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Q4 2023 earnings conference call transcript

February 27, 2024

Corporate Participants

- **Guo Xiao** — President and Chief Executive Officer
- **Erin Cummins** — Chief Financial Officer
- **Rob Muller** — Global Head of Investor Relations

Presentation

Rob Muller
Hello, everyone. Welcome to Thoughtworks Earnings Call for the fourth quarter of 2023.

We will be recording today's call and during the presentations all lines will be on listen only.

Joining us today will be Thoughtworks President and CEO Guo Xiao and CFO Erin Cummins. The earnings press release was issued earlier today and is also available on our Investor Relations page at thoughtworks.com.

Some of the matters we'll discuss on this call, including our expected business outlook and anticipated costs and benefits of our restructuring actions are forward-looking and as such, are subject to known and unknown risks and uncertainties. These include but are not limited to those factors described in today's press release and discussed in the risk factors section of our annual report on Form 10-K and other reports we may file with the SEC from time to time. and uncertainties could cause actual results to differ materially from those expressed on this call. These forward-looking statements are made only as of the date when made.

During our call today we'll reference certain non-GAAP financial measures. We'll also provide growth rates in constant currency as a framework for assessing how our underlying business performed, excluding the effect of foreign currency rate fluctuations. We include non-GAAP to GAAP reconciliations in our press release furnished as an exhibit to our Form 8-K. The non-GAAP financial measures provided should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with GAAP.

Thoughtworks assumes no obligation to update or revise the information presented on this conference call.

I will now hand over to Xiao.

Guo Xiao
Thank you, Rob. Hello, everyone and thank you for joining us. And thank you to all Thoughtworkers for the extraordinary impact they deliver every day with our clients.

2023 was a challenging year as we navigated a difficult macroeconomic environment. It was also a year of transformation and investment in our business. Last year, we embarked on the biggest change as a company in 20 years. We began the restructuring of our business to establish a new operating model.

We're pleased with the resulting cost savings in 2023 of $81 million on an annualized basis. We centralized our operational functions to reduce costs and drive efficiencies. We set up a global digital engineering center. The DEC helps us respond faster to clients, support the continued shift to offshore and to manage utilization, which continues to improve quarter-on-quarter on a seasonally adjusted basis. Finally, we organized our regional sales teams around an industry-based go-to-market so that we can build expertise and specialization in specific industry verticals. We began this restructuring during the third quarter of 2023, and we will continue the transition in 2024.

Alongside the transformation of our operations, we continue to invest in our business. Our investments in sales and marketing, partners, new services and capabilities positioned us as a stronger company as we head into 2024.

We undertook this change while staying true to who we are: a company of brilliant technologies, intensely focused on helping solve our clients' toughest challenges by harnessing our expertise with cutting-edge technology.

Now, let me share our fourth quarter and 2023 full year results.

We generated revenue of $252 million during the fourth quarter with an adjusted EBITDA margin of 5.5%. We recognize that the fourth quarter was short of what we originally guided to in November. Our results were primarily impacted in two ways.

Around two-thirds of the revenue shortfall was due to specific supply-side limitations. This was primarily due to the scale of the structure change in our operating model, which caused some disruption to our operations in the fourth quarter. We have taken steps to address this going forward.

Around one third of the shortfall was demand side. Continued client caution resulted in smaller project ramp-ups, more project delays, and we had slightly higher pricing pressure than we anticipated. We expect this cautious behavior to continue into 2024.

Now turning to the full year 2023. We delivered revenue of $1.1 billion for the full year and an adjusted EBITDA margin of 9.9%. While 2023 was a year of transformation, our foundation is strengthening, supported by a strong client base and long-term client relationships.

Our deep and trusted client relationships are again reflected in the 54 clients with bookings over $5 million at year-end. New client acquisition remains a strength, and we continue to gain momentum. We contracted with 156 new clients in 2023, 46 of those in the fourth quarter. Bookings from new logos in 2023 was around $120 million. We have seen traction from our vertical focused sales model with higher new logo acquisition in energy, public and health services and financial services and insurance verticals. These are the verticals that we have intentionally focused on.

Our DAMO™ Managed Services are getting good uptake with 30% of our top 50 clients now benefiting from the cost savings and quality improvements. DAMO Managed Services are valued by clients because it is both a cost play and enabler of faster digitization. It's strategic for Thoughtworks for both service expansion and as a shift to longer-term contracts.

We are taking an early lead in AI-first software delivery, and we're pleased by client interest in GenAI with over 50 client projects at year-end. GenAI is acting as a catalyst for companies to modernize their legacy systems, capitalize on the cloud and make better use of their data assets.

We have observed that client spending priorities have changed. We're seeing a reduction of growth-oriented consultancy work, which has historically been a high percentage of our business. While we believe discretionary spending will return, we have been diversifying our business to address more of our clients' urgent needs where we have the right to win. For example, enterprise application modernization, third-party software implementation and DAMO.

