Q1 2024 earnings conference call transcript

May 7, 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. And welcome to Thoughtworks' Earnings Call for the First Quarter of 2024.

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, quarterly reports on Form 10-Q and other reports we may file with the SEC from time to time. These risks 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 will also provide growth rates in constant currency as a framework for assessing how our underlying business is 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. Earlier today, we announced that I will be stepping down from my role, and the Board has selected Mike Sutcliff as my successor, effective June 17th.

I have spent 25 years at Thoughtworks, starting as a software developer in 1999 before taking on various leadership roles around the world, and I'm grateful for the many opportunities I've had. It has been a privilege to be a Thoughtworker, and to be able to learn from the best and brightest in our industry.

I'm proud of what we have accomplished together, growing this business and delivering extraordinary impact for our clients around the world. And now it's the right time to pass the baton.

We're expecting to return to sequential growth in Q2, and I know I'm leaving this business in very capable hands. I will continue to support as an adviser to ensure a smooth transition. In Q1, we exceeded our revenue expectations. We delivered in the context of a macroeconomic environment that though stable, isn't yet showing signs of improvement. Our sales cycles are still elongated but our client portfolio remains steady.

We're having more client conversations around growth-oriented work and seeing strong demand for AI and data services, enterprise modernization and DAMO managed services. However, in Q1, we fell short of our adjusted EBITDA margin guidance. This is primarily due to the timing of our ongoing supply rebalancing program, which includes adjustments to our offshore/onshore mix. This has resulted in a lower-than-expected gross margin.

Our ongoing restructuring program focuses on efficiencies, and we're committed to improving our margin profile, and we're executing our plan to achieve it. Our client strategies are centered around technology. Our investments in sales and marketing, partners and new services are paying off, and we continue to focus on delivering extraordinary impact for our clients.

Now let me share our first quarter results.

We generated revenue of $249 million during the first quarter, with an adjusted EBITDA margin of 2.7%.

Our industry-based go-to-market is gaining momentum. We delivered strong bookings in the quarter and expect to return to sequential quarter-over-quarter growth in Q2 2024.

We remain focused on growing our client relationships, as reflected in the 57 clients with trailing 12-month bookings of over $5 million at quarter end. New client acquisition remains a strength.

We contracted with 49 new clients in the first quarter compared to 46 in the fourth quarter of 2023.

We have seen traction from a vertical-based sales model with higher new logo acquisitions in our Energy, Public and Health services, Technology and Business Services. These are verticals that we have intentionally focused on.

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

Now let me hand over to Erin.

Erin Cummins
Thanks, Xiao. And thank you to everyone for joining our call today.

We continue to invest in strengthening our client relationships, and we are driving engagement with clients across all verticals.

Our focused approach to building demand continues to provide ongoing returns with 62% of quarterly bookings in Q1 coming from outbound efforts. Our teams are converting pipeline opportunities, helping us achieve topline results ahead of our expectations in Q1.

Our team's execution comes against the backdrop of a still challenged macro environment. That said, the macro remains steady and we have not seen the development of incremental client budget pressure since last quarter. Their digital needs remain intact, and we are partnering with our clients as they put their plans into action.

Now let's turn to more detail about the first quarter. Revenues were $249 million, representing a year-over-year decline of 19% in both USD and constant currency. Acquisitions completed in the last 12 months were immaterial to the revenue growth rate in Q1.

During the quarter, we saw year-over-year declines of 11% in APAC, 21% in Europe, 23% in North America and 31% in the LATAM. Among our industry verticals, revenue declined by 8% year-over-year in Automotive, Travel and Transportation; 12% in Technology and Business Services; 19% in Retail and Consumer; 25% in Energy, Public & Health Services; and 29% in Financial Services and Insurance.

Compared to Q4 of 2023, we saw sequential growth in Automotive, Travel and Transportation; Energy, Public and Health; and Technology and Business Services.

During Q1, as a percentage of total revenue, our top five, top 10 and top 50 clients generated 18%, 29% and 68%, respectively.

As of the end of Q1, we had 27 clients with TTM revenues greater than $10 million.

On a TTM basis, around 95% of our business came from existing clients. As of Q1 of 2024, our annualized average revenue per employee was $92,000. We continue to believe that this metric, which remains above the industry average reflects the strategic importance of our work.

On a trailing 12-month basis, we finished Q1 with bookings of $1.2 billion, down 20% compared to Q1 of 2023. Our year-over-year TTM bookings reflect the change in client behavior that developed over the prior year, which pressured contract length and sizing. However, we continue to see relative stability among our clients and TTM bookings were unchanged sequentially from Q4 of 2023. As Xiao mentioned, our Q1 bookings were strong.

Adjusted gross margin was 31.0% for Q1 compared to 36.4% during the prior year. Our Q1 adjusted gross margin continued to be impacted by lower onshore utilization and high single-digit pricing declines on a like-for-like basis.

In the first quarter, our adjusted SG&A as a percentage of revenue was 28.3% compared to 25.1% in the prior year. We've seen a year-over-year reduction of $7 million in adjusted SG&A through proactive cost management while still investing in demand generation.

