Q2 2023 earnings conference call transcript

August 8, 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 second quarter of 2023. We will be recording today's call and during the presentations all lines will be on listen-only. Joining us today is 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, 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'll reference certain non-GAAP financial measures. We'll also provide growth rates in constant currency as a framework for assessing how our underlying business performed, excluding the effect of foreign currency rate fluctuations.

We include non-GAAP to GAAP reconciliations in our press release furnished as an exhibit to our Form 8-K. The non-GAAP financial measures provided should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with GAAP. Thoughtworks assumes no obligation to update or revise the information presented on this conference call. I will now hand over to Xiao.

Guo Xiao

Thank you, Rob. Welcome, everyone, to our second quarter earnings call. I would like to start by sharing an overall update on our business, and then Erin will take you through our second quarter results in more detail. Erin will share our guidance, and then we'll open for Q&A.

In the second quarter of 2023, we delivered revenue of $287 million with an adjusted EBITDA margin of 10.2%, both of which were below our guidance for the quarter. I want to first discuss the factors that impacted our Q2 results before moving on to the actions we're taking to address our performance going forward.

This quarter, we experienced challenges with three of our top clients during the second half of Q2, where the scope of work being executed was reduced due to client-specific budgetary decisions or shift in the client's strategic direction. These unforeseen decisions accounted for approximately 2/3 of the revenue miss in the quarter when compared with our guidance. We attribute the remainder of the shortfall to broader macroeconomic factors.

During the quarter and, in particular, the latter half, we witnessed a slowing of pipeline conversion. The change in client behavior that we have highlighted in recent quarters, including incremental project ramp-ups and delayed decision-making, continued during the quarter to a greater extent than anticipated. In response to these challenges, we undertook a total review of our business, and today we're announcing a structural reorganization.

As part of the program, we're reducing our employee headcount globally by approximately 5% to 6%. With this structural reorganization, we will move operational functions from a geographically dispersed to a centralized model, create a new organizational home for the majority of our professional services workforce, our digital engineering center, and evolve our regional market structure.

Centralizing operations globally will reduce overall costs, better align resources to strategic priorities, right-size operations and increase operational efficiencies. The new digital engineering center will provide supply across the regional markets and allow us to respond swiftly to client requirements, including the continued shift from onshore to offshore delivery.

Over our 30-year history, we have built various digital engineering centers across the world as a result of our geographic expansions. The time is right to further optimize our global delivery capabilities. The DEC will play an important role in capability building, developing talent and driving innovation with our clients. We expect that the DEC will help improve our utilization rates and optimize resource deployment.

We're pleased to share that the group will be led by Sudhir Tiwari, our Regional Managing Director of India and the Middle East. Finally, these changes will enable our regional markets to shift to a more client and industry-based go-to-market focus and allow the company to continue to fund investments in demand generation. And we will continue to invest in our outbound demand generating capabilities.

The investments that we made over the last year are paying dividends as we continue to see an increasing share of our new TCV attributable to our outbound efforts. Driving additional business through our focused sales efforts remains a key part of our strategy, and we're pleased to announce that we have promoted Chris Murphy to the newly created role of Chief Revenue and Client Officer in order to oversee these efforts.

Through these changes, we expect to emerge a stronger company in order to navigate the current difficult macro environment while best positioning ourselves for the future. We will do this while staying true to who we are, a company intensely focused on helping solve our clients' toughest challenges by harnessing our expertise with ever-evolving and cutting-edge technology.

Now I'd like to move on to additional details about the quarter. I'm pleased to share that Thoughtworks was among the leading providers in the Q2 2023 Global ISG Index Breakthrough 15 category for the AsiaPac region. This is based on annual contract value won over the last 12 months. We contracted with 29 new clients in the quarter, a year-on-year increase of 12% as we continue to build upon our outbound sales motion.

Our voluntary attrition rate of 12.6% on a TTM basis remains well below industry norms and demonstrate the strengths of our employee value proposition. In June, we published our annual social impact report. I'm very proud of the work Thoughtworks does to amplify positive social change while advocating for equitable tech future.

Now let me share a few themes we're seeing in the market. We're focusing our demand generation programs on data and AI services. And we're seeing a lot of client interest, especially for generative AI, and Thoughtworks is well positioned to meet this demand.

We have multiple initiatives underway to enhance our service offerings, capitalize on inbound interest and generate outbound demand. First, at the end of Q2, we have trained around 500 Thoughtworkers in AI-assisted software development with a target to train a total of 1,800 by September 2023. We're trialing a broad array of technologies to quantify their impact within software development lifecycle.

For example, we developed Team AI, a springboard to create custom tools to leverage GenAI to accelerate software delivery tasks, including requirement analysis, code generation and test planning. Second, we're developing new services and tools to help our clients pursue GenAI-led innovation and maximize value while upholding high standards in responsible tech. We just launched the Thoughtworks generative AI product accelerator. This is in response to client demand for Gen AI-enabled product development.