We have outstanding technologists and a reputation for innovation and thought leadership. We are well positioned to help our clients evolve their operations to harness the power of cloud, data and AI to adapt for future success.

Now let me hand over to Erin.

Erin Cummins
Thanks, Xiao, and thank you to everybody who has joined our call today.

We remain close with our clients, and we continue to invest in building those relationships. We're pleased with the progress we've made as we've built out our sales and marketing capabilities. In the fourth quarter, 58% of bookings were from outbound sales and marketing to complement our historically strong inbound interest.

Investments in our partnership channel have resulted in our current sales pipeline, having double the partner participation compared to a year ago. We have embedded partners in our standard sales processes, further expanded our certification programs and are leveraging the capabilities of ITOC.

We believe we have the best technologists in the industry. Our attrition rate, which remains below industry averages, reflects a strong sense of belonging among our employees. In Q4, voluntary attrition on a TTM basis was 12.0%, an improvement sequentially from 12.2% in Q3 2023 and stable year-over-year from 12.0% in Q4 of 2022. At the end of 2023, our headcount was around 11,000. We continue to selectively hire with a focus on specific skill sets such as data and infrastructure.

Now let's look at the fourth quarter in more detail. Revenues were $252 million, representing a year-over-year decline of 19%. In constant currency, revenue declined 20%. Acquisitions contributed approximately 1 percentage point to the revenue growth rate in Q4.

For the quarter, we saw year-over-year declines of 10% in APAC, 20% in Europe, 23% in North America and 38% in LATAM. Among our industry verticals, revenue declined by 5% year-over-year in Automotive, Travel and Transportation, 11% in Financial Services and Insurance, 21% in Energy, Public and Health Services, 24% in Technology and Business Services and 26% in Retail and Consumer.

During Q4, as a percentage of total revenue, our top five, top 10 and top 50 clients generated 19%, 29% and 65%, respectively. We had 31 clients with revenues greater than $10 million during 2023.

Adjusted gross margin was 33.6% for Q4 compared to 39.7% during the prior year period. Our Q4 adjusted gross margin saw year-over-year headwinds due to the temporary costs of shifting mix offshore as well as high single-digit pricing declines on a like-for-like basis.

In the fourth quarter, our adjusted SG&A as a percentage of revenue was 28.0% compared to 22.1% in the prior year period. Adjusted EBITDA was $14 million for the fourth quarter for an adjusted EBITDA of 5.5%.

Q4 GAAP diluted loss per share was ($0.07) compared to earnings per share of $0.05 in the prior year period. Our adjusted diluted EPS was $0.02 compared to $0.10 for the fourth quarter of 2022.

We recorded free cash flow of $10 million during Q4 compared to free cash flow of $28 million in the prior year period.

We have good liquidity with a cash balance of $100 million and our outstanding term loan balance stood at $295 million as of December 31, 2023. Additionally, our revolving credit facility of $300 million remains undrawn.

Turning to our full year 2023 results, we recorded revenue of $1.1 billion, down 13% versus 2022 in both U.S. dollar and constant currency. Acquisitions contributed 2 percentage points to the full year revenue growth rates. For 2023, our average revenue per employee was $98,000, which continues to reflect the strategic importance of the work that we deliver. Our revenue per employee remained above the industry average.

During 2023, around 93% of our business came from existing clients. For 2023, we recorded bookings of $1.2 billion, down 14% compared to 2022 as cautious client behavior throughout the year pressured contract length and sizing. New bookings compared to revenue realization remain resilient.

Adjusted gross margin was 36.1% for the full year 2023 compared to 41.6% in 2022. Full year adjusted SG&A margin as a percentage of revenue was 26.3% in 2023 compared to 22.4% in 2022.

Adjusted EBITDA totaled $112 million during 2023 with an adjusted EBITDA margin of 9.9% compared to an adjusted EBITDA margin of 19.8% in 2022.

For the full year 2023, we recorded GAAP diluted loss per share of ($0.22) compared to a loss per share of ($0.34) in 2022. Full year adjusted diluted EPS was $0.11 compared to $0.43 in 2022.

We recorded free cash flow of $40 million for the full year in 2023 compared to $65 million in 2022.

Now let me hand the call back to Xiao to share a broader update on the business.

Guo Xiao
Thanks, Erin. I am also very pleased to share that in the fourth quarter Thoughtworks has been included for the first time in the Gartner Magic Quadrant. We are positioned in the Visionaries Quadrant in the 2023 Gartner Magic Quadrant for Custom Software Development Services, Worldwide.

We believe our inclusion in the Visionaries Quadrant means we understand where the market is going and have a vision for changing market rules. Further, we believe this positioning is a reflection of Thoughtworks' investments in shaping and defining many of the leading digital trends today such as evolutionary architecture and data mesh.

We continue to execute our vision to deliver extraordinary impact for our clients. Let me share some of the client stories to bring this to life.