Adjusted EBITDA was $7 million for the first quarter for an adjusted EBITDA margin of 2.7%.

Q1 GAAP diluted loss per share was $(0.10) compared to $(0.03) in the prior year period. Our adjusted diluted loss per share was $(0.02) compared to adjusted diluted EPS of $0.03 during the first quarter of 2023.

Free cash flow was negative $20 million during Q1 compared to free cash flow of $31 million in the prior year period. The timing of certain items in addition to year-over-year revenue headwinds impacted cash flow in the quarter. We expect positive cash flow in Q2.

As of March 31, 2024, our term loan balance stood at $294 million. We continue to have good liquidity, ending the quarter with a cash balance of $73 million and an undrawn $300 million revolving credit facility.

Our outstanding employees make our achievements possible, and we continue to believe that we have the best technologists in the industry. Our attrition rate remains below industry averages. In Q1, voluntary attrition on a TTM basis was 12.4%, slightly up sequentially from 12.0% in Q4 2023, and an improvement year-over-year from 13.1% in Q1 of 2023. At the end of Q1 2024, our headcount was around 11,000. We are hiring selectively focusing on specific skill sets, such as data and infrastructure.

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

Guo Xiao
Thanks, Erin.

We are making steady progress and we're pleased to receive recent recognition from Forrester, a leading global market research company. Thoughtworks was named in 'Innovation Consulting Services Landscape, Q1 2024' report by Forrester Research. We were pleased to be the only listed service provider with a geographic focus on four continents. 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.

Foxtel Group, Australia's leading subscription television company, has worked with Thoughtworks since 2021. We actively engage with Foxtel Group to integrate their innovative streaming services, aggregator platform, Kayo Sports, BINGE and Hubbl. We also aim to shape the future of Kayo Sports, a thriving sports streaming service under the Foxtel Group umbrella that is affiliated with American conglomerate News Corp.

Autotrader is the U.K.'s largest automotive marketplace, providing access to over 80% of U.K.'s automotive retailers. Autotrader brings together the largest and most engaged consumer audience with the largest pool of vehicle sellers. Autotrader partnered with Thoughtworks seven years ago on a major transformation. Today Autotrader is working with Thoughtworks to realize their aspirations to provide an industry-defining connected customer experience.

At our client, Total Wine & More we are building upon our enterprise modernization focus and expanding to drive broader organizational change with a Product Thinking approach. Having grown into the largest independent retailer of fine wine in the U.S. operating 265 stores, Total Wine prioritized applying this approach to its ERP systems for impactful business outcomes. Total Wine applied product thinking to internal systems, supporting the buyers' response for reviewing and acting on extensive and intricate datasets, while adhering to a tight schedule for product to get it on store shelves in time. Using a product-led approach, Total Wine aims to improve the ERP experience for buyers and streamline buyer tasks, making them easier and more efficient. The initiative is also expected to cut down tedious work and reduce operational costs.

Together with our partner, Google, we have enabled Brazil's leading communication entertainment group, Grupo Global to migrate one of its key products, Globoplay, from a legacy system to Google Cloud platform in just nine months. This project was driven by the need to increase efficiencies, reduce costs, optimize processes, integrate teams and linked to ESG commitments. Through this migration, Globo saw a 78% cost reduction in marketing and commercial intelligence and better financial transparency.

The streamlined reuse of data and code allow it to reduce the size of its dataset by 34% and improve scalability and processing efficiency.

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

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

We're delighted to announce the successful acquisition of the talented individuals, IP and technology from Watchful. Watchful is a San Francisco-based company that helps organizations accelerate the creation, enhancement and deployment of AI models. This acquisition enables Thoughtworks' strategy to become a leading AI transformation partner globally. The integration of Watchful's technology into Thoughtworks' suite of data and AI services will expedite client AI deployment, moving projects from proof of concepts to production rapidly and effectively, thereby providing clients with faster returns on their AI investments.

Our clients are still early in the AI journey. We're pleased that some are moving from proof of concepts to operational deployment and we see a long runway of direct and indirect opportunities.

In the first quarter, we powered up our services launch engine, launching eight new AI services. For example, AI-first software delivery, AI-powered digital products and AI platforms. We believe these AI technologies and services, covering a wide range of use cases, will be a source of value for our clients and followers. We're also seeing AI increase demand for our enterprise modernization and data service offerings as clients focus on improving their systems and data to harness AI's potential.

Let me share a few client examples. We have worked with a global top 10 bank to streamline its customer complaints process. We have been working with this bank for a decade on data platforms, and more recently, large language models. The bank's complaint team faced many challenges, resulting in a poor customer experience. We built and delivered a system to extract and summarize complaint text and audio based on large language models. Additionally, we delivered a web page summary for complaint analysis and a customer web chatbot. To minimize hallucinations, we employed common cue word techniques, conducted structural analysis and filtered out irrelevant and harmful information. We achieved 75% of efficiency improvement and agents can now save approximately 40 seconds per customer complaint interaction.