The generative AI product accelerator combines Thoughtworks proven approach to developing products with our expertise in data and AI. This helps rapidly embed generative AI into ambitious digital products. We are already working with a top 50 client and seeing value creation in just a matter of weeks. We have had many questions from clients about how to build GenAI applications, and so we recently published an article to share insights "Lessons and practices in building an LLM power generative application."

And third, actively engaging with clients. We're currently working with 12 clients on generative AI projects and a further 20 clients, where the work we're doing involves coding assistance with GenAI. A number of these are top 50 clients. The work we're doing with clients is across a diverse set of use cases, for example, software development, search, knowledge management, data analysis and product development.

We're working with a new client, Bolt.Works, a Finnish technology company specializing in staff recruitment, Bolt.Works employ recruiters to skim unstructured text to find potential matches for candidates, interviews and final recruiting decisions. This manual process is a bottleneck for scalable growth. Thoughtworks built a large language model-based matching engine for jobs and workers to enhance scale and speed up the capabilities of their platform and business.

Our solution is based on ChatGPT, coupled with an open-source large language model, for the more sensitive data operations. Other service offerings that drive productivity and cost efficiencies are gaining traction in the market. For example, FinOps. Clients are looking to achieve efficiencies from their cloud estate.

We recently worked with a global top 10 pharmaceutical client by applying our differentiated approach to FinOps, which combines FinOps platforms with continuous automated remediation. We were able to identify $30 million of cost savings across the cloud estate, which had expected spend profile of $100 million over five years. And we're seeing good progress in our digital application management and operation services, DAMO.

DAMO helps our clients achieve zero maintenance of their software by leveraging our strength in digital application management and operations. 11 of our top 50 clients are DAMO clients at the end of Q2. Our DAMO team is working with Authority Brands, a U.S. leading home service franchise group, to evolve their Successware product and continuously improve and ensure its long-term reliability, stability and success.

We continue to invest in our capabilities and we believe we have the best digital talent in the industry. For these reasons, we believe that Thoughtworks is well positioned in the market. At the core, our strategy is to deepen relationships with existing clients and win new logos. We then supplement this with focused strategies around M&A, partners and geographic expansion. We continue to focus on the shift of our portfolio to more resilient verticals while investing in our service offerings, for example, DAMO.

First, starting with partners. I'm pleased to share that Thoughtworks recently became an official Premier Google Cloud partner in North America. We have an exciting program planned at Google Next in San Francisco later this month. Our client, Globo, Latin America's largest media company will be speaking. Globo will share how, by working with Thoughtworks, they successfully migrated a petabyte-scale data pipeline from a legacy platform solution to Google Cloud.

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.

We're focused on improving the resilience of our vertical client portfolio, for example, in public sector. A new client in the U.S. federal sector is the U.S. Consumer Financial Protection Bureau. Thoughtworks along with its partners have been awarded a five-year design development blanket purchase agreement to provide IT and digital services, including web security, DevOps, design and product development.

And at our existing public sector client, the National Payments Corporation of India, our architects are working closely with NPCI to scale the Unified Payments Interface ecosystem as its protocols are entering new countries, including the ones in North America and the Middle East. We also worked with NCPI on enhancing and upgrading BHIM. BHIM is a payment app that facilitates easy and fast financial transactions using the Unified Payments Interface.

Thoughtworks redesigned BHIM's customer onboarding and lifecycle. We migrated the app from a legacy framework to a highly scalable React-Native framework using a strangler approach. You can find details of some of these client successes on our 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 everybody for joining us on today's call. Earlier this morning, we released our second quarter results. As Xiao already mentioned, unexpected ramp-downs by three significant clients in the second half of the quarter drove approximately two-thirds of the quarterly revenue miss compared to the guidance we provided in May.

In addition, our performance was impacted by slower pipeline conversion and incremental project startups. While these trends were previously witnessed during recent quarters, the degree to which they impacted client behavior, and therefore, our results was greater than we anticipated.

Moving to our results. Revenues declined 14% year-over-year during Q2 to $287 million. In constant currency, revenue declined 13% compared to the prior year period. Acquisitions contributed 1 percentage point to the revenue growth rate in Q2. We remain close to our clients while macro uncertainty disrupts near-term budget spending.

We are ready and committed to assist our clients with the toughest challenges of their multi-year digital transformation journeys. Our thought leadership and expertise allows us to solve these difficult problems and our annualized average revenue per employee of $100,000 for the second quarter, which remains above the industry average, reflects the highly strategic work that we deliver for our clients.

Now let's move to additional details about the quarter. We had another stable quarter with respect to bookings, and we are pleased to report that our overall bookings at the end of Q2 on a TTM basis stood at $1.5 billion. Our revenue base remains diversified and we continue to focus on increasing the participation from more resilient verticals. For the quarter, we saw year-over-year declines of 8% in both Europe and APAC, 20% in North America and 25% in LatAm.

Moving to our industry verticals. Automotive, travel and transportation continues to be our fastest-growing vertical, rising 18% year-over-year. Energy, Public & Health Services declined 2%. Financial Services declined by 12%. Technology and Business Services declined by 27% and our Retail & Consumer vertical decreased by 29%. For the second quarter, on a TTM basis, around 92% of our business came from existing clients. We currently have 35 clients with revenues greater than $10 million on a TTM basis, two more than the second quarter of 2022.