We have been working with the top four U.S. headquartered global investment bank since 2013. We're going to be rolling out our Sustain Engineering services to help this firm operate their digital assets in a more modern way by adopting our engineering effectiveness capabilities to help teams deliver the software they need more quickly, cost-efficiently and at a consistently high standard.

We're working with Germany's number one eCommerce fashion and lifestyle company, OTTO, as their strategic technology partner. We helped them expand their business into a multichannel banking model by developing OTTO Payments and Marketplace. Their recent success within this market serves as a powerful example of the potential unlocked through strategic technological and business evolution.

International meal company, IMC, is one of the largest food retail companies, operating such brands as KFC, Pizza Hut and Frango Assado, among others. Pizza Hut, Brazil now has an app created by IMC in partnership with Thoughtworks. The app is powered by a proprietary platform, which uses data science and artificial intelligence to personalize the traditional food delivery experience for customers and make store operations more dynamic, intelligent and strategic by supporting last-mile concepts and product and service recommendations.

Across these examples, you can see that our brilliant technologists are intensely focused on helping solve our clients' toughest challenges by harnessing our expertise with cutting-edge technology.

Now let's turn to GenAI. Client interest and demand for our AI and AI-related work remains strong, and our team of world-class service professionals are working to bring clients’ AI ambitions to reality. At the end of the first quarter, we're working with over 50 GenAI related projects.

We're helping our clients achieve cost improvements while simultaneously enhancing the experience for their customers. Our clients are still early in the AI journey, and we see a long runway of direct and indirect opportunities. There is demand for our enterprise monetization and data service offerings as clients are focused on improving their existing systems and data in order to properly harness the potential of AI.

We're focusing on four main areas: AI-assisted software delivery; AI-powered digital products; AI and data platforms at scale; and AI adoption strategy. We also see vertical opportunities, for example, in energy, public and health services. We believe that GenAI Technologies will be a source of value for our clients and Thoughtworks over time and our projects cover a wide range of use cases.

For example, at one of India's largest non-banking financial firms, we're using AI to enhance new client onboarding for a retail lender. We have piloted the development of a human avatar-assisted loan application journey to reduce dropout rates. We have developed internal AI knowledge assistants to empower employees. We have empowered over 100 sales agents with improved query handling, saving time searching through documentation.

We defined a strategy to harness the power of AI responsibly for a global biotechnology company dedicated to revolutionizing cancer care. The strategy empowers multiple proof of concepts, provides a holistic governance framework, establishes an AI center of excellence and has created a new AI-driven research assistant to accelerate insights.

We created an AI-driven platform that combines the power of a Large Language Model with traditional machine learning to match adult learners with the best online courses in a fraction of the time previously needed for an online education platform. With more than 1,000 courses to choose from, finding the right courses for each student takes a lot of time, which puts pressure on customer service personnel. We created a system that automatically inputs the work history and career aspirations of each student and compares that to the database of open courses and recommends the best feeling courses to the student.

Our approach to GenAI is three-fold. We're building an ecosystem of partnerships with hyperscalers and start-ups. Our clients look to us as a trusted partner to help them navigate the emerging ecosystem, which is complex and fast moving. We offer a service that builds a GenAI technology and tools blueprint mapped across the software life cycle for the specific client. This is one of the ways we're helping our clients navigate the GenAI ecosystem.

Second, we're investing in our talent with 3,200 Thoughtworkers in GenAI. In December, we launched Prompt Camp. Each track provides practical hands-on learning experiences. For example, the solution design focuses on designing effective solutions using techniques such as prompt engineering, Retrieval Augmentation Generation, self-RAG and Fine-tuning for Large Language Models solutions.

Third, we are embedding AI across our services portfolio and our core operations. All this is built on our expertise in, and commitment to, ethical technology. More than ever this is critical to our clients as they look to deploy and scale fast-moving AI technology in complex, often regulated environments.

Our clients often tell me that our technologists and thought leadership are two of the things that really differentiate Thoughtworks. They look to us to help them make the right technology decisions, which has arguably never been more challenging.

Our annual technology trends report, the Looking Glass, is a tool to support our clients making the right technology choices. In the 2024 edition we published in January, we've identified over 100 trends through five lenses that we expect to define the future of technology. Examples of lenses include AI everywhere and Realizing value from Data and AI platforms. Client feedback has been positive with clients requesting technology roadmap workshops as a result of reading the Looking Glass.

I am also pleased that Thoughtworkers continue to write the books that matter to our clients. Just published - ‘How to build an organization that creates great products’. The book offers practical advice based on observations and evidence seen over many years of working with clients. Alongside Thoughtworks’ luminaries, the book shares insights from leading companies The Very Group, dunn humby, Atom Bank, and Sportsradar.

Back to you, Erin.

Erin Cummins

Thanks, Xiao. Now let me discuss our business outlook for Q1 and 2024.