We use data modeling to reduce maintenance costs in one of the world's top 20 airlines by revenue. We built an optimization algorithm to find an optimal maintenance sequence to reduce the number of days airplanes are grounded due to maintenance activities. We integrated this with the airline's internal system to visualize and update the maintenance chain in real-time. We developed data models to evaluate and optimize the trade-offs between operational disruptions and holding inventory costs. This ongoing program has already delivered double-digit million dollar cost savings ahead of schedule.

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.

Diversifying our service portfolio is a priority. We're pleased that Thoughtworks' DAMO managed services are getting good uptake with 16 new deals in Q1. Thoughtworks' AI-powered DAMO managed services go beyond simply sustaining client applications. We help them continuously enhance and transform, and we expect to deliver 10x the productivity that labor-intensive managed services providers offer. DAMO managed services is strategic for Thoughtworks to shift to longer-term contracts and for service expansion.

Our clients often tell me that our technologists and thought leadership differentiate Thoughtworks. They look to us to help them make the right technology decisions, which has arguably never been more challenging. Clients turn to us because we write the books that shape the future of technology.

This quarter, Thoughtworks luminaries published two new books. Software architecture can be a tricky area to get started with, even for relatively experienced software developers. The book ‘Head First Software Architecture’ takes a radically different approach to technical books, bringing the key concepts and ideas behind software architecture to life in a visual and engaging way.

Demand for machine learning solutions has grown significantly in recent years. The book ‘Effective Machine Learning Teams’ bridges the gaps between software engineering, lean product practices and machine learning models. It is an essential guy of practitioners who want to better understand how to deliver machine learning backed products.

I'm also proud to share that we published the 30th edition of the Thoughtworks Technology Radar. This twice-yearly snapshot of tools, techniques, platforms, languages and frameworks is based on the experience of Thoughtworks global teams working with clients. Through a series of blips, it highlights to clients what they should adopt, trial, assess and hold. Edition 30 includes over 100 blips and a third relates to AI.

Back to you, Erin.

Erin Cummins
Thanks, Xiao.

Now let me discuss our business outlook for Q2 2024 and the full year.

We are seeing stability among our client base and the macroeconomic environment is unchanged. Clients remain focused on achieving more with less, but we did not see incremental budget pressures developed during Q1. Our teams are focused on converting pipeline opportunities within the framework of client budgets. We are seeing the benefits of our vertical-focused approach, which helped drive faster conversion in Q1 and into Q2.

For the second quarter of 2024, we expect revenues to be in the range of $250 million to $255 million, reflecting a year-over-year decline of 13% to 11%. At current rates, guidance incorporates an immaterial FX impact in Q2.

We expect adjusted EBITDA margin for the second quarter to be in the range of 5.5% to 7.5%.

For the second quarter, we expect adjusted diluted earnings per share to be in the range of negative $(0.01) to positive $0.01, assuming a weighted average share count of approximately 323 million diluted shares outstanding.

Turning to our full year 2024 outlook, we now expect revenues in the range of $995 million to $1.02 billion, reflecting a year-over-year decline of 12% to 9% in USD and 12% to 10% in constant currency.

Additionally, for the full year, we still expect adjusted EBITDA margin of 8.0% to 10.0%.

We remain focused on driving efficiencies in both our supply and our G&A functions, and we continue to expect margin expansion as we progress through 2024.

As of March 31, we have realized $87 million in annualized cost savings since we began our restructuring program last August.

As we have undergone the process of improving our cost profile, we have identified further savings opportunities. Accordingly, we are raising our targeted range of total cost savings to $100 million to $115 million from our initial targeted range of $75 million to $85 million. With the increased cost savings target from our restructuring program, we now expect total pretax charges of $26.5 million to $33.0 million, of which we have already recorded $21 million through the end of Q1. Importantly, we do not anticipate any disruption to client service as we execute upon these incremental savings opportunities.

For the full year, we now expect adjusted diluted EPS of $0.02 to $0.08, assuming a weighted average share count of approximately 330 million diluted shares outstanding.

For the full year, we expect share-based compensation will total $42 million. Altogether, we believe that we are at an inflection point and are seeing signs of stability.

Our expected growth into Q2 is encouraging. We are intensely focused on improving results and driving margin expansion. We are building a more resilient company while delivering client impact through our thought leadership and technology excellence.

Before we get into Q&A, I would like to say thank you to Xiao for his many years of leadership. You've seen this business through many changes, and your passion for the work and for all Thoughtworkers has never wavered. We greatly appreciate all that you've contributed throughout your time here. It's been an honor to work with you.

And with that, let's move to Q&A.

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

Q&A

Operator
(Operator Instructions) Our first question comes from Tien-Tsin Huang with J.P. Morgan.