In the second quarter, as a percentage of total revenue, our top 5, top 10 and top 50 clients generated 18%, 28% and 67%, respectively. Adjusted gross margin was 36.6% for Q2 compared to 40.6% during the prior year period. Average bill rate and utilization were primarily responsible for the year-over-year decline. We saw modest low single-digit pricing declines on a like-for-like basis, while also performing certain exploratory work for clients.

In the second quarter, our adjusted SG&A as a percentage of revenue was 26.5% compared to 23.7% in the prior year period. Adjusted EBITDA was $29 million for the second quarter and adjusted EBITDA margin was 10.2%, below our guidance mostly due to lower-than-expected revenue. Q2 GAAP diluted loss per share was $0.04 compared to a loss of $0.13 in the prior year period. Our adjusted diluted EPS was $0.03 compared to $0.11 for the second quarter of 2022.

We had negative free cash flow for the quarter of $19 million compared to free cash flow of $20 million in the prior year quarter, mostly due to the payment of Connected Labs earn-out and quarterly income tax payments in the U.S. Our cash balance stood at $88 million as of June 30, 2023, alongside an undrawn revolving credit facility. We've made continued progress on repaying our debt this year and our outstanding term loan balance was $299 million as of June 30, 2023.

Now let me move to our business outlook for Q3 and for the full year 2023. We remain focused on expanding our pipeline as new and existing clients come to Thoughtworks to not only help solve their toughest challenges today but also to prepare for future technology opportunities such as AI.

For the third quarter of 2023, we expect revenues to be in the range of $275 million to $285 million, reflecting a year-over-year decline of negative 17% to negative 14% or negative 19% to negative 16% in constant currency.

For the full year, we now expect revenues in the range of $1.137 billion to $1.157 billion, reflecting a year-over-year decline in the range of negative 12% to negative 11% for both reported and constant currency revenues. We expect acquisitions will contribute approximately 1 point to the revenue growth rate in Q3 and 2 points to the revenue growth rate for the full year. We expect adjusted EBITDA margin for the third quarter to be in the range of 9% to 11%. For the full year, we now expect adjusted EBITDA margin of 11% to 12%.

We expect that the actions we are taking with respect to restructuring and the realignment of our cost base will remove $75 million to $85 million of costs from the business on an annualized basis. This initiative will begin in the third quarter and is expected to be completed within the next 12 months. We expect total pretax charges of $20 million to $25 million. We expect to incur the majority of the pretax charges in 2023. We expect that the charges will be offset by pretax savings.

For the third quarter, we expect adjusted diluted EPS to be in the range of $0.02 to $0.03, assuming a weighted average share count of approximately 332 million diluted shares outstanding. For the full year, we now expect adjusted diluted EPS of $0.11 to $0.13, assuming a weighted average share count of approximately 332 million diluted shares outstanding. Our Q3 guidance incorporates share-based compensation of $18 million. For the full year, we expect share-based compensation will total $74 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 shaping our guidance for Q3 and the remainder of the year. First, the general contracting environment grew more difficult as we progressed through the second half of Q2, and we are factoring a continuation of recent trends into our guidance for the remainder of 2023. Specifically, we have moderated our expectations for the pace of pipeline conversion as we continue to see caution with client budgets.

Second, we have factored in specific project ramp-downs that occurred in Q2 and will impact the rest of the year. Third, our guidance incorporates a higher mix of offshore delivery compared to our previous forecast. We have previously discussed the ongoing shift of work from onshore to offshore delivery, but we have observed a faster-than-expected pace of change. While this dynamic is generally margin accretive, it does present a headwind to the top line and is impacting margins in the short term as we rebalance supply and demand in onshore versus offshore locations.

Overall, while Q2 results did not meet our expectations, we are confident that we are taking the appropriate steps to build a more durable business. In addition to the actions we are taking to centralize our operations and reduce costs, there will also be some reductions in our professional services headcount where individual skill sets or experience levels no longer align with client requirements and to enable us to make geographic adjustments to better align with client needs. The majority of the annualized cost savings will come from reductions in operating spend, particularly in non-client, back-office functions.

We are focused on driving efficiency while also providing the appropriate investments for the long term, such as continuing to build our outbound demand generation and fortifying our technology leadership. Our clients' needs for digital transformation remain intact. Our pipeline is building, and we remain close with our clients. And we are partnering with our clients as they look to capitalize upon the various technological innovations of both today and of the future. 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 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, JPMorgan

Sorry, can you hear me? This is Tien-tsin.

Guo Xiao

Yes, we can.

Tien-tsin Huang, JPMorgan

Yes, so lots of digest, I know, here. Let me start maybe with just your reinvestment into the outbound demand side. Of course, the macro is tough. I'm sure you're thinking about replenishing the pipeline and going into next year. So I'm thinking about currently what percent of deals are a result of some of your outbound efforts now? And as you're looking to diversify your revenue streams and you're moving more to this industry-specific outbound effort, is there a risk that we'll see some sales disruption, Xiao, during the transition? How quickly do you expect to see some of the results, assuming a stable macro from here?