Overall, the demand outlook continues to be variable due to macroeconomic-driven caution. Our clients are required to deliver more with the same budget. Budgets are still tight, mostly flat from 2023 to 2024. While we are seeing more discretionary and growth-oriented consultancy work in the pipeline compared to prior quarters, it is not yet back to our historical norm.

We expect 2024 to be a year of transition. We are pleased that our pipeline is strengthening. We expect our investments in sales and marketing, partners, and new services to build momentum as 2024 progresses. We are committed to being a trusted partner for our clients and remain focused on converting open opportunities, which we expect to drive volume increases quarter-to-quarter as we move through 2024.

For the first quarter of 2024, we expect revenues to be in the range of $241 million to $246 million, reflecting a year-over-year decline of 21% to 20%. At current rates, guidance incorporates an immaterial FX impact in Q1.

We expect adjusted EBITDA margin for the first quarter to be in the range of 3.0% to 4.0%. For the first quarter, we expect adjusted diluted loss per share to be in the range of ($0.02) to ($0.01), assuming a weighted average share count of approximately 323 million diluted shares outstanding.

Our Q1 guidance continues to factor in the cautious behavior that clients exhibited in 2023 and that continues today. We expect sales cycles to remain elongated with programs of work broken up into smaller deals.

Our Q1 guidance incorporates share-based compensation of $11 million.

Moving to our full year 2024 outlook, we expect revenues in the range of $980 million to $1.01 billion, reflecting a year-over-year decline of 13% to 10% or a decline of 13% to 11% in constant currency. Compared to 2023, our guidance reflects lower pricing on a like-for-like basis as well as a shift mix with more work being done offshore. Last year, we were intentionally more aggressive on pricing in order to retain and expand our wallet share in response to market and client trends. We expect our average price to start stabilizing in 2024 as most of our contract portfolios have turned over to reflect the new pricing environment.

Additionally, for the full year, we expect adjusted EBITDA margin of 8.0% to 10.0%. We expect our adjusted EBITDA margin to expand throughout 2024 as we focus on supply side efficiency, including utilization and the continued mix shift to offshore delivery. We expect continued G&A efficiencies, including non-wage related items, to further support margin expansion as we progress through 2024.

With respect to our restructuring program, we continue to expect total pretax charges of $20 million to $25 million, of which we have already recorded $19 million through the end of 2023. The majority of our wage-related actions are complete, and we remain focused on driving operational efficiencies in 2024.

As of December 31, we raised $81 million in annualized cost savings, which puts us within a targeted range of $75 million to $85 million. We are focused on driving continued efficiency across the organization, and aim to be at the high end of the targeted range.

For the full year, we expect adjusted diluted EPS of $0.01 to $0.06, assuming a weighted average share count of approximately 333 million diluted our outstanding.

For the full year, we expect share-based compensation will total $46 million.

Now let me hand the call back to Xiao for closing remarks.

Guo Xiao

Thank you, Erin.

I believe that we have the best talent in the industry. I'm proud of the community and culture we've built and the people that we are able to attract and retain. Our people remain at the center of everything we do. We were delighted to be recognized in the fourth quarter at number 14 on Fortune's prestigious list of World's Best Workplaces for 2023.

I am proud that Thoughtworkers' passion and commitment for our social impact work is unwavering. We bring cutting-edge technologies to important social causes. One example is Jugalbandi, an outcome of a strategic collaboration as part of the OpenNyAI mission. Jugalbandi harnesses the power of Generative Pre-trained Transformers and Indian language models to power conversational AI solutions for every Indian citizen. Indian citizens can discover the right government scheme by describing their needs ‘in vernacular’ through a voice-enabled system. This demonstrates our utmost belief in the potential of open source to contribute towards a more sustainable and inclusive future.

In closing, our foundation stands strong, bolstered by our client portfolio and client relations. Thoughtworks’ outstanding technologists underpin our reputation for innovation and thought leadership. As we move forward, we are well positioned to deliver extraordinary impact for our clients as they modernize and evolve their operations to harness the power of Cloud, Data and AI, and adapt for future success.

Before we move to Q&A, I’d like to take a moment to thank all our stakeholders for their contribution to Thoughtworks in 2023. To our clients, we entrusted us to solve their greatest technological challenges; to our employees, who delivered extraordinary impact every day and kept our company on the cutting edge of technology; and to our investors who offered their advice and support as we navigated a challenging landscape in 2023. We're excited about the opportunities ahead of us as we focus upon returning to growth.

With that, I'll turn the call back over to Rob.

Rob Muller
Thanks, Xiao. You can find our investor presentation on the Thoughtworks investor relations website. We will now move on to Q&A. I ask that you each keep to one question and one follow-up to allow as many participants as possible to ask a question.

Operator, would you please provide instructions for those on the call?

[Operator Instructions]

Q&A

Operator
Our first question comes from Bryan Bergin with TD Cowen.