Tien-Tsin Huang, J.P. Morgan
Yes, thanks so much and good morning, Xiao, wish you the best, of course, with the transition here. I wanted to ask just on the -- what the transition and your successor, Mike, who's a great choice. We know Mike. But it is the first time, I think, bringing in an outsider to lead Thoughtworks, if I'm correct? I'm just curious around the balance of that change together with the importance of the Thoughtworks culture, which I know is really important to you and everybody, just trying to think about that balance. And can we expect a continuation of some of the things you've talked about like verticalization as well as bringing in more systems integration and package implementation type of work. Just whatever you can share before Mike officially joins would be great.

Guo Xiao
Sure. Hi Tien-Tsin, thank you for the question. So we are at a phase where I think we are looking at the next four, five years, obviously not just the next one or two quarters.

We've done a good transition, restructuring. And then I think we're on the path to a growth trajectory, we believe. And then we think that is time to look at, longer term, to see what we need to continue to grow the business.

And one of the things we consider is to bring in more new blood, more external expertise and experience. As you mentioned that, Tien-Tsin, we have a lot of long tenured leaders in Thoughtworks. We think it's time to take what we believe, what we have and then combine that with more external experience. So that's the rationale.

And then to the point of strategic change, we're on the path in terms of the restructuring, the vertical focus and also the intention to bring more system integration and the package software implementation.

We're not planning to change that. We do see our clients, for example, asking us very often about supporting them on system integration, package software implementation, especially because Thoughtworks, we, at Thoughtworks we have more -- we have a lot of experience on legacy modernization. And we do believe that by expanding into those areas helped Thoughtworks to become a better strategic partner to our client and also increasing our TAM.

And then at the end, I also just want to mention, as you asked, that we are proud of the unique culture that we have built, that focus on technology excellence, pursuit of excellence, continuous improvement. And then, Mike has been in the industry for a long time, and he knows about Thoughtworks' has long admired our culture and is committed to our purpose of creating extraordinary impact through our culture and technology excellence. So we're confident that it's going to be a win-win situation.

Tien-Tsin Huang, J.P. Morgan
Great. No, glad to hear it. I'm sure that's the case. On the -- just my second follow-up question, just on the stability that you commented on, that's great to hear, no incremental pressures and whatnot. Just on the pricing front related to that, do you have good visibility here around the pricing environment and switching projects forward?

Guo Xiao
Sure. So the pricing drop we mentioned in Q4 '23, and then we're also seen in Q1 this quarter. As we talked about it last quarter, it was mostly driven by the year-end client negotiation for 2024 budgets, especially some of the big deals that we signed during the quarter or during Q4 and during Q1. So we believe that the new pricing dynamics is already, at this moment, reflected in the majority of our contract portfolio. So further pricing declines from Q1 to Q2 should be much less significant and should stabilize.

In the meanwhile, the new logos we're signing up for and a new work tends to start at a higher rate than the bigger deals where we have to give -- sometimes give volume discounts. So overall, it is normalizing and stabilizing. We don't expect a significant pricing drop to continue.

Operator
Our next question comes from Moshe Katri with Wedbush Securities.

Moshe Katri, Wedbush Securities
Xiao, it's been great interacting with you. And good luck. I just wanted to pick up the conversation on pricing again. So was there any factor here in terms of offshore mix that's been driving some of that pricing pressure, rather than just like-for-like pricing pressure? That's my first question.

Guo Xiao
Hi Moshe. Yes. It's been great working with you. So thank you for the question. The offshore -- the pricing drop I mentioned earlier was referring mostly to like-to-like

price comparison. The offshore/onshore mix definitely creates a pressure on what we call the average bill rates across the world.

And then it is an impact to our average pricing. And then we expect that -- definitely, we expect that to continue as more work moves to offshore, but that's also being offset by higher margin, higher utilization.

Overall, we don't mind the pricing decrease if it were because of offshore/onshore mix. But we were -- I think ours is mostly referring to the like-for-like pricing environment, they're being stabilized.

Moshe Katri, Wedbush Securities
Understood. And my follow-up is on APAC. In the past, you guys provided us some updates on what you're seeing there in Singapore, Australia and China. Maybe some color there? Thanks a lot.

Guo Xiao
Sure. APAC has been pretty resilient over the last quarter. And then we have seen stronger growth in Singapore and Indian local market for that matter.

As you mentioned, Australia has been -- seen slower growth over a long period of time, mostly because of our exposure in tech and then tech sector in the Australia local market. And then we're seeing recovery. It's stabilizing. It's definitely not declining further. We're seeing greenshoots. Some of our long-term tech clients are now adding headcount, ramping up projects, but it's not as fast as we were hoping for from a rebound perspective. So we just continue, I think, incrementally getting better.

China from a -- there are two perspectives. One is there's offshore work we do there. There's also the local work we do there. The local work is getting back to growth after the country opened up, the economy start to return to growth. It's not as fast as -- the economy growth rebound is not as fast as a lot of the economies we're expecting, but it's still growing. And so we are, we're seeing the rebound. It's not growing as fast as it might have been otherwise, but it's still stabilizing and growing. Offshore market for China has been a constraint for a little while because of the geopolitical tension. And then we're also being conscious of the risk exposure. So we're not pushing hard on growing the offshore in China, instead we're looking at offshoring more to India and Latin America, Southeast Asia and some of the other Eastern Europe, some of the other areas.

