Q1 2023 earnings conference call transcript

May 9, 2023

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 2023. We will be recording today's call and during the presentations all lines will be on listen-only mode. Joining us today will be Thoughtworks' president and CEO, Guo Xiao, and CFO, Erin Cummins. The 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, are forward-looking and as such, are subject to known and unknown risks and uncertainties, including, but 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, our 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 will reference certain non-GAAP financial measures. We will 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. Welcome everyone to our first quarter earnings call. I would like to start by sharing an overall update on our business and then Erin will take you through our first quarter results in more detail. I will then share some of our business highlights before Erin provides guidance and we open for Q&A.

Let me start with a recap about Thoughtworks. We're a global technology consultancy that integrates strategy, design and engineering to drive digital innovation. We mark a big milestone this week as Thoughtworks turns 30 years old. I joined Thoughtworks almost 24 years ago. and I'm proud of the impact we've had on our clients and the world at large. Our services have helped to transform industries, create new opportunities and make people's lives better, and that's something to celebrate.

I'm pleased to report good results in our first quarter 2023, driven by the continued demand for our digital transformation services. We delivered revenue of $307 million in the first quarter of 2023, $3 million better than the midpoint of our guidance. We contracted with 47 new clients in the quarter, and our overall bookings at the end of Q1 on a TTM basis stood at $1.5 billion. We now have 39 clients with revenue greater than $10 million on a TTM basis, a 26% increase year-on-year.

Though the demand environment is less bullish than a year ago, our sales pipeline is building well. Our proactive investments in sales and marketing are starting to show results, and we're seeing larger deals in the pipeline.

At the end of March 2023, we had 11,840 Thoughtworkers in 18 countries across five continents. The number of Thoughtworkers employed at the end of the quarter factors in some phasing of employee reductions due to the reduction in force program we conducted in February and March 2023. The RIF program impacted approximately 4% of our workforce.

We continue to hire specific skills. We're driving our business with rigor and discipline while managing supply and demand. As we exit the first quarter, we're pleased that our utilization is now in line with our target operating levels.

I would like to thank every Thoughtworker around the world for the extraordinary impact they create through our technology excellence and culture and for their commitment during this time.

Global uncertainty continues in the first quarter. However, the recent volatility in the banking industry had minimal impact on Thoughtworks. We continue to stay close to our clients, helping them to be adaptive to change and get better returns from their investments in technology.

For many businesses, keeping up with technology can be a real challenge given how rapidly the industry changes. To address this gap, we publish our annual technology vision, the Thoughtworks Looking Glass, which identifies six mega themes. These themes represent significant opportunities for our clients and for Thoughtworks. This year's themes, which we call Lenses, include Platforms as products, Making the metaverse and Partnering with AI. With each lens, we categorize hundreds of trends in two dimensions — horizon scanning plus our recommendations.

Looking Glass helps our clients make informed decisions about what technologies to prioritize to best capitalize on opportunities. Let me share some examples of our technology vision in the context of recent client work.

First, Platforms as products — designing and delivering platforms which are relentlessly committed to end user value. With our client, First Student, we're working to deploy a digital platform to help address nationwide bus driver shortages and provide reliable, cost-effective transportation to students with special needs. First Student is North America's leading school transportation solutions provider, completing five million student journeys each day.

Together, we created a digital platform on AWS. The platform enables First Student to work with third-party transportation providers to leverage their unused hours of drive time. Among the platform's benefits is data analytics. This matches student needs to specialized vehicles — for instance, those with wheelchair ramps. The platform helps provide timelier route efficient transportation, and it is having an extraordinary impact on the experience of drivers, students and parents.

The second example of our technology vision I'd like to talk about is Making the metaverse — how extended and augmented reality enables new forms of connection. We're working with Google Public Sector to digitally transform the visitor experience at the Abraham Lincoln Presidential Library and Museum. Our collaboration will use artificial intelligence, extended reality and augmented reality technologies. These will be hosted on Google Cloud to create accessible, engaging and interactive visitor experiences.

With this partnership, the museum will use XR to bring American history to life for millions of visitors. The third example I'd like to share is partnering with AI as machine intelligence becomes mainstream. We're seeing this trend in the automotive sector around software-defined vehicles and autonomous cars. We recently won a new contract with an existing client — one of the top 10 automotive companies in the world — to provide a fully managed offboard AI platform tool stack. This enables its data science team to provide AI connected services and products in its vehicles.

Partnering with AI is a subject of great interest to clients. They're asking us how they can capitalize on opportunities driven by ChatGPT and other large language models.