Bryan Bergin, TD Cowen
Hi, good morning, thank you. I'll start on the '24 outlook on the demand front. So, can you just dig in more on what has -- what seems to have changed in client behavior over the last three months? I believe we thought there was some stabilization that

seemed to be forming. So, can you expand on where you saw some of that pressure resurface? Was it broad-based? Or more so maybe in certain large clients or certain industries or geos?

Guo Xiao

Sure, so think you, Bryan. The client behavior in the current environment is similar to what we have described in the last quarter. It's stabilizing with respect to project churn. But we also, at the same time, continue to see pricing headwinds, project delays and slower ramp-ups. So, while project cancellation is becoming much less frequent, clients are still very cautious about releasing budgets. The sales cycle is still long, deal sizes still compressed, ramp-up is incremental. Then I want to call out that throughout the year-end client negotiations for 2024 budget, we heard our clients' budget is going to be largely flat year-on-year. At the same time, they need to do more with the same budget. So, we have to sharpen our pencils and be more aggressive with our pricing while pushing for more work offshore.

And that said, we are seeing some openings of discretionary spending where there's a strong case for ROI, and we closed quite a few large deals in Q4 and early Q1 which will ramp up in due time. We feel very good about win rates on the large deals, but it also comes with the pricing pressure that we're seeing right now. So, putting this together, we do expect Q1 trending towards where we're guiding towards, but followed by small incremental sequential growth throughout the year.

Bryan Bergin, TD Cowen

Okay. And my follow-up then is on the supply constraints. So, it sounds like a little bit of this is caused by the transition to the centralized model. But maybe can you dig in a bit more specifically on what caused the challenges in 4Q? What you've done that gives you the confidence that you've remedied the issues? And should we -- is there any risk of a client loss due to these constraints?

Erin Cummins

I'll start with that. Thanks for the question, Bryan. We talked about this a bit in our prepared remarks, but I'll add a bit more color about what happened in fourth quarter. As Xiao noted earlier, if we look at our revenue actual versus our guidance, about two-thirds of that miss was related to internal factors. And as we commented, but is certainly worth restating, these are factors that we see as temporary limits to our supply.

To answer your question, we do feel that we have remedied these issues, we touched on the restructuring program, and we are definitely seeing upfront benefits and efficiencies from the program, but the process itself resulted in temporary friction in the fourth quarter. It was a bit more than what we were expecting.

We saw this around both staffing and leave coverage and ultimately, it impacted revenue capture in the fourth quarter. We're also seeing some supply constraints around particular skill sets. We are seeing a lot of strength in demand and data, and that's where we see the demand remaining very strong. It was in fourth quarter, and it continues to be now in Q1. But we have addressed these issues. We've addressed the processes, the underlying processes, driving accountability throughout the organization. So, we think that we have fixed the challenge that arose in fourth quarter, we're not going to see that again.

The restructuring, again, it's the right approach for the company. But the change where that country business unit layer was adjusted and removed, it did cause impact. Then finally, just on your point from a client perspective, No. We're not concerned about client relationships. We didn't see disruption from a client perspective. We think that was well managed. And so, there isn't any concern there.

Guo Xiao

I want to take the opportunity just to reiterate the importance of this restructuring and then the benefit it brings to us. I think we talk a lot about the cost side of it. But at the same time, we're centralized and also verticalized our sales force. So, they are more client-centric and can build expertise in specific industry verticals we want to focus on. And as a result, our go-to-market is a lot more responsive to our clients, we more than doubled our partnership supported deals, and we also are closing more new logos in the sectors that we want to focus, for example, energy, public, healthcare and then banking and financial services. At the same time, we have also centralized the management of most of our professional services people into this global structure called DEC. Then over time, we should definitely see better capacity planning, utilization optimization and also deliver efficiency in the long run. We're absolutely convinced that this is the right thing to do, but due to the scale of the structure and process changes in the short term, we saw some disruptions in our operations in Q4. It's painful, but necessary. Then we also believe that it was temporary and behind us already.

Operator

Our next question comes from Moshe Katri with Wedbush Securities.

Moshe Katri, Wedbush Securities

So, the comment on pricing, is it kind of a function of renewals? Is it on the -- I think you mentioned it also includes the new deal flow? Then is there a way to kind of quantify the overall pricing pressure that you're seeing this year? And maybe in that context, is it also a function of the shift in execution more towards offshore. So, obviously, you have some cannibalization there?

Guo Xiao

So, as Erin mentioned earlier, the pricing dynamic mostly was driven by a lot of contract renewals and then extensions, sometimes expansions, by the year-end. Then we talked to our clients, we recognize their budget constraint, and then we're working with them to resolve that. I mentioned briefly earlier that we closed quite a few large deals that's on top of our list to close in Q4 and early Q1.