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

Zach Ajzenman, TD Cowen
Hi, thanks, Zach Ajzenman on for Bryan. First question we had on demand. Just wanted to dig further into what's giving you confidence in the implied sequential growth view for 2Q, which would be the first time in almost two years? What else could you say about how demand indicators have changed over the past three to six

months? And any notable vertical or geo call-outs that you would highlight as a tailwind or headwind looking forward?

Guo Xiao
Sure. Hi Zach, we -- from a macro perspective, Erin called out earlier, the client behavior in the current environment is similar to what we have described in recent quarters, hasn't fundamentally changed. It's stabilizing with respect to project churn, but we continue to see longer sales cycles and smaller deal size compared with a couple of years ago, for example.

But that said, we are seeing some opening of discretionary spending where there's -- especially where there's a strong case for ROI.

We're also -- I think probably more importantly, we're also seeing our restructuring efforts paying off with increased investments in sales and marketing and a vertical-focused approach. Our team did a good job converting pipeline opportunities in Q1. And then we also have strong bookings in Q1. So those give us confidence for the coming quarters. So putting this together, we do expect Q2 to return to sequential growth and then followed by a similar trajectory later this year.

Zach Ajzenman, TD Cowen
Got it. And on the supply constraint, so it sounds like these internal limitations that initially emerged last quarter are still causing some friction, but this time, more so on the margin front, whereas 4Q is a revenue fulfillment issue. Could you elaborate on the latest here and if it's expected to impact results in the coming quarters?

Erin Cummins
I'll take that question, Zach. Just in terms of the internal frictions and what we touched on in the last earnings release, I'm pleased to say, that has been addressed as we had expected. That was more around just some specifics, as you mentioned, with revenue fulfillment, just some of the change from the restructuring but we did put in new processes and things have normalized, and that's been fixed now.

What Xiao touched on as well as I did that's impacting the margin is the adjustments on offshore/onshore mix. Really, what we're seeing is higher utilization with our offshore supply and then a little bit lower utilization with the onshore supply. And so that is what is impacting the margin.

We had highlighted those -- we highlighted that issue, I should say, last quarter and did note that it would take a couple of quarters to work through all of that. So on the whole, the supply issues that we talked about in our Q4 release, they've been addressed. We're feeling very good and we are focused on the rebalancing of our supply. It will take us a couple of quarters to get there, but that also is progressing to plan.

Zach Ajzenman, TD Cowen
Understood. Xiao, it's been good to work with you and we you wish you luck on the next chapter.

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

Tyler DuPont, Bank of America
Hi, good morning Xiao and Erin. This is Tyler Dupont on for Jason. First, I just want to start, if you could maybe just spend a minute and discuss sort of the types of projects you're working on and the visibility in demand across those projects. It sounds like the focus continues to be less on the more discretionary high bill rate consulting-oriented initiatives that Thoughtworks is known for and more on those projects with the short-term realizable ROI. Given the historical focus of Thoughtworks, can you just discuss how your current go-to-market differs between the project types? Particularly if there's a difference in any win rates between those two that are worth calling out? And if you're seeing in 1Q, particularly sort of what pricing concessions you had to make as you compete more aggressively for work?

Guo Xiao
Sure. Thank you for the question. So we do -- we've historically done a lot of consulting work. And then I think what we're doing right now is a lot of delivery work but not necessarily everything is focused on short-term ROI. We do have a lot of long-term engagement with our clients. That continues getting funded because they're strategically important.

So from a go-to-market perspective, we do focus a lot more on expanding our service offerings but not so much as kind of steering away from short-term consulting projects to just -- from consulting kind of projects just to delivery projects. And then what we're seeing really is just the client buying behavior.

It's -- their funding is not so much focused on or sometimes it's getting pulled back more on the consulting side, a bit more focused on just executing and delivering products. So that -- our go-to-market hasn't fundamentally changed. Our win rate has been consistent and then moving up over the last couple of quarters, especially this quarter. I think part of that is because we are turning over some of the contracts, and we are going to the market with a more aggressive, more realistic pricing in the current environment.

And also, our vertical-focused approach, we believe that’s giving us a lot more ability to be relevant to our clients from solving their domain-specific problem perspective, that, we believe, gives us another edge in increasing our win rates. So overall, we're feeling good about our win rate, both in terms of new projects and then extension from a consulting and then delivery perspective, the win rate is similar. There's not much difference there. I think the lack of consulting projects is more due to clients pulling back on budget as opposed to competing against competition.

Tyler DuPont, Bank of America
Okay. And then just as a follow-up on margins, it looks like 1Q came in modestly below the low end of the range. And based on full year numbers, it looks like we're definitely more back half weighted. I'm curious if you can walk us through the margin dynamics facing the business through the year and what gives you confidence in that back half

reacceleration, if you will? It sounded like many pricing concessions made were for projects across 2024, the budgets across '24 broadly. So do you anticipate pricing strength in the back half of the year on new projects to offset that? Or just any clarity there would be helpful.