What other themes are we seeing from customers looking to partner with AI? Let me share a couple. Alongside Thoughtworks' 0-1 product innovation capabilities, we're helping clients answer the question: "How should I be thinking about using generative AI and large language models to support product and customer experience?"

And another theme is software development productivity. Our recent work with clients points to the productivity to be gained by using large language models as a junior partner in software development. A Thoughtworks engineer provides architecture guidelines and the AI codes accordingly, showing its reasoning. Then the engineer and the AI collaboratively work together to refine the output. Early tests are encouraging, and we have observed good productivity gains with AI-assisted software development. Working with our clients, we're also embedding guidelines for the ethical and responsible application of AI. You can read about our learnings in a recent article called "An example of large language model prompting for programming" by Martin Fowler, Thoughtworks' Chief Scientist.

We also continue to see client interest in our propositions that drive productivity and cost efficiencies. For example, engineering effectiveness solutions, which boost the productivity and retention of critical engineering talent. Also, our DAMO managed services offering helps our clients achieve zero maintenance of their software by leveraging our strength in digital application management and operations. Five of our top 50 clients signed up for DAMO services in Q1.

For all these reasons, we believe that Thoughtworks is well positioned in the market.

Now let me share some more details of our growth strategies. At the core, our revenue growth is from deepening relationships with existing clients and winning new logos. We then supplement this with focused strategies around M&A, partners and geographic expansion.

First, let me provide an update on partners. Our primary focus is to develop go-to-market partnerships with the hyperscale cloud providers, including AWS, GCP and Azure. Directionally, our goal is to drive 25% of our revenue growth by working with partners. We continue to invest in our partner capabilities. In the first quarter, we achieved a swath of certifications and specializations. These include AWS Data and Analytics Competency, Google Cloud Data Analytics Services Specialization and Microsoft Data and AI Solutions Partner designations.

Turning now to our client portfolio. The depth of our expertise and breadth of our capabilities means that we can help clients address a broad range of challenges. We assist from strategy right through to business outcomes. Our clients appreciate the value we create with them and increasingly look to ThoughtWorks as a strategic digital transformation partner, able to scale new technology across their enterprise. This is reflected in the nine-year average tenure of our top 10 clients at the end of 2022.

For example, Thoughtworks has had a long-term digital partnership with MYOB since 2019. MYOB is a leading provider of business management solutions. We're pleased to have signed a new contract cementing the partnership for another five years. The signing positions Thoughtworks to continue to work with MYOB's most important digital initiatives. And Thoughtworks has been working with Singapore's Government Technology Agency (GovTech) for around six years. In 2019, we began our partnership with GovTech on Singpass, Singapore's National Digital Identity Initiative (NDI). NDI is a Government Strategic National Project to drive and adopt digital technologies to support the city-state's digital transformation into the world's first smart nation.

The evolution of Singpass focuses on three goals. First, to build a trusted, secure and innovative platform. Second, to offer an entire ecosystem of services to Singapore residents, and third, to be cloud-native to provide flexibility, scalability and reliability. Singpass is now one of the world's leading NDI platforms used by more than 4.5 million Singapore residents. Transactions that previously took days or hours to complete, offer requiring physical visits, now take minutes.

They can be performed from anywhere with an internet connection. As of March 31, 2023, Singpass offers seamless access to more than 2,000 services from 700 organizations. It supports more than 350 million personal and corporate transactions every year. Its evolution as a trusted, all-in-one services app is ongoing.

Now, turning to new clients. We have a focused approach to new clients, helping the organizations we work with to deliver rapid business value from digital transformation. We see continued momentum in new logo acquisition, and we have contracted with 47 new clients in the first quarter.

We're working with new client Total Wine and More, (TWM), North America's largest independent retailer of fine wine, spirits, beer and related products. We have a multi-year agreement to apply the building blocks of a modern digital business. We're working on TWM's enterprise resource planning applications with Microsoft Azure.

By embracing a product-centric delivery model, the engineering team will be able to innovate and evolve legacy applications. This includes those that support the merchandising and supply chain processes, helping to drive productivity and effectiveness.

You can find details of some of these customer successes on the news section of our website, Thoughtworks.com. I'm now going to hand over to Erin, so that she can take you through the numbers in greater detail.

Erin Cummins

Thank you Xiao and thank you to everyone who has joined today's call. We are pleased to announce our Q1 results with both revenue and adjusted EBITDA margin exceeding the guidance that we provided in February. Revenues in Q1 declined 4% year-over-year to $307 million. In constant currency, revenue declined 1% compared to the prior year period. Acquisitions contributed three percentage points to revenue growth in Q1. Adjusted EBITDA for the quarter was $35 million, equating to an adjusted EBITDA margin of 11.4%.

