progressively build in every other industry.

The second piece, I would say, is client centricity. I think over the years, Cognizant's growth has actually come from mining accounts with the breadth of capability Cognizant brings. And of course, the entrepreneur spirit of our

teams. These are the three things which stood out for me. And in fact, some clients actually who have worked with us for very long, actually said we are fans of Cognizant. I mentioned that on my initial remarks. And that was – that really stuck to me that these are clients who want us to move with them, who want us to challenge them and who want us to co-create along with them for their technology future, if I may. So there can never be a better time for the confluence of technology and industry, and I think we are so well positioned for that.

Lisa Ellis

Analyst, MoffettNathanson LLC

Thank you.

Q

Operator: Thank you. Our next question comes from Bryan Bergin with TD Cowen. Please proceed with your question.

Bryan C. Bergin

Analyst, TD Cowen Inc.

Hi, good afternoon, thank you. My first one is a margin, and I guess, a NextGen program clarification. And sorry if I missed this, but can you give us a sense of what the run rate cost reduction or the net savings you expect to achieve by the end of 2024? And I'm trying to understand if the 20 to 40 bps of 2024 operating margin is incremental to what you would normally had planned for? Or if that's kind of the total level of operating margin expansion, which would align with prior targets?

Q

Jan Siegmund

Chief Financial Officer, Cognizant Technology Solutions Corp.

Yes, Bryan, there's many moving parts here. So let me talk first about the overall program of \$400 million of restructuring charges, of which \$200 million comes from severance and \$200 million comes from real estate. We provided really only an expected run rate savings rate to materialize in 2025 at the full range of \$100 million for the real estate component. We offer that savings opportunity because we feel it's hard from the outside to calculate of how restructuring charges in the real estate space translate actually into full run rate savings. So that's kind of we wanted to help you with the impact of the \$200 million component for real estate with that. A portion of that – a meaningful portion of that will be achieved in 2024 and then the full run rate in 2025.

A

On the severance, we haven't given you a net impact or a gross impact. Number one, I think you can fairly easily calculate by the number of employees affected in the severance volume that we anticipate and make an assumption about the cost savings that we would see. There are many factors, and you'd see this reflected in a relatively wide range of margin that we give for the year is wage inflation, there's an uncertain pricing environment and other things that we will have to manage through. So, we haven't given more detail about the \$200 million severance charge at this point in time.

For 2024, the 20 to 40 basis points of margin expansion would be off the exit rate in 2023, and that would be our current outlook to 2024. It should signal from our point of view, our confidence that the full run rate of this program will help us to not only offset large deal pressure that we're going to see for this first year business cases of the larger deals plus the wage inflation plus other elements for 2024. So it's a little unusual that we give that early an expectation on the margin. But we felt, given that the program is fairly sizable and only a portion is going to be realized in 2023, it will be helpful for you to know that we are confident about return to margin expansion in 2024.

Bryan C. Bergin

Analyst, TD Cowen Inc.

Q

Okay.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Just adding one additional thing out here. I think these are two structural shifts in our cost as well. We listed cost in a hybrid environment as well as the structural shift in our personnel cost, which is a part of our SG&A, I think is an important part of this program, it's a structural shift.

Jan Siegmund

Chief Financial Officer, Cognizant Technology Solutions Corp.

A

Yeah, we should mention that we did, I think, in our script that we are focusing on non-billable and corporate functions. So these are intended to actually lower our SG&A rate basically.

Bryan C. Bergin

Analyst, TD Cowen Inc.

Q

Okay. I appreciate that. That's helpful. And then a follow up, Ravi, on the large deal front, I guess, maybe the Salesforce. Can you talk about what you're doing specifically in these large deal pursuits and maybe your initial assessment of the Salesforce and the [ph] incent (00:45:22) structure. I'm curious what you may have put in place here early on in 1Q to give you some quick wins.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yeah. So we're very excited about the large deal momentum. This is initial momentum based on the bookings this quarter as well as a good pipeline. I would say there are two swim lanes to this. One is a swim lane on transformation deals, which I think, in some ways, now a little slowed down with the current economics environment. There is a second swim lane on cost takeout, cost takeout, specifically in industries, which went through a higher growth rate in the last few years, but are starting to go back to the pre-pandemic growth rates.