Some of these are new deals like an airline client, manufacturing client, a large retailer, but many of these are large extensions to our top automobile clients, public sector clients and the business services client. They're all in the Fortune 500 company-type, all these deals are in the $10 million to $40 million range, large deals. So, we felt good about the win rate on these large deals, but come with pricing. That said, I think we're seeing, excluding the shift mix to offshore, we're seeing high single-digit year-on-year like-to-like pricing decline. But we also believe that the new pricing dynamics is already reflected in the majority of our contract portfolios and then further decline on pricing from Q1 to Q2 going onwards, further than that should be much less significant. And so, we do expect that to stabilize.

Moshe Katri, Wedbush Securities

Understood. Then my usual question is about APAC. Maybe we can talk a bit about what you're seeing there in terms of the three geographies there, Australia, Singapore, China, and given the magnitude of the declines on a relative basis versus other regions, it seems that it's probably doing a bit better than North America and Europe. Is that the right way of looking at it?

Guo Xiao

It is. Thank you for noticing that. We have always, I think felt that early on during the macro downturn, we saw a bigger impact from APAC. But also, we felt good about the diversification of our portfolio across geographies. So, across the three main markets in APAC, Singapore is seeing very healthy growth, has been seeing that consistently over the last few quarters. China is recovering, but because the economic growth is not as fast as people expected in the local market, we're seeing a slower rebound of the local market growth on the back of the economic growth after COVID. At the same time, I think we have seen more signs of recovery and then discretionary spending returning from Australia, given that it was the first market that went into this macro headwind, about two years ago. We're definitely glad that it's returning and we're seeing signs of growth there. I think that's, as you really pointed out, that APAC is performing better at this moment than other markets.

Operator

Our next question comes from Jason Kupferberg with Bank of America.

Tyler DuPont, Bank of America

This is Tyler DuPont on for Jason. I wanted to start by touching on the cadence of revenue growth as we look to 2024. I know you mentioned on the previous call that sequential growth would be roughly flat in 1Q, obviously, given guidance this morning that that's not going to happen. But just given the push to the right, if you will, from a growth perspective, when should we be looking for that inflection positive? And what do you need to see from a demand standpoint for us to reach that level?

Guo Xiao

So, from a sequential growth perspective, we do expect that to continue to improve throughout the year. We're not obviously calling Q2 at this moment, but we feel that with the large deals we've signed up and then the stabilization of the pricing and then the discretionary spending opening up in some pockets of our portfolio that we should see steady growth coming soon.

Now if we're still, I think, at the stage where it's -- there's a lot of uncertainty. If the pipeline conversion slows down from where we're seeing today or the pricing pressure continued to get worse we'll probably be trending towards the low end of our guidance, which means that the sequential growth will be further delayed.

But if what we see in the pipeline converts as we expected, even though with some delays, and then slower ramp-up that we're already baking into our guidance, or if the pricing pressure alleviates, that we can see some returning of consulting work, which tends to give us opportunity to do more value-based pricing. And in that case, we could be trending towards the high end of the guidance, which means that the return to sequential growth will come a lot earlier. But like I said, we're not ready to call Q2 yet. But for the full year, we feel that we're definitely trending in that direction.

Tyler DuPont, Bank of America

Okay. Great. That's helpful, Xiao. I appreciate that. Then just as a follow-up, just looks like based on my initial math here that the top five clients saw roughly around an 8%, let's say decline in the quarter. Can you sort of discuss the dynamics you're seeing there among your top clients? Are those revenue declines due to pricing? Or are there any rampdowns in projects? Or just sort of the moving pieces among those top clients would be appreciated?

Guo Xiao

Sure. So, our top five and then probably extend it further to top 10 even, the revenue decline is less driven by volume, it is more driven by shifting to offshore for some of them and also the pricing pressure we mentioned earlier. Many of them saw big extensions and renewals towards late Q4 and the beginning of Q1. Then we sharpen our pencil, so work within their budget. But we're definitely retaining wallet share and volume with our top five and top 10 clients.

Operator

Our next question comes from Dave Koning with Baird.

David Koning, Baird

I guess my question is around margins kind of over time. I guess in 2023, revenue was down about $170 million and EBITDA down $145 million. So very strong flow through right to EBITDA. It's hard to see a lot of cost savings in 2023. But I'm wondering what happens as we go forward, can you get back to 20% margin? And maybe describe a little why we didn't see a little better EBITDA in 2023?

Erin Cummins

It is fair to say that we did see impact from the revenue headwind on our EBITDA and our margins. The shifts that we've been talking about, we did see some project ramp downs in the middle of Q3. Those larger ramp downs that we had talked about before had slowed down. So, we see that as very positive. But that was a quick impact to our business that impacted margins.

We also have touched on the move from onshore work to more offshore work. So actually, we're very proud of maintaining the client relationships as we have and as Xiao has talked about. We're also proud of the agility that we demonstrated in our business where we're shifting service from one location to another without client disruption. So, we did that very well. But at the same time, that impact on the top line and pricing, it did have an effect on 2023.