I am thankful for our team's ability to execute in the midst of a difficult macro environment. As we previously outlined, remaining close to our clients is a core strategy while we navigate today's landscape, and our sales efforts are driving results. We are partnering with our clients as they undergo their long-term digital transformations, and we are working closely as clients weigh short-term decisions within long-term programs.

Our clients recognize our thought leadership and value working with Thoughtworks. We see this reflected in our annualized average revenue per employee, which was $100,000 for the first quarter and remains above the industry average. While some clients still exhibit caution in their buying patterns, our solutions remain highly strategic.

Now let me share some additional details about the quarter. Our overall bookings at the end of Q1 on a TTM basis stood at $1.5 billion. We have a well-diversified revenue base across geographies, industry verticals and clients. Europe was our best-performing region on a year-over-year basis, followed by APAC, North America, then LATAM.

Due to the diverse nature of our business on a geographic basis, 65% of our first quarter 2023 revenues were contracted in non-USD currencies. As a reminder, our primary revenue-generating currencies alongside the U.S. dollar are the Euro, Great British pound and Australian dollar.

Turning to our industry verticals. Automotive, Travel and Transportation continues to be our fastest-growing vertical, rising 22% year-over-year. Energy Public and Health Services saw solid growth at 9%, and Financial Services declined by 6%. Technology and Business Services declined by 13%, and our retail and consumer vertical decreased by 23%.

For the first quarter, on a TTM basis, around 89% of our business came from existing clients. We now have 39 clients with revenues greater than $10 million on a TTM basis, eight more than the first quarter of 2022, a 26% increase year-on-year. We have a balanced customer portfolio with relatively low client concentration. In the first quarter, our top five, top 10 and top 50 clients generated 17%, 27% and 67%, respectively, as a percentage of total revenues.

Adjusted gross margin was 36.4% for Q1 compared to 45.6% during the prior year period. Utilization was primarily responsible for the yearly decline, but I am pleased to share that we exited the quarter with utilization in line with our target operating levels. In the first quarter, our adjusted SG&A as a percentage of revenue was 25.1% compared to 22.6% in the prior year period.

Adjusted EBITDA was $35 million for the first quarter and Adjusted EBITDA Margin was 11.4%. Adjusted EBITDA Margin declined year-over-year from lower utilization and the recognition of approximately $6 million in severance-related expenses. Q1 GAAP diluted loss per share was $0.03 compared to a loss of $0.14 in the prior year period. Our adjusted diluted EPS was $0.03 compared to $0.13 for the first quarter of 2022. Free cash flow for the quarter was $31 million compared to negative free cash flow of $11 million in the prior year quarter.

We have ample liquidity with a cash balance of $109 million as of March 31, 2023, alongside an undrawn revolving credit facility. We continue to reduce our outstanding term loan, which stood at $301 million as of March 31, 2023, following a $100 million prepayment in February.

Now I would like to hand back to Xiao to share additional updates on our business from the first quarter.

Guo Xiao

Thanks, Erin. Let me start with our amazing Thoughtworkers. With a long-term focus on diversity and inclusion, our community of 11,840 Thoughtworkers included 43% women and underrepresented gender minorities (WUGM) as of March 31. Our voluntary attrition of 13.1% on a TTM basis demonstrates the strength of our employee value proposition. We believe that Thoughtworks has the best digital talent in the industry. and this positions us well to create extraordinary impact for our clients.

In the first quarter, we're pleased that Thoughtworks has active Great Place to Work certification in 13 countries with an average Trust Index score of 90%. Our priority is for Thoughtworks to be a place for talented technologies to grow and have impact. Our global Glassdoor rating is a measure of the progress we're making. In the first quarter, our overall rating was 4.08, which is higher than the rating for the IT services sector of 3.91. We're delighted to be ranked ninth on LinkedIn's Top Companies 2023, the best workplaces to grow your career in the U.S.

LinkedIn ranked companies based on eight pillars that lead to career growth, using data from LinkedIn Talent Insights. The pillars include ability to advance, skills growth, external opportunity and gender diversity. The ability to advance pillar tracks employee promotions within the company and when they move to a new company. Skills growth looks at how employees are gaining skills while employed at the company.

Now let me hand back to Erin.

Erin Cummins

Thank you, Xiao. Turning to ESG, I am pleased to update that in the first quarter Thoughtworks' science-based climate commitment targets were validated by the Science Based Targets initiative. You can find details of our SBTi targets in our investor presentation. As a co-founder of the Green Software Foundation, Thoughtworks is committed to helping our clients adopt sustainable technologies, while we reduce our own carbon footprint.