Guo Xiao

Well Thanks, Tien-tsin. We do believe that the outbound demand generation effort is paying off already. Historically, Thoughtworks enjoys a plentiful of inbound leads and that's our main go-to-market for many years.

I think that average number -- average amount of new wins coming from outbound was only about 15% of our portfolio. And we have achieved, I think, even in Q1 almost 30% of our new wins coming from outbound demand efforts; and in Q2, that number has risen to 45%.

So clearly, we've made a lot of progress in generating demand proactively by going outbound through BDMs, targeted marketing campaigns, account-based marketing campaigns. And we continue to do that and our focus, as you mentioned, Tien-tsin, is not across all the industries. We tend to -- we're trying to focus a bit more on more resilient verticals in this current downturn from public to health care to automotive. And then we believe that with further effort, we can even further increase the outbound demand outcomes from 45% to even more. And at some point, we definitely hope that in the long run, that with inbound leads coming back again, it will give us even a bigger pipeline to work with.

Tien-tsin Huang, JPMorgan

Great. No, that's very clear, 45%. Okay. That's helpful as we think about tracking next year. So just maybe on -- for you, Erin. Just on the gross margin side, a quick follow-up, if that's okay. Just I heard both utilization impact as well as bill rates driving the decline. I wasn't sure if that impact on bill rate was representative of what you're expecting for the second half of the year versus what you're trying to change on the utilization front. So maybe can you walk us through those dynamics as we resketch our second half outlook. Thank you.

Erin Cummins

Yes. Let me start with utilization. We did see an improvement in our utilization from Q1 to Q2. So obviously, that's a positive sign. But it's important to note, in both Xiao's comment earlier as well as mine that, that improvement was not evenly distributed across our business. We've seen lower utilization in our onshore locations versus our offshore locations, and that has an impact both on our top line as well as gross margin.

For Q2, we saw utilization of about 3 percentage points below what we typically target. Again, that's an improvement from what we saw in Q1. But the other impact is, you mentioned, Tien-tsin, is around the bill rate. The bill rate is 2 dynamics. The first one is that shift in mix, again, from onshore to more offshore focus. That's impacting the bill rate on the whole. It's also being impacted on some like-for-like adjustments where we did see low single-digit like-for-like reduction in bill rate year-over-year in Q2. That compares to what we saw in Q1 where we were more flat. Now in terms of what we expect going forward, we're seeing more stability in terms of that bill rate impact. We're not expecting a further big movement, but to be more consistent with what we observed in Q2.

Operator

Our next question comes from Maggie Nolan with William Blair.

Maggie Nolan, William Blair

Hi, thank you. Can you elaborate a little bit on how the move to a centralized model is going to affect your ability to sell new business into existing clients? And then is there anything else that you would anticipate needs to change as you manage those relationships and attempt to continue gaining share in existing accounts?

Guo Xiao

Sure. Thanks, Maggie. The centralized model we mentioned earlier talks about two parts. One is we want to centralize our capacity, delivery capacity and consulting capacity around the world, moving from a country-managed structure to a global-managed structure.

On the other side, I think more significantly is we're evolving our original demand generation structure to be more centralized as well. And our main focus to be more client-focused and client-centric than our current country regional focus. The main impact we hope is going to help us from a new business -- from winning new business with existing clients is that a lot of our customers, they are global customers. They work in multiple regions across the world. And our geo model tends to focus on generating demand and then excellent delivery in a specific country or even a region. But we tend to lack the global focus when it comes to going after new business. With a global model, our teams will report centrally by client, by vertical to a global role.

That will allow us to go to market more focused on a global delivery footprint and then working with our clients across multiple countries than just focusing on a specific one. So definitely, we believe that it will help expanding our spending with existing customers in a more efficient way in the future.

Maggie Nolan, William Blair

That's helpful, thank you. And then when you think about the restructuring savings, what's the cadence of how those will hit the P&L? And how long does it take for those to start materially impacting the P&L? And then what does the ramp look like towards that kind of annual run rate that you expect?

Erin Cummins

With the restructuring from a savings perspective, once the actions are complete, we anticipate annualized cost savings of $75 million to $85 million. We anticipate that we'll achieve most of those savings, about 80%, on a run-rate basis before the end of this year. I did also touch on and just will, as a reminder, say, on the whole, the savings of $75 million to $85 million, we expect to incur related costs that we'll see via restructuring charges of approximately $20 million to $25 million for the total program. Again, the majority of that will be incurred before the end of the year.

We have a clear action plan where we're focused is the areas that Xiao just touched on. Particularly from a cost savings perspective, I would highlight that we expect the majority of our cost savings to be coming from non-client or back-office functions. And our drive will be on not only efficiency and improvement and what we'll see by the time we get to an exit rate for Q4 2023. But importantly, we think it sets us up very nicely for the longer term.

Operator

Our next question comes from Ashwin Shirvaikar with Citi.