They're starting to see that there is significant opportunity to takeout cost, and they're using vendor consolidation or cost takeout as a way to construct a large deal. I see more of them now. And I would say both the swim lanes are equally important as the economy takes an upturn, you're going to see more transformational digital work coming the other way. So I would really say both – these are the two big categories of large deals. And the industries where we see more of it are the ones where there was a swing of growth during the upward trajectory of growth in the last few years where that growth has started to taper down.

The timing wise, also the labor market is a little soft end. So this is a good time for all our clients to start to get efficiencies and cost takeout and use a partner like Cognizant to support it. So we see more of them now than before. And of course, it's also reflective that our clients have the confidence to – for us to execute to those deals.

Bryan C. Bergin

Analyst, TD Cowen Inc.

Q

Thank you very much.

Operator: Thank you. Our next question comes from Ashwin Shirvaikar with Citi. Please proceed with your question.

Ravi Kumar Singiseti*Chief Executive Officer & Director, Cognizant Technology Solutions Corp.*

Hey Ashwin, you may be on mute.

A

Ashwin Vasant Shirvaikar*Analyst, Citigroup Global Markets, Inc.*

Hey, sorry. I didn't recognize it was my name being called, sorry. Ravi, hey, good to hear from you. Clearly, you guys have both been very busy. I appreciate the well thought-out commentary. I guess I wanted to ask first about the cadence that you expect. Obviously, you've given 2Q outlook. Is there more of a ratable improvement from that rate to get to the full year? Or is it more of a – I don't want to call it a 4Q hockey stick, but is it a sharper improvement to the positive for 4Q? And then a similar question on margins, if you can talk about cadence.

Q

Jan Siegmund*Chief Financial Officer, Cognizant Technology Solutions Corp.*

Yeah. I mean you see our revenue guidance for the second quarter is largely in line with our revenue guidance in the first quarter. And so, we do not anticipate a really material contribution of the large deals that we signed until the third and fourth quarter of this year. So, we do anticipate revenue growth acceleration throughout the fiscal year, throughout the quarters. And I think we're giving you a fair revenue guidance for the second quarter. We did still see basically pressure on some discretionary projects and smaller deal, as I mentioned in my comments before.

A

So I think the revenue guidance is kind of where we really solidly think we're going to be at. The margin guidance is a very important question, Ashwin. And so keep in mind, we do implement for the vast majority or have implemented in April a merit increase. And the second quarter will, therefore, be different from our historic profile of margin that we have shown in the past year.

So our second quarter, I think, warrants a good look of what happens when we implement that merit increase, which happens historically in our fourth quarter. And so, think of it as a normal merit increase and the margin pressure that we will get from it. And that's going to be some material impact for us in the second quarter. That's why I'm mentioning it.

And if you do the math of our comparable merit increase in the fourth quarter and exclude the onetime components of the fourth quarter that we had, you'll see that in the fourth quarter, we recorded about 100 basis points impact of that merit increase on our margins. And fair to assume that things wouldn't be that different in the second quarter, may be actually even probably slightly a little bit more pressure because the economy is changing a little bit. But that's kind of the framework. That's why I want to point that out.

So – and then the people action of our NexGen program, we're going to start to execute in the second quarter, but given of how we're going to be executing, of course, the third quarter and the fourth quarter will be reflecting the impact of a big portion of the program [indiscernible] (00:51:02) portion of that program.

Ravi Kumar Singiseti*Chief Executive Officer & Director, Cognizant Technology Solutions Corp.*

And Ashwin, if you – just to jog your memory on this, we actually did one in October, a merit cycle, and we're doing one more in April. So these are two merit cycles. In fact, three merit cycles in 18 months. It's good for our associates. It starts to reflect on our attrition numbers starting to drop. And you've already seen that it's an investment for the future, but it equally has pressure on our margins.