In the first quarter, Thoughtworks undertook a sustainability tech assessment for Xero to explore how technology can accelerate achievement of its sustainability goals. At the end of the engagement, a road map was developed, categorized into now, next and later horizons for helping to achieve tech-enabled organizational sustainability goals.

Now let me move to our business outlook for Q2 and for the full year 2023. Both new and existing clients continue to engage with Thoughtworks to drive their digital transformation journeys. These needs remain intact, and our pipeline continues to grow. For the second quarter of 2023, we expect revenues to be in the range of $300 million to $304 million, reflecting a year-over-year decline of negative 10% to negative 9% or negative 9% to negative 8% in constant currency.

For the full year, we expect a revenue decline of 3% to 1% or 3% to 1% in constant currency. We expect acquisitions will contribute approximately two points to revenue growth in Q2 and two points of growth for the full year.

We expect Adjusted EBITDA Margin for the second quarter to be in the range of 15% to 16%. For the full year, we expect Adjusted EBITDA Margin of 17% to 18%. For the second quarter, we expect Adjusted Diluted EPS to be in the range of $0.03 to $0.04, assuming a weighted average share count of approximately 329 million diluted shares outstanding.

For the full year, we expect adjusted diluted EPS of $0.31 to $0.34 assuming a weighted average share count of approximately 333 million diluted shares outstanding. Our Q2 guidance incorporates share-based compensation of $18 million. For the full year, we expect share-based compensation will total $76 million. As a reminder, beginning in 2024, we anticipate annual stock-based compensation to range between 2% to 4% of revenue.

Now we would like to provide some context that is informing our guidance for Q2 and the rest of the year.

First, the general contracting environment is similar to what we noted last quarter, but there are incremental green shoots. Clients are discussing larger, more widely-encompassing projects compared to earlier in the year. We still see elongated sales cycles and clients continue with more incremental ramp-up, but the size and scope of our pipeline is strengthening. However, pipeline conversion is moving more slowly than previously anticipated, and we are therefore seeing a slower ramp-up in certain projects. This has led to our revised full year guidance.

Secondly, we are seeing resilience in Europe and early signs of recovery in China as we enter Q2. We continue to see caution exercised in Australia, while continued strong growth in India serves as a positive offset within APAC. The environment in North America remains relatively in line with last quarter.

Third, and consistent with recent quarters, we still see strength in our Automotive vertical, while Technology and Retail verticals face pressure.

Lastly, we continue to build our outbound sales generation capabilities, and we are seeing progress. We saw strong bookings in the quarter while also bringing in 47 new logos.

In 2023, we remain focused on executing against a robust and expanding pipeline while managing our costs, balancing supply and demand and investing into our growth initiatives. We continue to believe that our talent represents the best in the industry, and I am extremely thankful for the efforts of all Thoughtworkers as we navigate this macro environment.

We will remain close to our clients as our services remain a key element of their multiyear digital transformation journeys. Our renewal rates are strong, and we are growing the number of $10 million annual revenue clients, underpinned by our highly relevant service offerings. Now let me hand back to Rob.

Rob Muller

Thanks, Erin. You can find our investor presentation on the Thoughtworks Investor Relations website. We will now move on to Q&A. I would 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 Tien-tsin Huang with JPMorgan.

Tien-tsin Huang, J.P. Morgan

Great to talk to everyone again today. I'm not sure, just to ask you upfront Xiao, just if you can comment on some of the press reports of a take-private bid for Thoughtworks. I know it's always tough to ask that on the public call, but we're getting questions on it. So I figured this is a good opportunity to ask your thoughts on leverage and just the news itself.

Guo Xiao

Thanks, Tien-tsin. As we all know that we, as the management team, is mostly focused on execution of our strategy, our people delivering our value to our clients and growing our business over time. Obviously, if there's any offer on the table, it's the board's responsibility to evaluate that carefully. But we, as a management team, we're not in a position to speculate or comment on any street rumors.

Tien-tsin Huang

Very good. Appreciate why I ask the question, Xiao — so let me ask on the business side, directionally very consistent with what we've heard from some of your peers. I know you mentioned some of the turmoil in the banking system, which happened in March. So I'll ask on just maybe a little bit more detail on how the demand environment shaped up as the quarter progressed and as we went into April, do you have any exposure on the financial services side that we should be watching, for example, I think, Erin, you didn't mention financial services as your call-out. So just any update on the cadence of demand as the year played out?