Ashwin Shirvaikar, Citigroup

Hi, yes, Hi Xiao, Erin. I guess let me start with the deceleration in revenue per employee. What percentage of your revenue base has the offshore onsite ratio and other cost side metrics that clients are seeking in the current environment? And the underlying question is, there is a demand weakening that's broad and has affected every player in the industry. It's why we've kind of -- maybe not consensus, for example, but Thoughtworks seems to have this incremental demand issue for its particular weighted average price point. So why should investors believe that you aren't, say, for example, in the early innings of the impact as opposed to the later innings?

Guo Xiao

Sure. Thanks, Ashwin. So I'll start with the onshore/offshore split. Our revenue per employee is still in the $100,000 range, mostly due to the strategic kind of work we do and also our onshore presence. But as you were alluding to, as our client budget gets tighter, we do work with them to find solutions such as moving more delivery work to offshore or offer DAMO to run existing systems better versus building new ones right now.

As a result, actually, we sold more hours in Q2 than Q1. But the mix is a bit -- is more offshore-heavy, hence, the revenue is lower from Q1 to Q2. Now how far we have been going down this journey, I think it's worth to keep in mind that we started our entire portfolio from a work location perspective, 100% onshore about 30 years ago. We've added offshore over the years, started from early 2000. At this moment, we have a more than 75%-25% split from a headcount perspective, offshore-onshore.

And then the movement, the speed of movement, as you mentioned, that from moving from onshore to offshore has been about 1 to 2 percentage points every two or three quarters, three, four quarters. So the movement is not that speedy from a change of portfolio perspective. Now we do want to -- actually ourselves wants to get to 80% or even perhaps slightly more than that from onshore-offshore percentage perspective.

We believe that it's beneficial to both our clients and Thoughtworks from a delivery mix perspective. So it is aligned to our own strategy to move towards that ratio. And then how far, to your point, do we think this will go? Is this going to go further to the 90%, 95%. We don't believe that will be the case. I think a lot of this near-term pressure is to move the engineering type of work to offshore.

But the higher value-add, the consulting work, the strategy work, architecture, cloud and data AI, a lot of that work still remains onshore. And then I think as the macro eases a little bit, as the budget cycle we're in now is through to the next one, we do believe that our onshore presence will continue to be a strategic advantage that will allow us to strengthen our relationship with our clients, and we will still be able to drive significant revenue growth from that. I hope that makes sense.

Ashwin Shirvaikar, Citigroup

I appreciate that insight. The second question is with regards to sort of visibility. And you went through several points with regards to your new assumptions. It was very helpful. I just want to kind of ask, as you sort of looked at Q2, were things getting sequentially worse? Has the situation maybe stabilized at the lower level in July? Is it still getting worse? If you could kind of re-go through the buffers in our outlook, so to speak, right? And maybe any changes that you made with regards to your forecasting methodology?

Guo Xiao

Sure. That's a good question. Thanks, Ashwin. So the macro environment for us definitely grew more challenging in Q2, especially during the second half of the quarter. And that's the main reason we have reduced our expectations for the full year. And about a third of the reduction we have with our -- we're forecasting is due to Q2 miss.

And the rest is due to the extension of the challenging Q2 demand environment, specifically the factors Erin mentioned earlier, project turnover, slower pipeline conversion and then the work moving from onshore to offshore. And let me add some color to that in terms of how much buffer, what's our visibility on each of these factors.

From a project turnover perspective, we've seen most of that in Q2. And that's what we called out driving that -- that's driven the miss. We're still seeing some of that. One of our top clients paused the major re-platforming initiative at the beginning of Q3, at the beginning of July. And we believe that some of our clients are still adjusting and adapting to the challenging macro environment. And then we're probably going to continue to see project turnovers in Q3 due to that, and we factored that into our guidance.

And in terms of the slower pipeline conversion, I mean, the themes around client buying behavior remains the same. Still, sales cycle is long, clients are tight on budget, it's slower to ramp up. And it did become more difficult in Q2, incrementally more challenging in Q2. And the pipeline is moving slower than we anticipated compared to the last time we reported. So our guidance does incorporate in the slower rate of conversion into the rest of the year. That said, we do have a growing pipeline.

We have a lot of clients engaging with us in driving new opportunities, new work. So the size and then the number of leads in the pipeline continue to grow. And we do have better coverage for Q3 and Q4, but we are taking a conservative view from a conversion rate perspective based on what we've seen in Q2. And then so we extended that view and then used that lower conversion rate to calculate our guidance. So we do feel confident about where we're guiding.

And then I think, finally, I just want to point to this booking number. We do have a stable booking in H1. And then as Erin mentioned, $1.5 billion TTM. That implies Q2 booking is in line with -- Q2 '23 bookings in line with Q2 '22 booking, which was a better demand environment. And then now the ramp-up is more incremental, so not everything will be converting to revenue in the near term as soon as we probably have seen before. But sooner or later, these bookings will convert into revenue, and that gives us confidence that we have a better visibility for Q3 and Q4.