Now more importantly, what are we doing going forward, which really is where your question is getting at. So 2023, we saw lower utilization for the year on the whole. We did start to see improvements across the year. It's telling us that we're moving in the right direction, but it still was lower in 2023 than we expected. So, that is a top focus for us. We are taking a programmatic approach to addressing the utilization, and we have our operational excellence team that lives and breathes it every day. And again we're on the right track, we're seeing good progress, and we expect 2024 to improve significantly.

Now I touched on the shift from onshore to offshore. And as I said, the demand shift happened more quickly than the supply shift. So, we continue to work through those issues. It does just take a little bit more time, again impacting 2023. But as we look across the improvement in 2024 that we anticipate, that's definitely part of the story. There are pockets where there's lower utilization, and that's oriented in the higher cost locations, and that's -- that has a disproportionate impact on our gross margin. It's temporary. It's going to take us a few quarters to fully address this, but we're confident in our ability to do it.

Then as we talked about the pricing assumptions embedded in our guidance, it is a headwind for 2023. It's reflecting the general macroeconomic caution, the competitive dynamics we're seeing and lower levels of that consulting and growth-oriented work. So, we do think these dynamics are temporary. But at the same time, as we have considered our guide for the year, we've assumed they're in place for 2024. So, we don't think that's going to benefit 2024 necessarily. It may but perhaps in the second half of the year, more likely at this point, it would be beyond 2024 and to 2025. So, that's -- the key piece of it is around gross margin.

I'd just highlight from a cost restructuring perspective, we are doing really well. We took out $81 million in cost, which I touched on. The reorganization that we went through in Q4 is in the good, but early stages. So, we still have efficiencies that we're driving there. So, bringing it all together, what we expect for 2024 is consistent margin improvement, we don't think we'll get back into that high teens level in 2024. But certainly, the opportunity remains there for 2025 and beyond.

David Koning, Baird

And maybe just one quick follow-up. Number of clients, I think was 502 ending the quarter, I think that was one of the strongest quarters of gains in clients we've ever seen. I mean, is that a good early indication that some things are going in the right direction? Or is it just much smaller contracts per client on some of the new ones, and that's why we're not seeing it yet?

Guo xiao

I think it's both. First of all, we have definitely been investing heavily into additional sales and marketing capacity. We definitely believe that we have the right value proposition, the thought leadership and our brilliant technologists. But I think that we have opportunity to expand our demand generation capacity, especially in outbound demand generation.

So, as Erin mentioned earlier, over 50% of our new wins in Q4 came from outbound efforts compared with historically it's only 15%. Combined with our inbound, the outbound, definitely reaching out to more clients or potential clients. We're seeing the acquisition of these new logos and the new clients we're retaining many of them. But at the same time, as you mentioned, that deal size tends to get smaller in the current macro environment. Initially, when clients start working with us, they don't sign up, as with a couple of years ago, much bigger deals. So, we tend to see smaller deals, shorter deals but we're really happy that we're expanding our client base. That gives us opportunities to work and expand from there.

Operator

Our next question comes from Matthew Roswell with RBC.

Matthew Roswell, RBC

Two questions. I'll get sort of the easy one out first. And Erin, how should we think about free cash flow in '24? And are any of the restructuring charges, are they cash related? So, should we expect like severance coming out in first or second quarter?

Erin Cummins

Yes. So, the restructuring charges did impact 2023. There will be some impact in 2024, but it will be less than 2023. So, if we compare free cash flow year-over-year, the restructuring charges overall will be a benefit. From a CapEx perspective, in 2023, we did have lower than historical levels. It was, as a percentage of revenue, CapEx was under 1%. And for 2024, we're not expecting significant changes in CapEx, but I do expect an increase from where we were in 2023.

On the whole, if we look at cash flow 2023 to 2024, not a significant change, but given the focus on our operational efficiency alongside the reduced restructuring charges, I am expecting increased free cash flow in '24 compared to 2023.

Matthew Roswell, RBC

And I guess there's a bigger picture question, I guess this is more for Xiao. When you talk to clients, what percentage of them do you think can actually implement GenAI programs now versus having to put in place the prerequisites, so do they have the data? Do they have the architecture to actually implement GenAI?

Guo Xiao

Sure. From a -- in terms of percentage of them who are really already implementing GenAI at large scale with all the prerequisites - platforms, the data ready - very small. What we're seeing is the majority -- first of all, majority of the clients we're working with, they're doing proof of concepts. Just trying to prove out both the business case and then technical viability. So, there's -- I think 2023 was just a year full of POCs. And most of them, at the same time, recognize that they have to do a lot of work to prepare themselves. We call it AI -- GenAI readiness. That is having the right data in the right place with a clean data with updated data and then building the data platforms that require to -- especially the modern platforms that allow them to run GenAI on top of that.

Only a fraction, I would say probably less than 15% of the clients have these data platforms ready, which was a result of years of working, especially in the last few years, of preparing and getting ready for -- not necessarily for GenAI, but just generally getting ready to get value from data. I think these small percentages of our clients are running real large-scale GenAI applications using large language models we're fine-tuning, for example.