Guo Xiao

Sure. So first of all, the banking crisis, we kind of mentioned briefly that we don't have any direct exposure, very little direct exposure to the crisis itself. And then we did decide to invest intentionally in the financial services sector last year, knowing that we only have maybe less than 17%, 18% of revenue of our entire portfolio that's in this sector, and it's a sector that's going to — it's still going through a lot of digital transformation.

We believe there's a lot of potential in the long run, so we did invest in it. And then despite the current headwind in the sector, we feel strongly about the long-term potential. So we'll continue to focus on it. But just generally, you asked, Tien-tsin, that the demand environment, we’re coming into April, it's still similar to the recent quarters, we have commented before. Macro headwinds persist, clients are cautious and tight on budget, but we're seeing more and more conversations about larger programs of work.

In fact now we're starting some of them. It's just that they're ramping up, are more going to kick in later during the year in Q3 and later. So overall, still cautious, tight on budget, but we're optimistic about the pipeline, the health of the pipeline, the activity in the pipeline and also the conversations we're having with our clients about larger programs of work starting.

Operator

Our next question comes from Maggie Nolan with William Blair.

Maggie Nolan, William Blair

I wanted to know if we should expect any further changes in your cost initiatives in light of the lower expectation for revenue? And can you give us an idea of what Adjusted EBITDA Margin would look like in Q3 compared to Q4?

Erin Cummins

Hi Maggie, sure. So just in terms of how we're managing our costs and our cost initiatives. There's two primary focal points. The first one that you've heard us talk a lot about in prior quarters and remains is driving higher utilization. So as we look to increase our EBITDA margin levels across the year, a big piece of that is the increased utilization expectation.

We are managing our headcount very closely, just a low number of hires we are hiring, but we're hiring in very limited places. And so as we continue to have normal course attrition, voluntary attrition, then that is a good path along improving utilization as well as the increase in the top line that we anticipate in the second half.

In terms of just overall SG&A management, again, this is a continuing theme for us. Our focus is investing in sales and marketing spend, that remains a commitment for our business, and we did see that in Q1, and we continue that in Q2. So we will do that, as Xiao talked about in some of his earlier comments, we are starting to see the benefits of that pay off and good signs there.

So if we look at SG&A in the whole, we are investing in sales and marketing, we're looking to continue to drive efficiencies in G&A. So it's really about where that spend is while remaining thoughtful about discretionary spend and keeping that to limited amounts. And then in terms of the margin in the second half of the year, Q3, Q4, I would just remind everyone that there are seasonality factors that are at play with respect to margins.

Q2 does tend to be a quarter where we have lower margin seasonality. Q3 tends to be higher and then Q4 a little bit lower. So we have no reason to believe that normal margin cadence wouldn't apply for this year.

Maggie Nolan

And on some of the more cost-focused solutions that you've announced, like the engineering effectiveness solution and the digital application management, are those playing a role already in some of the new logos that you signed this quarter? Or how is the demand looking for those and what impact are they having on the pipeline?

Guo Xiao

I'll take that question, Erin. Thank you, Maggie. We're — thank you for calling out those two new services offerings we put out there. We're definitely seeing a big uptick on these two specific new offerings that's cost oriented, especially definitely in the new logos we have acquired Q1 this year. By definition, some of these engagements are smaller, given that they're cost oriented, they're focused on taking out some of the costs our clients are looking at.

And then we mentioned earlier that of the top 50 clients, we're also getting engagements in these two areas besides the new logos. So we're seeing a pipeline developing. We're seeing new opportunities getting started. They might start small, but we believe that's going to give us a bigger baseline of revenue in the following quarters.

Operator

Our next question comes from Matthew Roswell with RBC.

Matthew Roswell, RBC

I guess thinking about the delays in the pipeline implementation, how much of that is just clients being cautious sort of about changing things given the macro environment? And how much of that is because budgets might be constrained?

Guo Xiao

Thanks, Matt. It's a little bit of both. We are seeing some of the ramp-ups that starting later and starting smaller than we thought. It's mostly because the clients are cautious. We sign up these bigger deals, as you can tell from the stronger booking we have in Q1, we had — our TTM booking's now $1.5 billion compared with $1.4 billion in Q4. So lots of signing. Revenue is contracted, but the ramp-up is getting slower than we thought, mostly because the clients are cautious. They want to start small. They want to prove that it's working before they — or at least see that risk is not as big as they thought before they ramp up to a bigger team.

So that's one factor. We're also seeing some of this is due to budget constraints that instead of — especially on existing work streams, instead of continuing with certain amount of budget and certain amount of the size of the team, we're seeing some pressure, downward pressure on reducing the team size. That's what mostly gave us the caution about Q2. And then both factors play into to some extent as in the current macro environment.