Operator

Our next question comes from Bryan Bergin with TD Cowen.

Bryan Bergin, TD Cowen

I wanted to start with a follow-up on outlook reduction here. So looking at some more detail on the cancellations and the deferrals, I heard that, I think, three large clients that accounted for a large portion of this. Are these still clients of Thoughtworks? Can you comment on the industries and the regions, those weighed on most? And I'm curious, are projects like these coming out of plans entirely? Or do they in-source them, to your competitors? Anything -- any added color to be mindful there.

Guo Xiao

Sure. Thanks, Bryan. So the clients we called out, they were top clients and then the work was stopped unexpectedly, not completely, but the scope reduction was significant and team size reduction was significant. As we were mentioning, they were in -- they were actually spread across multiple industries, one financial services, one in tech -- one in energy and one in retail.

It's -- none of this is because the clients are complaining about work or concerned about the quality of the work. They're also not being in-sourced or lost to any competition. It's purely budgeting concerns. The clients are going through their own budget adjustment cycle and then they either decided to ramp down or stop or not to extend the current work stream. But they are all still ongoing clients. We are still working with them.

As I mentioned earlier, in this tough environment, even though there's a contract that says we have -- there's contracts, bookings that were supposed to execute against, we want to maintain the long-term relationships to clients, we want to foster this partnership. And that's why our top 10 clients’ average tenure is 9 years. So we work with them trying to accommodate by ramping down the team, moving to offshore or using DAMO to run the application -- existing application infrastructure rather than build a new one. So we pivot. But it's -- inevitably, it's a smaller revenue footprint from that point.

Bryan Bergin, TD Cowen

Okay. Understood. And then on bookings, just can you give some more color as it relates to the composition of new bookings and really looking for the nature of the work. Is this shifted predominantly toward more efficiency initiatives for clients? And can you give us a sense of how maybe the average size of your engagements coming into bookings compares versus, let's say, last year?

Guo Xiao

Sure. The new work that we were signing up, including expansion, are not substantially different from what we're doing today. They're essentially still focused more on enterprise monetization, platform, cloud, data, AI, user experience, products. The cost savings -- efficiency saving programs, there are more, but they're not substantially more.

And then this is -- some of this is driven by our intention to push, for example, more DAMO service into our portfolio. But it's not substantially different. And then sorry, what was the second part of the question?

Bryan Bergin, TD Cowen

Just as it relates to average size of the engagement.

Guo Xiao

So the booking itself is -- hasn't been a significant change. The size of the SOWs, total bookings we're signing, they're still large-sized engagements, multi-year programs. I think it's the ramp-up is more incremental than we've seen before. That is as starting team become smaller, it takes longer to get to the full team size.

Previously, at some point, it would probably take 30 to 60 days to get to the full team size. Now, it will take up to 90 days to get to the full team size. Clients just get a bit more caution about their spending. But the booking average size of booking from a contract perspective is still similar to what we've seen before. It was slightly smaller, but not substantially different.

Operator

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

Jason Kupferberg, Bank of America

I wanted to circle back on the three large clients that, I guess, accounted for two-thirds of the shortfall here. So just so we were clear, is this simply that they're delaying new starts and/or pausing existing projects? Or have there been some outright cancellations here? And if it's more the former, what's your sense on when they expect to re-engage with those delayed or paused initiatives?

Guo Xiao

It's a mix -- and thanks, Jason. It's a mix of both situations. One situation, for example, the client has engaged with us since the mid of last year on a large multi-year re-platforming initiative, replacing all their infrastructure that's running their back-end operations.

And then around middle of the year, just before the -- late in Q2, our clients, their Board, has done another ROI analysis. They just couldn't justify the return on investment given the current budgetary and macro environment. So they decided to pause the entire program.

Now they might come back at some point. We don't know if that's going to be anything in the next quarter or two. But we have to pivot to something slightly different, helping them to run their current infrastructure better. So that's a complete -- that's a stop, but we don't know whether it's going to start. Another one is -- example is a pivot. And that is the initiatives our clients are running is for business case built for the entire Europe region.

And then I think there's an understanding realization that, that project was too ambitious given the current macro. They reduced the scope to focus only on U.K. And that means a lot of this architecture product design has to change. So that's a restart to -- and it's going to restart to a smaller team. We're still engaged, but we know that's going to be -- even if it restarts, it's going to become a smaller team. So those are the two examples I can think of, if that helps.

Jason Kupferberg, Bank of America

It does help, it does help. I guess the guidance for the back half of the year implies that quarter-over-quarter revenue growth will continue to be negative in Q3 and in Q4. I mean, I guess, in a base case scenario, when do you think Thoughtworks can get back to positive quarter-over-quarter revenue growth?

Guo Xiao

I think there's just one caveat. From a numbers perspective, it does look that way, but we do have seasonality in our business. So Q4 naturally have more holidays and then vacation days, which tends to have lower revenue in Q4.

If we think from a revenue per day perspective, from -- we do expect from Q3 to Q4, it should stabilize already. So that if we just look at the revenue per day perspective, we actually feel that Q4 will have better coverage in Q4 and we're confident that it should already stabilize in Q4 and should be able to return to growth from there.