Erin Cummins
Thanks for the question, Tyler. I'll start. In terms of the pricing dynamics, no, there is not an assumption of improved pricing dynamics included in the margin guide for the year or in the back half. We are seeing a stabilized pricing environment, which Xiao talked about. But on the whole, our expectation is that the macro will stay largely unchanged.

And then while we are seeing some discretionary work, we are not expecting the mix of consulting to change. But why do we have confidence in the increased margin? So I touched on this a little bit already. And I also talked about this last quarter. It's worth a reminder. As we look at 2024, the two key elements to our margin improvement, first of all, is increasing utilization. While we have seen some increase in utilization, there's still plenty of room to go. The second piece of that is the rebalancing of our onshore and offshore supply mix, particularly because we have lower utilization that is oriented towards the higher cost locations. So that has been driving part of that margin headwind that we've experienced.

As we go forward, where we have confidence, first of all, as I touched on in my prepared remarks, we are at an inflection point for the year. We're feeling positive about the top line momentum that we have in the strong bookings and our Q2 guide incorporates sequential growth from Q1 to Q2. And so that obviously helps. At the same time, we are managing our costs very carefully, and we are aligning our supply base with that shift to offshore.

So really, it's a combination of the stability in our revenue base plus continued discipline in improving our utilization and our cost management. And that is what we expect to drive that consistent margin improvement. In Q2, I have guided to a margin uptick, and I expect to see more margin uptick in the second half of the year.

Operator
Our next question comes from David Koning with Baird.

Jacob Haggarty, Baird
This is Jacob on for Dave. I just want to ask, you have big restructuring savings, you raised that. But the margin guide stayed intact. Why wasn't the margin guide raised in line with the restructuring savings?

Erin Cummins
The restructuring savings, the additional savings, I guess, first of all, I will say, as a reminder, we have delivered $87 million in annualized savings at the end of Q1.

Now there are some timing differences of when those savings will come through, some of that will come through, most of it will have been realized certainly in Q2, but some of it won't come through until Q3 and a little bit in Q4. So part of it is timing differences. And really, that would be the most of it.

As we had talked about with the Q1 view, there's just the shift of our supply mix, it's something that we're taking very thoughtfully and carefully, actions around making sure that we are not impacting client service. We've done an incredibly good job so far and we intend to continue to do that. So I would say, on the whole, we're focused on doing the right thing for our client. We're doing the right thing on the cost base, but the timing of the adjustments is shifted a little bit, and that is why we haven't updated the margin guidance.

Jacob Haggarty, Baird
That makes sense. And then just one more question for you. So the share count guide was down. Could you guys expand on why that was?

Erin Cummins
The share count guide would just be from some changes that took place, some assumptions that took place in Q1 because we did have some issue of shares in the quarter. But for the fuller view, I will come back to you with a question. I don't have the specific answer now but we'll make sure that we get an answer out that's clear.

Operator
Our next question comes from Matthew Roswell with RBC.

Matthew Roswell, RBC
Yes. Good morning and thank you very much, Xiao, it's been a pleasure to work with you over the last couple of years. I guess following up on the restructuring question. What makes you think that you're -- that you're maybe not cutting too much when it comes to the restructuring? And I guess, as part of that, what areas were -- are you finding the extra cost savings in?

Erin Cummins
As I mentioned earlier, in terms of the restructuring savings, we are being very thoughtful about the actions that we're taking, and we're very focused on client execution as well as making sure that we see continued momentum into our demand and our go-to-market. So where we are focused is areas where it's non-client facing in particular, Again, there's some adjustments because of the onshore/offshore mix. And so where we don't expect to see improvements in utilization over the next six months or so, that would be a place where we're looking.

In addition to that, we are seeing -- from an operating expense perspective, we've, really by the end of Q1, fully realized what we expected. We had good movement with our functions supporting our business as part of the restructuring around the globe. We see further opportunities for decreased operating expenses in some of our office-space rationalization as well as some of our vendor expenses.

So on the whole, it really is in line with the restructuring program that we started last year. It's very consistent. It's just an increase because we've identified more opportunities. We are treading very carefully to make sure that client service continues to go well.

Guo Xiao
Yes. And then just to add to that client services part, we do expect to see sequential growth. We do think that demand for service is increasing, but it's unevenly distributed. Now we know that we're going to see more demand for offshore services. For example, we're going to see more demand for infrastructure skill sets, data skill sets and cloud skill sets and then that's slightly different than what we have developed so far over the last few years. So as we move forward, we're trying to increase capacity skill sets in certain areas and reducing in some of the other areas. So all this is done in the spirit to support the growth, to empower the growth as opposed to optimization at the cost of the growth.

Matthew Roswell, RBC
And if I could follow up on the mix shift and increasing the utilization on the onshore utilization. Is that -- what percentage of improvement is sort of under your control? And what percentage is kind of based on the market stabilizing or improving? Hopefully, that question makes sense.