A

Ashwin Vassant Shirvaikar*Analyst, Citigroup Global Markets, Inc.*

Q

Understood. Understood. I guess the first part of that question was on revenue cadence, so if you could address that. But then I also want to ask you, your head count did go down sequentially. When do you expect that to stabilize and start to grow, I guess, in anticipation of revenue growth in the future? And what part do you think increased automation? Applying AI to yourselves might play as you think of head count in the future?

Ravi Kumar Singiseti*Chief Executive Officer & Director, Cognizant Technology Solutions Corp.*

A

Ashwin, that's a great question actually. One of the things, as I mentioned my priority is, is to get commercial momentum, large deals, reduce our attrition and be an employer of choice. The third piece I spoke about is simplification of our operations. The NextGen program is an important program to delayer our organization and to simplify our operations. Equally, one of the things we're going to bring a huge cadence on, I think in the last 12 months or so, we had some – we had a very good initiative around pricing in the market. And that's a way to actually keep your margins intact.

One of the focus areas for me moving forward is increased utilization, higher offshoring, better pyramid ratios, better leverage of GenC program. And the fourth is what you just mentioned, which is embrace of automation in everything we do. In fact, just a few weeks ago, I launched a platform called Neuro IT operations where we are going to go relentless on applying automation to ourselves, both on technology as well as IT operations and of course, on the process side. So we do think this is going to be a little bit of a structural shift in the way we see our operating model, where we look at an uplift of margins, not just through pricing but also through operational efficiencies and the leverage of automation.

Automation is a moving scale. When everybody moves on that scale, you then start to share those benefits with your clients. And when you start to share those benefits with your clients, you have to reinnovate so that you can actually be ahead of the curve and keep it for yourself. So it's kind of a cycle you have to keep working on. And when everybody – when you start to share it with your clients, when there is a new baseline, you have to rebaseline it with more innovation.

So I would say we are now – we've got into that rhythm. So we are very excited about how we could be competitive to our deals, which we are starting to see and how we could also on the downstream price deals to win and deliver them to margins using automation as a lever. So it's an important shift in the way we are seeing our operating model. And it's an evolving scale because of the fact that technology in that space is evolving so fast, including the leverage of Generative AI to increase developer productivity, which is the new thing we are working on.

Ashwin Vassant Shirvaikar*Analyst, Citigroup Global Markets, Inc.*

Q

Thank you very much.

Operator: Thank you. Our next question comes from Surinder Thind with Jefferies. Please proceed with your question.

Surinder Thind*Analyst, Jefferies LLC*

Q

Thank you. Following up on the last question, Ravi, can you maybe talk about the level of productivity gains in terms of potentially automation and the level of disruption here? And what I'm getting to here is, is there the potential for a step function change? And if there's a step function change, how does that impact the revenue model as you look over the long term, right? I assume you won't be able to generate the same level of revenues for a given level of service.

Ravi Kumar Singiseti*Chief Executive Officer & Director, Cognizant Technology Solutions Corp.*

A

It's an interesting question because it all depends on how much you want to leverage the productivity you generate out of these tools and instrumentation and platforms into your deals and use that to win more and share it with your clients. And how much you could actually constantly innovate beyond the time when you start to win the deals to when you start to execute the deals. So it's a very difficult one because it's a moving scale because nobody spoke about Generative AI in 2022. Everybody is speaking about it because just the scale at which it's come to disrupt various businesses in the world, including ours, right?

So I would say it's a hard one to put a quantifiable impact on revenue and on margins. It is a moving scale. We have to be constantly ahead of the curve. And again, constantly ahead of the curve not to execute programs, but also equally to win business because these are the same productivity baselines we actually take it to our proposals. So sometimes, we wonder as the baselines constantly change whether it will translate that back to your bottom line, or it will translate that back to better win ratio. So you have to keep that balance so that you have growth. And equally, you are able to generate that growth in a profitable way by not just leveraging the traditional levers of higher utilization, higher offshoring, better roll mix, but also using technology as a lever to do this.