Matthew Roswell

Okay. And I guess as my follow-up for Erin. Should we think about any changes in seasonality when it comes to the revenue cadence between third quarter and fourth quarter given the possibility of these ramp-ups?

Erin Cummins

No, I don't expect any changes in the cadence around revenue seasonality. It really — our expectation is that it would remain similar to prior years in line with what I just mentioned in Maggie's question earlier.

Operator

Our next question comes from David Koning with Baird.

David Koning, Baird

I guess my first question, when we look at top clients, top five clients in the filing, I think they were up 9% year-over-year. So pretty good trends there. And then the non-top five clients, and we kind of did the math, I think, were down 7%. So pretty big disparity. Is there something to that, either bigger clients are actually spending more right now? Or maybe the acquisition brought on one or two like very, very large clients this quarter. Maybe just kind of talk through that.

Guo Xiao

Sure. Thanks, David. Our top five clients, similar to the top five, in fact, that we look at both top five, top 10, top 50, our larger clients cohort indeed, are growing faster than the longer tail of the smaller clients we have over this period of time. And it's not because we just brought in one or two of them. In fact, out of top 10 — the average tenure of our top 10 clients was nine years. So they're a pretty stable cohort.

Now we believe that the fact that they are growing faster in our portfolio is both because, for two reasons. One is in the current macro environment, one it’s tough. We are — we have a better chance of going for expansions, extensions with existing customers than ramping up big projects with new logos who are a little bit more risk-averse at this moment, trying to try new partners, new things.

And the second is that with the top clients we have, they are also going through in this current environment, a bit more vendor consolidation than they would otherwise do in a normal time. We're actually benefiting from that. We believe we're taking more wallet share with our top 50 clients during this time. So that's the second reason we believe that we're growing faster with the top clients.

Like I said, it's not just top five, it's top 10, top 50. And then the other, I think, data we shared earlier is that we now have 39 clients that have a TTM revenue of over $10 million, compared with 31 a year ago.

David Koning

Got you, thank you. And just my follow-up, gross margin, I think, was like 36% compared to 45% in the last Q1. Do you expect that to recover like towards the back half of the year? Will it be pretty flattish — in the back half, it was about 40% last year? Like just kind of how do you see the cadence of improvement in gross margin?

Erin Cummins

We do expect that to recover. We are, in fact, seeing that in the second quarter already. We won't see the full extent of the recovery until we get to the back half of the year. And again, that's in line with the improvement around utilization that we talked about. But with respect to gross margin, of course, our Q1 was impacted by the one-time costs related to the reduction in force.

In total, the costs were about $6 million. A lot of that was included in gross margin. So that impacted Q1 specifically. And then I did talk about in my comments earlier that we are seeing utilization start to trend at higher levels. That was true. As we exited Q1, that continues to be true now into the second quarter. So we still have room to go. We're still moving up with respect to utilization, but that will drive higher levels for the year.

On the whole, we consider gross margin in 2023 expectations versus last year. I would say we expect it to be relatively similar, in line, no major differences, but the shape of that will be quite different than last year where, clearly, we're starting 2023 out at a more challenging level than we expect to finish for the year, whereas the opposite was true last year.

Operator

Our next question comes from Bryan Bergin with Cowen.

Bryan Bergin, Cowen

My first one is on per capita revenue, I think, now around $100,000. Can you comment on the drivers here as far as how onshore / offshore mix has shifted as you're potentially work in lower cost for clients versus things like like-for-like pricing versus other factors on timing of workforce optimization?

Erin Cummins - Thoughtworks Holding, Inc. - CFO

Hi Bryan, yes, happy to comment. The main factor actually is back to the utilization piece of it. And so obviously, that's a recurring theme for us. That is why it is our number one priority. So I would firstly highlight the impact that we are seeing from lower utilization, which is, of course, a temporary dynamic. I would then say that with respect to the other factors, our pricing in general is stable. And given the more challenged macro, we see that as being a good outcome and so stability in the pricing, and we will continue to focus on that and to get higher pricing where appropriate.

The geo mix is shifting. That is something where we're seeing. We're seeing — we talked about where we had more headwinds. Part of what we're doing is rotating certain work for our clients, while staying with the clients, but rotating certain work from onshore locations to offshore or nearshore locations. So that's shifting the geo mix that is reflected somewhat in the pricing. And then, of course, there's a little bit of an FX headwind that remains from the shift change from 2022 to 2023. So those are all factors that are changing the per capita on the revenue per employee. But the biggest one to mention is utilization. And again, that's a temporary dynamic.