Erin Cummins
It does make sense. 80% of it, Matthew, would be under our control. Part of it, of course, market dynamics matter. But what we've talked a lot about, we have seen stabilization in the market dynamics, which we're really pleased about, again, worth mentioning the go-to-market momentum, the strong bookings that we had for the quarter and the sequential growth we expect in Q2. So clearly, the market matters, but most of it is under our control, and we feel very confident about the path that we're on.

Operator
Our next question comes from Darrin Peller with Wolfe Research.

Paul Obrecht, Wolfe Research
Hi, thanks, this is Paul Obrecht on for Darrin. Can you provide some more detail on how the new industry-based go-to-market approach is resonating with customers? Maybe both as it relates on winning new customers and maintaining existing ones who are going to them for renewals? And do you find that this model is mostly optimized at this point? Or is there still some work to be done to further develop the sales and marketing capabilities?

Guo Xiao
Thank you for the question. We're definitely only at the beginning of this journey. There's a lot more to be done. The vertical sales and go-to-market approach is the intention – the hypothesis is that our sales team, our go-to-market team and then especially our professional services team on the ground would focus on a particular vertical over a longer period of time so that we build and retain lot more domain expertise as opposed to them constantly being changed and diluted. So when we talk

to our clients, we have more relevant point of views and then understand how to solve their biggest business problems with our technology.

And then we're seeing that paying off, I think, at this moment, especially with new pursuits, new wins where we have people who are more savvy and then -- and understand and can speak the same language with our clients. That's why we are seeing higher new logos, especially in the verticals we've chosen to focus on. For example, energy, public sector, auto and then financial services. And then for -- it definitely helps with ongoing clients. One of the challenges our clients have had over time with Thoughtworks is we keep rotating people out of their team, out of the vertical and then they seem to believe that it's a lost opportunity, given the domain knowledge they have built so far.

So with this model, we have more key technical talent and delivery talent that's ring-fenced in a particular vertical over a longer period of time. So they get to become a better expert at helping our clients solve their problems. But like I said, it's only the beginning of the journey. We have only been doing this for a couple of quarters. We believe that over time, we're going to see this approach paying off even more.

Paul Obrecht, Wolfe Research
Great. And then as a follow-up on the topic of Gen AI, I know the majority of the work being done is mostly proof of concepts and getting the data platforms ready. But do you anticipate we could see Gen AI work begin materially contributing to revenues maybe by year-end as clients start deploying it at scale? Or do you expect this won't happen until 2025? I know it's early. Just trying to think about this from a timeline perspective.

Guo Xiao
You're definitely spot on in terms of, there's a lot of POC kind of short-term work. And there's a lot of preparation work building the data platforms. The Gen AI work itself, especially large language model building, hasn't really been a main theme yet. We do expect it to pick up at some point. Now it's going to be end of the year, probably some of them next year, definitely more of it. That's part of the reason that we have acquired Watchful, it's a product company. It specializes in building tools to accelerate large language model development from POC to scaling, for example, especially the eval feature to tell you which model is more effective than the others. And this is definitely what we believe is going to be a key area for us later this year, early next year. So we do see -- we do expect to see more large language model development. We're seeing a few of them, but it's still not the norm. But your guess is as good as ours, which is probably going to be later at the end of the year or beginning of next year.

Operator
Our next question comes from Maggie Nolan with William Blair.

Kate Kronstein, William Blair
Hi everyone, It's Kate Kronstein on for Maggie. Congrats, Xiao, and we wish you luck on your transition. I wanted to start off asking about the top five and top 10 client

buckets. It looks like those both increased sequentially. Can you guys talk a little bit more about the current dynamics you're seeing in those cohorts this quarter?

Guo Xiao
Sure. So the top five and top 10 clients have -- like as you pointed out, has increased incrementally by 1% from a constant revenue concentration perspective. It's still in the 18%, 29% range, which is relatively well diversified. So we're not overly concerned about it. But the increase is mostly due to -- given the current environment, we tend to focus more on retaining our top clients and then develop longer term, more strategic relationships, for example, adding new service offerings like DAMO, packaged software system integration. So we'll continue to expand our footprint.

Given the macro, it's easier to -- from a revenue perspective, to expand with the current existing top customers, especially when some of them have the intention to consolidate their vendors. And so we are actually benefiting from that, gaining more momentum with our top clients.

That said, we are also seeing a longer tail, especially new logos increasing. It's just that some of these new projects, given the current environment, is starting at a smaller size, smaller deal size. And so we're not getting a lot of big deals at the get-go. And then we're following a lot of the land and expand approach there.

Kate Kronstein, William Blair
That's helpful. And then my next question is, last quarter, it was mentioned that Thoughtworks was seeing some supply constraints around certain skill sets. Can you maybe expand on what you're seeing now on the hiring front?

Erin Cummins
I'll take that question. Thanks, Kate. We touched on it a little bit earlier. Xiao was speaking about some of the skill sets where we are seeing lots of demand. Where we are doing more hiring, it's particularly around data and infrastructure skills that continues to be a place where we're seeing good demand.