We do believe that in 2024, we would see more clients moving from POC to real large-scale implementation where they are ready. Most of them will still be doing work to prepare themselves for AI-readiness.

Matthew Roswell, RBC

Is there a disconnect between that preparatory work for Gen AI and the focus on near-term return on investment that your clients are seeing? Because I would think a lot of that work is -- doesn't have an immediate payback.

Guo Xiao

I think it depends -- it's definitely a good call. It depends on the type of GenAI use cases. Some cases would require, rightly so, years of investment, at least a year or two, especially building large language models, it would take a while for that to get the payback. Then some of our clients are ready to do that and they're willing to make that commitment. Then -- so those are the ones moving forward with that type of gene implementation.

But a lot of the use cases are, I would say, low-hanging fruits. They are not involved in the fine-tuning or large language model building, they're more involved just using APIs of the open platforms out there. Or building some custom user interface on top of that. I think the most common use case we've seen is ultra personalized experience, which is definitely going to return -- provide a return in the near term, but it's also a limited use case of how GenAI can be used.

Operator

Our next question comes from Paul Obrecht with Wolfe Research.

Paul Obrecht, Wolfe Research

This is Paul Obrecht on for Darrin. Could you touch on the demand trends you're seeing across end markets? It looked like energy continued to decelerate while automotive declined year-over-year for the first time in quite some time. So, I'm curious on what client engagement looks like across the segments and what the expectation is going forward through '24?

Guo Xiao

Sure. So, as you point out, performance across our industry verticals was down in Q4, reflecting the challenging macro environment, including auto, I think the most resilient vertical for us. But I'll go through most of them. From the tech retail sector perspective, we continue to see further pullback of spending as our clients go through tight budget cycles. We're still seeing some of them even doing layoffs at this point. Financial Services is relatively stable on a whole. Then it's also an area we want to focus on. We're seeing some budget opening up in this vertical, especially in Asia Pacific, especially in the Australian market. Energy, public, and healthcare is a strategic focus for us, as they're more resilient from a recession perspective.

Then we also continue to see growth opportunities from our clients in these verticals, especially I'll call out life science, we're seeing a lot of exciting opportunities in that sector. It's -- this is now 25% of our portfolio, this vertical. So auto, travel, transportation even though it's declining year-on-year, a lot of this is due to the pricing pressure I mentioned earlier, but it's still our most resilient vertical, and we are very much focused on driving growth from that sector.

Paul Obrecht, Wolfe Research

That's really helpful. Then as a follow-up, how are you thinking about headcount this year? I know total employees declined notably in the past two quarters. I guess the question is in the event of a demand rebound with easing client budgets, what changes would be needed on the supply side to meet this demand? Then I guess somewhat related, what has been the internal response to these restructuring efforts?

Erin Cummins

I'll start with headcount. So, on the whole, we are seeing, right now, our voluntary attrition outpace the hiring. That's likely to continue for another quarter. We are hiring. However, we have a very strong recruiting capability. We have a very, very strong employer brand. So, we're continuing to hire in select pockets, particularly in geo where we're more sold out or for skills I mentioned data earlier, where we continue to see strong demand. So, on the whole, even though total headcount is coming down somewhat, we are continuing to hire, and we have a high degree of confidence in our ability to hire when demand rebounds. So, feeling fine about that particularly.

I would just touch on the restructuring and how employees are feeling. Certainly, 2023 was a challenging year across our business. But we have an open dialogue with our employees. We're focused on being in person where we can and just helping people understand what we're doing, why we're doing it. And that really has been our key focus. It's part of the values that we have across Thoughtworks, and we think that is important in resonating well. Then positively, some of the changes we're seeing from the restructuring are starting to come through. So, we're going to keep the dialogue going. We think that's a critical part as we go through this change process. Then we believe very much in the restructuring, and we know that the outcomes will help make people be confident around what we're doing. So on the whole, going okay.

Operator

Thank you. At this time, I'd like to turn the call back over to Xiao for any closing remarks.

Guo Xiao

I want to reiterate that digital transformation is a long-term strategy for most companies, our clients and Thoughtworks differentiates ourselves through technology excellence over 30 years of thought leadership. We believe that we'll continue to differentiate in areas like cloud, platform, data, AI, GenAI, customer experience and product, and then at the same time, we're also diversifying our business to address more of our clients' urgent needs. For example, Enterprise Application Monetization, DAMO.

So, despite some year-to-year fluctuation, we believe our tech strength and these investments will position Thoughtworks well to drive steady growth in the long run. With that, I want to thank you for joining our earnings call, and I would like to acknowledge the continued support of our Board and shareholders. So, stay well, and we look forward to catching up with you next quarter. Thank you.

Operator

Thank you for your participation. This does conclude the program. And you may now disconnect. Everyone have a great day.

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