So, I know I've given you a high-level answer, but it's very hard to simulate and put a revenue model attached to it, because it is just such a fast moving curve. I actually think we are well equipped to capitalize on the advances in the space and we are well equipped to generate that value for our clients, and we're well equipped to actually evolve our business model, which is potentially going to go from people to a people-plus-machines model, if I may, or a people-plus-AI or a AI-amplified-human model, which I've been very fascinated about.

Surinder Thind*Analyst, Jefferies LLC*

Q

Thank you. That's it from me.

Operator: Thank you. Our next question comes from Bryan Keane with Deutsche Bank. Please proceed with your question.

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

Q

Yes, hi. I just had a question on the overall IT services environment. Just thinking in your conversations you had with the 100 or so clients, Ravi. Are people expecting the environment to stay similar in their IT spending budgets? Or do you think people will put further pressure on budgets and IT spend as we go forward through this year?

Ravi Kumar Singiseti*Chief Executive Officer & Director, Cognizant Technology Solutions Corp.*

A

Yeah, it's a great question, actually. I will kind of pivot this in a little different direction. If you are working on traditional technologies or classical technologies, as I call it, which is enabling a business, the pressure on IT budgets is going to be very high because a lot of it is cost driven. If you're building a CRM system, if you're building an HR system, a supply chain system. I think the pressure of IT budgets with the economic uncertainty is going to be very – it's going to be tight. That's how I see it.

If you're leveraging technology to disrupt the core of a business, say as an example, if you're doing the connected car initiative of an automotive company, I don't think budgets will come on the way because it's a disruption of the business model.

Equally, the capability you need is going to be deep as well, which means you have to build different swim lanes in your operating model so that you could cater to classical technologies on one side, but equally cater to deep expertise needed for disrupting the core of businesses. This is a swim lane which did not exist before because most businesses enable the businesses using technology. Now, technologies immersed into businesses, which I think will have more flexibility on budgets because the paranoia about the core changing means you could become irrelevant if you don't make the change, and therefore, you allocate more for securing your future as a business.

Some industries are doing it more paranoid because there is more change in the core products and services, and some are actually not as worried about this issue. I would say, depending on where you are, this would – you would find IT budgets to be under stress or you're going to find IT budgets not to be under stress.

The second piece, I would say, we all have to think about is our universe is not as much just tech spend of enterprises. Our universe is operations spend of enterprises because technology is so deeply immersed into operations. So if you put that lens in, operations, which have to be automated for better experience, for lower cost, for higher – for high-touch services, you could potentially immerse in technology, outsource and immerse in technology for companies like Cognizant to benefit out of it.

So if I see that as the universe, that's a very different universe. In fact, just to give you a case in point, there are companies which have accumulated cost equivalent to the growth rate during the pandemic. And when they go back to the pre-pandemic era, those growth rates start to taper down. They have to take their operations cost down. So they could either do it by automating it, or they could do it by outsourcing and off-shoring it. So it can have a benefit there.

So I would say these are three different things to look at. Even today, there is consolidation of providers, cost takeout, which is actually winning [ph] on the turns (01:02:04), as I call it, where customers don't spend more but there is a swap of the portfolio between one provider to another provider, which means one wins and one loses. So it's kind of – if I just look at straight IT spend in classical technologies, you'd have a different answer for core, you would have a different answer. And of course, if you're consolidating providers, it's a win for one and loss for somebody else.

Bryan C. Keane

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Great. Yeah. Thanks for the color.

Operator: Thank you. At this time, I would like to turn the floor back over to management for closing comments.

Tyler J. Scott

Vice President-Investor Relations, Cognizant Technology Solutions Corp.

Great. Thank you, everyone, for joining. We look forward to catching up with you next quarter.

Operator: This concludes today's Cognizant Technology Solutions first quarter 2023 earnings conference call. You may disconnect now.

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