A lot of this, obviously, is due to the fact that we are making intentional investments in demand generation, the outbound demand efforts, the positive signs we're seeing from automotive vertical, for example 18% growth, and then the solid bookings we've seen in H2. So we do feel that despite the quarterly number itself, from a revenue per day perspective, H2 stabilization from Q3 to Q4 is essentially going to be flat.

Operator

Our next question comes from Moshe Katri with Wedbush Securities.

Moshe Katri, Wedbush Securities

Hey, thanks. Can we talk a bit about APAC? That region was underperforming relative to some of the others in the past. I don't know where it is now, maybe it's stabilized, maybe it's not. But maybe talk a bit about Australia, Singapore and China, what's going on there? And maybe talk a bit about the headcount plans for China as well. Thanks.

Guo Xiao

Sure. Thanks, Moshe. So APAC, from a year-on-year perspective, declined by 8% last quarter, and it's mostly driven by Australia. So if we measure by -- if you look at our revenue by currency, by Australian dollar contracted almost 20%. So that's the main driver of the performance in APAC. And then in itself, it's mostly due to our high exposure in tech and retail in Australia and then the slowdown it's having a bigger impact to the country than others.

And if we look elsewhere impact, in fact, Singapore has had stellar growth in H2 last year, and we continue seeing good growth coming from Singapore, even though it slowed down a little bit due to tough comps. But still healthy growth. India remains a strong growth engine. In fact, we've seen the demand from Indian local market, especially in the financial service sector grow significantly.

China is recovering in this post-COVID environment, but it's not rebounding as fast probably as what we expect just on the general economy in China. But it is recovering from last year already. And then from a headcount perspective, we do intentionally want to contain our exposure from a headcount perspective in China. So the headcount growth in China is -- we're benchmarking that at a much lower level than India, Latin America and other offshore regions.

Moshe Katri, Wedbush Securities

Great. And just a follow-up, going back to TCV, $1.5 billion. Can you remind us if you include any renewals in those numbers?

Guo Xiao

It does. It does include renews. It's both new business renews, and that's why the number is significant from a TTM perspective. It's $1.5 billion versus our, I think, guide revenue for the year is $1.13 billion. So it includes everything.

Moshe Katri, Wedbush Securities

Okay. So is there any way to kind of dissect it by new logos versus a year ago where we are?

Guo Xiao

It's -- not from a booking perspective. We don't report that from a booking perspective. But there's another color around the revenue we get from the existing customers versus new customers. I think a couple of quarters ago, that number from, the revenue we get from existing customers was around 88%. I think this quarter is 91%. So we're definitely getting more revenue from existing clients than from just purely new logos. And that's a combination of new work streams, new contracts and extensions with existing customers, if that helps.

Operator

Our next question comes from Arvind Ramnani with Piper Sandler.

Arvind Ramnani, Piper Sandler

I just wondered kind of the three clients that kind of declined revenue. Can you just give a bit more color on some of the underlying reasons? Was it anything to do with execution? Or were these sort of like more internal discussions? And is there any view that those projects may restart?

Guo Xiao

Sure. Thanks, Arvind. So we -- with some of the declines we're seeing, I think you're alluding to is, are they going to restart or not. We definitely feel that the work is not going away itself. We're still talking to our clients about what needs to be done. And then in their digital transformation journey, we're still doing multiple streams of work. Some of the streams of work gets delayed, paused or even canceled purely because they have to prioritize from a budget perspective.

The stakeholders we work with, we talk to, they know they need this done. They know the work is necessary, is critical for the future of their own business growth. And that's how we started engagement, we signed the contract. We are working with them. But then they were surprised themselves a lot of times, getting the mandate from their own CFO or CEO or even the Board that they had to pause because there's no budget or the ROI calculation doesn't make sense in the current environment. So a lot of this surprised both us and our immediate stakeholders with our clients.

Now that said, most of the cases, we managed to pivot one way or the other, even including having a couple of people there doing work for free to keep the lights on, help them bridge this budgeting cycle. I do feel that many of the cases, if not most, many of the cases, we would expect the work to restart one shape or another when the budget pressure is gone or when they get a new phase of budgeting cycle, we'll be able to restart some of that work. So definitely, the work is not going away. It's just being squeezed by the budgets.

Arvind Ramnani, Piper Sandler

Terrific. And then just to clarify, this $130 million reduction in guidance for the year is largely related to these three clients. And kind of back of the math calculation suggest that this is about 1,100 or 1,200 kind of decline in number of employees acquired, right? Like if you take your kind of the revenue hole and kind of disapply to your bill rate, it comes to like 1,100, 1,200 folks. What's the plan with these -- with the folks who are basically getting rolled off these projects?

Guo Xiao

Sure. Erin, I'll start with the $130 million and then feel free to jump in for the plan for the employees that are being rolled off. First of all, it's not all due to the three clients. It's -- I think that top three clients -- and then also the miss in Q2, generally, that contributed to 1/3 of the reduction.