And some of the data skill sets do have specialized skill sets or experience requirements. And so that's been a focus for our recruiting team. We put quite a lot of effort in our recruiting in the last quarter and are seeing some very positive momentum from that. And so on the whole, we are feeling good about the ability to fulfill that supply and where we continue to expect to see strong demand.

The other thing that I would touch on is that offshore has been pretty strong. And so where we're continuing to hire is more in our offshore locations. And on the whole, going well. So the supply constraints we think are well in hand, the recruiting, where we are recruiting in particular areas is going very well and we're pleased to see the momentum.

Operator
And our last question comes from Arvind Ramnani with Piper Sandler.

Arvind Ramnani, Piper Sandler
Thanks for taking my question. Xiao, it was a pleasure working with you and wish you the very best on your next endeavor. I just had a question, I mean on the demand environment, you'll kind of characterize it as still really no change, but it's not getting worse. But is there something specific about, kind of your offerings or your services where you are starting to see some signs of improvement? Is there something idiosyncratic to what you all have done or the type of work that you're doing, that you are seeing an improvement even though the demand or the demand environment has not necessarily improved?

Guo Xiao
Sure. First of all, thank you, Arvind. It's been a pleasure working with you, too.

So from a demand perspective, we believe that what has made it better for us, despite the macro environment, is that we have invested in additional sales and marketing capacity, especially our focus after the restructuring to focus more on outbound demand generation capabilities. You might remember that historically, we have only 15% of our new bookings is generated from outbound, 85% is from inbound given the strong brand and then we have enjoyed right now over 60% of our new bookings in Q1, for example, came from outbound efforts. That's definitely, I think, due to the effort, the sales and the marketing team has put in. And as a result, we're also seeing higher conversion from these opportunities.

And then at the same time, I mentioned earlier, we continue to invest in this vertical-based approach. And then we're focused on the verticals that we believe are more resilient in this current environment. For example, public, energy, health care, automotive and life science. And we're seeing that paying off as well. A large number of our new logos come from these verticals.

And finally, we are expanding our service offerings, especially in the efficiency and cost saving programs, catering for the short term and then -- but also the strategic nature some of the clients are asking for, where I mentioned DAMO, the digital application management operation services. Now approximately 30% of our top 50 clients are using this service. It was obviously zero a couple of -- a few years ago. We are continuing to expand this. Again, this gives us the opportunity to increase our total addressable market even with the same client portfolio we have.

Arvind Ramnani, Piper Sandler
That's really helpful. That explains it. And then on one of the earlier questions, I think what you were saying is still a lot of work around GenAI, proof-of-concept and pilot. So fairly small in scale. I just -- what I want to clarify is, is there any -- is there even a single large-scale kind of GenAI project you've seen at Thoughtworks or even at your clients and maybe Thoughtworks is not involved? Have you seen any large-scale GenAI project? And if you haven't, when it does come together, what kind of project would it be? Like where would you see -- even if you look at the proof-of-concepts you've seen, where do you see this promise where there could be like a much larger scale GenAI project?

Guo Xiao
It's a great question. So we do have a few fairly large Gen AI-related projects. And then to peel down the layers, what tends to happen in some of the POCs is just using the -- some of the open cloud-based platforms to use the existing large language model and then use that to do simple -- perform simple tasks like content generation and some basic analysis. And then you move to another layer up. There's the RAG-based, which is very popular right now, the RAG-based approach, that takes a bit more work to do before you feed any prompts into the large language model. So the work is around the large language model, but the large language model itself is still the commercial ones that's readily available.

And then a layer down, which is fine-tuning. We have certain projects that's doing the fine-tuning of large language model and that requires more effort, more data computing power and then that's a little bit more heavy lifting from a cost perspective.

The largest programs we've seen so far is the final phase, that is developing your own large language model. And then that's fewer, definitely, than the others. But we already have them in flight. And we do believe that as we progress, as the POC and adoption of GenAI progress, we're going to see more and more of this work moving from what I mentioned earlier, from left to right, slowly proceeding to finally building your own large language model. Now you don't need to build your own LLM in every case, but some of them will require that, and that's a significant effort and then those will generate much bigger projects.

Arvind Ramnani
Perfect. That's really helpful. Thank you very much, and once again, it was really a pleasure working with you.

Guo Xiao
Thank you, Arvind. Same here.

Erin Cummins
I'm just going to jump in quickly while we're still on the call, I wanted to quickly follow up on the share count dynamics that Jacob asked about earlier. I would simply highlight that the share count dynamics reflect the share price and how it impacts the accounting treatment with respect to dilution. So that's a big part of the change from last quarter to this quarter. An example would be dilution from options. And with that, I'll hand over to you, Operator.

Operator
There are no further questions. I'd like to turn the call over to Xiao for closing remarks.

Guo Xiao
Thank you. And thank you, everyone, for joining us today for our Q1 earnings call.

I want to thank all Thoughtworkers, clients and partners for the extraordinary impact we're delivering every day together. Stay well and all the best.

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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