Bryan Bergin

Okay. That's helpful. And then just a follow-up on some of the harder-hit industries, so retail consumer and biz tech services, do you have a view to stabilization in those industries? I guess can you talk about the delay versus the cancellation behavior there? And I guess how we should expect the trajectory to progress over the next several quarters.

Guo Xiao

Sure. Thanks, Bryan. So the harder hit sectors for us are mostly the tech and retail sector. Among our tech clients, there's still a push to keep more projects in-house to protect their own workers as they start cutting costs and sometimes doing layoffs themselves. As a result, we do expect this pullback of spending to continue in the tech sector for the next — at least the next two quarters.

The retail is probably — it's the other significantly-impacted sector. Given the consumer sentiment, we also believe that the spending cut from clients, the tight budget in this vertical will remain similar in the coming one or two quarters, it will remain challenging. For us, obviously, the bright spot is the energy public health care sector, which are — which is growing in a very healthy way.

And it's now 27% of our total revenue, up from low 20s last year since we decided to focus on this more resilient sector during a difficult macro environment. And then the bright spot for us is the automotive industry, where in Q2, it grew by — in Q1 grew by 21%, and we expect that strong growth to continue. We're excited to continue to work with the BMW Group, one of the world's leading premium manufacturers of automobiles and we support them both in Germany and international teams to develop their connected drive cloud platform and then to apply AI in their processes and infrastructures. So that's a quick highlight of what we see among the verticals.

Operator

[Operator Instructions]

Our next question comes from Moshe Katri with Wedbush Securities.

Moshe Katri, Wedbush

A couple of follow-ons here. If I remember correctly, APAC accounted for about a third of the revenue base last quarter. And that was probably the biggest issue impacting guidance for the year. I think you mentioned that China is looking a bit better. Maybe you can talk a bit more in details about China, Australia. I think in Australia, you have a large retail exposure as well, and Singapore in that context.

Guo Xiao

Sure. thanks, Moshe. APAC is indeed 33% of our global revenue. It saw a bigger headwind late last year earlier compared with the other countries, mostly was driven by Australia and China. Australia has, among all the regions we have, has a high exposure to tech and retail. So it was the first to be impacted. It was also the one that's having the biggest — seen the biggest impact right now.

And then China is definitely recovering in the post-COVID environment. Although it's a little bit slow given that it takes time to because we have half our revenue in China working for local clients, half of revenue for global customers takes time to build — to rebuild the pipeline and then start new work in the local market.

Singapore had a stellar growth in second half of the year last year, but they're a little bit late in the economic cycle compared to the other countries. So we're seeing a bit more headwinds in Singapore at this moment. Even though it's still growing, it's less of an accelerated growth as we have seen in H2 last year. So if you combine all this, there's a bit of a mixed news in APAC we expect, but we do expect overall positive growth in APAC in the coming quarters.

Moshe Katri

Okay. That's fair. And then Erin, you spoke about some green shoots in Europe. Maybe you can talk a bit about that in terms of where are we seeing these? And how does it look — how does Europe look for the second half of the year? .

Guo Xiao

I can take up that. So we are — as Erin mentioned, we're seeing a bit green shoots in Europe. Europe, we mostly with — our two biggest markets in Europe is Germany and UK. We've seen UK stabilizing. We have signed a couple of large clients. We do expect ramp-up to kick in later during the year. Germany is probably where we see more promising opportunities, especially in the automotive sector, as I mentioned earlier, is, the automotive sector continued to invest in the digital technologies as most of the car companies believe that digital is the center of their future strategy.

So we see — besides BMW, we're also working with several other large automobile companies and then we see large contracts extensions and expansions being signed. We believe that they're going to drive further growth — incremental growth for Europe later this year.

Operator

Our next question comes from Ryan Potter with Citi.

Ryan Potter, Citigroup

Hi, I'm on for Ashwin. Thanks for taking my question. I wanted to start with talk of — focus on sales and investments you've been making there. Could you give some color on where these sales and marketing investments have been so far? Has it been more concentrated in regions or specific capabilities? And I guess, could you give us a sense of how much larger the sales force has become and how much larger you expect it to become in the near term.

Guo Xiao

Sure. Thanks, Ryan. As we mentioned, the sales and marketing activity is both, we're spending money to recruit and then increase the headcount in the sales department as well as spending in resources and marketing activities to generate inbound and also outbound leads. It's across-the-board effort, but we are definitely focusing a bit more in the public energy health care sector that's resilient in this current macro environment.