So it's not an insignificant part but it's not a majority of the miss. The rest of the guide down is due to extension of this demand environment challenge we're seeing. So that will be further project turnover in some other clients we're expecting. And then a slower pipeline conversion and acceleration of work moving from onshore to offshore. Erin?

Erin Cummins

Yes. So in terms of the headcount impact and how to understand the prior guidance versus the updated guidance and then the headcount assumptions. Part of the reduced headcount assumptions isn't from people rolling off. It's actually what I would describe as just cost avoidance or hires that we would not make. We were expecting to hire more people in Q3 and Q4. We do have a dynamic hiring plan and we are always adjusting our hiring based on what we're seeing in the market and in the pipeline evolution.

So a lot of that, that you mentioned, Arvind, is actually just through reducing our overall hiring targets for the year. The other piece of it that is worth reminding is simply voluntary attrition. So we have been moderating our hiring levels already, and we do have natural attrition that occurs in our business in normal course, just under 13% on a TTM basis. And so again, that is another factor in how we're managing the headcount.

Now we have announced a restructuring plan today, and we talked about that quite a lot already. I would just reiterate that while the majority of that is focused on our operational spend, particularly in non-client back-office functions, we're making some adjustments in professional services where we've seen a bigger imbalance in supply and demand. And that's particular -- in large part to onshore versus offshore movement, where it's been faster than we expected.

Arvind Ramnani, Piper Sandler

Perfect. That's really helpful. And just kind of last question for me is, I mean, I know with a lot of these contracts, there's an MSA and kind of contracts written where there's potentially some offsets and notice periods that the client has to give. Is that -- are there any offsets to sort of the ramp-downs where clients are giving you like extended notice period or they're sort of paying for some kind of transition during some transition period?

Erin Cummins

Go ahead, Xiao.

Guo Xiao

Go ahead, Erin.

Erin Cummins

I was just going to say, we do -- each of these situations is on a client-by-client basis. As Xiao mentioned earlier, we're very much in a relationship business. Our goal is to maintain our relationships with the clients in the long term and continue to see growth.

There are notice periods, there are some degree of ramp-down clauses and/or offsets. But on the whole, it's -- I would just say it's client-by-client, and we are seeing the reduced project scope, as we've talked about, which has impacted the top line.

Operator

And our last question comes from Matthew Roswell with RBC.

Matthew Van Roswell, RBC Capital Markets

Yes, thank you for taking my question, I'm filling in for Dan Perlin. Hopefully, this will be relatively short. And I hate to keep circling around the guidance, but you said about a third of the guidance reduction was the second quarter miss. I was wondering if you'd be willing to bucket the remaining reduction between the categories you talked about, the shift offshore, the project delays, pipeline delays. And then I guess the other question is how much kind of downside had you booked into the guidance? In other words, are you expecting things to get worse from here or get better?

Guo Xiao

Sure. Thanks, Matt. So for the rest of the two-thirds, if we want to bucket it, it will be three buckets: project turnover, potential project turnover due to client-specific decisions. Actually, one of them, as I mentioned earlier, is 1 of our top 10 clients. And then the second is slower pipeline conversion and then finally acceleration of work moving from onshore to offshore.

It's probably more -- the first two is probably more significant than the final one, so maybe perhaps around 40% each is the weight we want to put out the first two factors, and maybe 20% of the weight we will put it on the third factor. That is for the rest of the three as three buckets, which overall contributed the rest of the two thirds of the reduction. And then, sorry, you had a second question, I think I missed that.

Matthew Van Roswell, RBC Capital Markets

Yes. I guess how much sort of conservatism have you built into the guidance?

Guo Xiao

Yes, that's right. So, we definitely feel comfortable with the guidance we've put out there from a visibility perspective. Yes, there is project turnover and we already know there's one and we probably expect some surprises at some point. But we're not seeing signals of more than we have seen to come from just a volume perspective.

And then from a pipeline conversion perspective, we do have more coverage for Q3 and Q4 than we had for Q2 from a volume perspective and from a number of leads perspective, from the size of the pipeline perspective. And then we factored in a slower conversion rate, a lower conversion rate based on what we have observed in Q2. So we already, I think in our situation, factoring the worst-case scenario we've seen in the previous quarters and used that as the way to calculate our conversion rate for Q3 and Q4.

And overall, I think from a visibility perspective, our bookings in Q1 continue to be solid. Our bookings in Q3 despite the revenue -- sorry, in Q2 -- despite the revenue shortfall compared with a year ago, our bookings is actually the same as a year ago. So all these -- put all these together, we feel that we have put a comfortable guidance. We feel that's achievable in front. And then we feel that our -- if we focus on executing, we're in good shape to meet the guidance.

Operator

Thank you. This concludes the Q&A portion. I'd like to turn the call back over to Xiao to make closing remarks.

Guo Xiao

Thanks, and thank you, everyone, for joining us today for our Q2 earnings call. I'd like to acknowledge the continued support of our Board and shareholders, and 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. This concludes the program. You may now disconnect. Everyone, have a great day.