And also in the automotive industry where we see a lot of promising opportunities as to how much — we don't have a — we don't report on the numbers of how much we're spending there, but it's a significant increase compared to what we're spending before. It's not to the amount of double but it's also not just a few percentage of increase, it's a pretty significant increase in spending. And then besides, on the vertical side, we're also increasing our sales efforts in this efficiency-oriented cost-saving programs in engineering effectiveness and then data digital application management, operating service — and operation services. So that's how we've seen some of the efforts paying off with this 47 new logos and strong bookings in Q1 that's kick in. Geography-wise, it's widespread. We're not just targeting one or two geographies.

Ryan Potter

Got it. And if I could shift to uses of capital. How are you kind of thinking of your capital allocation priorities? And just in terms of M&A, how's the M&A pipeline looking currently and what types of geographic or capability exposures are you looking at?

Erin Cummins

I'll touch on the capital allocation quickly, Ryan, and then I will just let Xiao talk a bit about the M&A pipeline. But on the whole, our capital allocation priorities remain consistent. Our focus is reducing our term loan as well as continuing with our M&A program. So that is absolutely part of what we expect from a capital perspective and investment.

You will, of course, have noted that we paid $100 million on the term loan in the quarter. And then we obviously had the successful acquisition of Itoc in first quarter.

So — those have been our priorities. They remain our priorities. Xiao, do you just want to touch on the pipeline a bit?

Guo Xiao

Sure. Our M&A strategy is still the same. It's important to us. We expect acquisitions will be complementary small tuck-ins to our core business rather than transformational, and we continue to build the M&A pipeline and also the muscle to execute on it.

Operator

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

Jason Kupferberg, Bank of America

So just looking at the revenue guidance for Q2 and the rest of the year, thinking about quarter-over-quarter growth rates. Q2 forecast to decline a little bit quarter-over-quarter. It looks like the full year guide then implies reacceleration in that quarter-over-quarter growth maybe to around mid-single digits. So just wanted to get your views on visibility of that ramp**?**

I mean I know that there's a lot of cross currents out there. You've talked about sales cycles elongating, pipeline sounds encouraging, but really wanted to hone in on visibility on the reacceleration in quarter-over-quarter growth in the second half.

Erin Cummins

Xiao, I can start, and you can feel free to add in. Jason, thanks for the question. Just with respect to Q2, what I would highlight is that sequentially, it is a small decline from our Q1. But if we normalize that for billable days in the quarter, it's flat to a small increase. And so while we were hoping to see and earlier expected to see a slightly larger increase from Q1 to Q2, we are encouraged certainly by the fact of our — an increase on a billable revenue per day basis.

So that's important to understand. And then Jason, you asked about visibility and you've heard us talk quite a lot about the pipeline. We continue to expand our pipeline. Xiao talked about the bookings, the new logos. There's a lot of encouraging signs there. Our win rates remain the same. Our pipeline is very healthy, and it is expanding. And so there is good visibility into Q3 and rest of the year. But that said, obviously, the macro conditions are a bit more cautioned and of course, we're talking about some budget conservatism and slower starts

So absolutely, we have the visibility — and we continue to focus on that. We feel good about how the second half of the year looks. And in fact, even with respect to Q2, again, the growth is a little bit lower, but we've seen stabilization and start to return on revenue per day growth basis.

Jason Kupferberg

Okay. So I guess just a follow-up question there is then does the second half outlook assume that underlying discretionary spending trends will actually improve versus what you're seeing right now? You've got the bookings in place like you said, but just thinking through dynamics that could impact converting bookings to revenue.

Guo Xiao

As you mentioned, Jason, we're seeing the strong bookings. We're seeing large clients ramping up in Q3, Q4. In terms of the pipeline conversion, our guidance and our expectation incorporates the extension of the current macro environment. We're not expecting this to get much better or much worse. So the conversion rate of the pipeline, we expect that to remain similar. Hopefully, it will get better, and that will give us more upside. But I think our confidence in the second half of the year comes mostly from, one, is the stabilization of the existing work we're doing with our clients. Second is that the intentional investments we're making in sales and marketing and the new service offerings, we expect that to pay off later this year.

Operator

There are no further questions at this time. I'd like to turn the call back over to Xiao for any closing remarks.

Guo Xiao

Well, thank you, and thank you for joining us for our Q1 earnings call. I would like to acknowledge the continued support of our board and our shareholders. In closing, I want to thank all Thoughtworkers, clients and partners for the extraordinary impact we're delivering every day together. Stay well, and we look forward to catching up with you next quarter.

Operator

Thank you for your participation. You may now disconnect. Everyone, have a great day.

