Kyndryl Holdings, Inc.
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Corporate Speakers

- Lori Chaitman; Kyndryl; Head of IR
- Martin Schroeter; Kyndryl; CEO
- David Wyshner; Kyndryl; CFO

Participants

- Tien-Tsin Huang; JPMorgan Chase & Co; Analyst
- James Friedman; Susquehanna; Analyst
- Divya Goyal; Scotiabank; Analyst

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PRESENTATION

Operator^ Good morning. Welcome to the Kyndryl Fiscal Third Quarter 2023 Earnings Conference Call. (Operator Instructions)

Please be advised that today's call is being recorded. I would now like to turn the call over to Lori Chaitman, Global Head of Investor Relations at Kyndryl. Thank you. You may begin.

Lori Chaitman^ Good morning, everyone, and welcome to Kyndryl's earnings call for the quarter ended December 31, 2022, the third quarter of our fiscal year.

Before we begin I'd like to remind you that our remarks today will include forward-looking statements. These statements are subject to risk factors that may cause our actual results to differ materially from those expressed or implied, and these statements speak only to our expectations as of today. For more details on some of these risks, please see the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2021. Kyndryl does not update forward-looking statements and disclaims any obligation to do so.

In today's remarks, we'll also refer to certain non-GAAP financial measures. Corresponding GAAP measures and a reconciliation of non-GAAP measures to GAAP measures for historical periods are provided in the presentation materials for today's event, which are available on our website at investors.kyndryl.com.

With me here today are Kyndryl's Chairman and Chief Executive Officer, Martin Schroeter; and Kyndryl's Chief Financial Officer, David Wyshner. Following our prepared remarks, we'll hold a Q&A session.

I'd like to now turn the call over to Martin. Martin?

Martin Schroeter^ Thank you, Lori, and thanks to each of you for joining us today. Kyndryl is continuing to drive progress both as the world's leading provider of IT infrastructure services and as an independent public company.

On today's call, I'll update you on our strategy and the meaningful progress we've made on our three A's initiatives, Alliances, Advanced Delivery and Accounts. David will then provide you with a more detailed review of our financial results and discuss our full year 2023 outlook.

Our transformation is well underway, and I'm proud of what our teams have accomplished. The essential non-discretionary nature of our business provides our revenue streams with some natural insulation to macro factors. As a result, demand for our services remains stable across the markets we serve. Equally important and independent of the broader economy, our continued execution on our three-A’s is delivering the benefits we need to strengthen our overall business performance and drive us toward profitable growth.

Our continued progress, combined with the nature of our business, should ultimately allow us to regularly return capital to shareholders. I'll circle back on this topic in a few minutes.

It's been about 15 months since we became an independent company and the world's largest pure-play IT infrastructure services provider. We employ nearly 90,000 people, we operate in over 60 countries, and we serve thousands of customers. We address a large and growing market through our array of practices and service offerings. With 30 years of mission-critical experience, we have unmatched technical expertise in managing complex hybrid IT environments for large organizations.

And in our business, scale matters. It gives us the ability to invest in leading technology, advanced delivery and automation, enabling us to expand our competitive advantage as well as our comparative advantage over in-sourced infrastructure management.

In this environment, we've been successfully executing on our three-A’s initiatives to drive business performance, and we're on track to deliver on our fiscal 2023 milestone. As a reminder, we provided a target of $1 billion in signings tied to hyperscaler alliances this fiscal year, $200 million in annualized cost savings from Advanced Delivery fiscal year-end and $200 million of annualized pretax benefit from our Accounts initiative. And our transformation work will not be done after this fiscal year. Over the next few years, we expect these initiatives to generate $1.6 billion in annual benefits.

In the first 9 months of this fiscal year, we generated $750 million of hyperscaler signings, putting us right on track to achieve our $1 billion year 1 target for our Alliances initiative. The number of customer contracts that now include a hyperscaler-related component has tripled since the start of our fiscal year. We've also continued to increase our hyperscaler certifications on top of our pre-existing IBM cloud certifications to nearly 32,000, a 98% increase from a year ago.

Our Advanced Delivery initiative has freed up over 4,500 delivery professionals this year to backfill attrition or address new revenue opportunities. At the same time, it's generating annualized savings of more than $225 million, surpassing already our $200 million fiscal 2023 year-end objective.

And in our Accounts initiative, we're addressing elements of our business with substandard margins. In many cases, we're driving margin growth by expanding the scope of work and optimizing our cost base through automation and greater standardization. We're now realizing pretax benefits of more than $130 million a year and progressing toward our $200 million year-end run rate goal.

Similar to last quarter, I want to share some customer success stories that demonstrate our team's execution on our three A’s. The underlying theme among these examples is that the combination of our broader ecosystem and expanded capabilities is resonating with our customers and providing Kyndryl with new revenue streams and higher margin opportunities.

Through our Alliances initiative, we won a new relationship valued at $170 million to provide Kyndryl Consult services and migrate workloads to a modern hybrid cloud infrastructure for a company in the services industry. Additionally, with an insurance company who's been a long-term customer of ours, we've expanded our scope of work to include cloud migration and hyperscaler services in order to accelerate their digital transformation and drive efficiencies. And for an industrial manufacturer, we're integrating our customers' IT operations into a hyperscaler ecosystem.

In Advanced Delivery, we've increased resiliency by more than 75% for a global consumer products company, enhancing system stability and availability. For an industrial company, we've created an opportunity to generate approximately $15 million in incremental annual revenue by expanding the scope of work to include network and edge automation. And for a global energy company, we reduced our staffing by 24% and increased system stability through automation and new ways of working.

In Accounts, for a large transportation company, we're increasing our gross margin by 50 percentage points by re-scoping our contract to those areas that make economic sense for us. This new contract will add $14 million in gross profit over the next 5 years. With a leading manufacturer, we extended our contract with a 25 percentage point increase in gross margin through delivery efficiencies, automation and changes in scope. And for a major technology company, we renegotiated specific elements of our contract prior to expiration to bring more flexibility to both our customer and Kyndryl. In the process, we're realizing an increase in gross profit of more than $25 million over the life of the previous contract.

Many of us at Kyndryl regularly engage with CEOs and CIOs of large organizations, which gives us insight into the technology challenges they face and the opportunities they see. This helps shape our view of the market and how we can evolve to meet our customers' needs and objectives.

Here's what we're hearing:

From financial institutions to manufacturers to transportation providers, virtually all firms operating at scale also need to be technology-driven companies, relying on IT infrastructure to operate and go to market.

Hybrid IT environments will continue to be the norm for most large organizations, and putting the right workload on the right platform will provide ongoing opportunities for cloud migration and optimization.

While enterprises are continuing to modernize their IT estates, many have already tackled the simplest transitions as it relates to cloud migration. As a result, their progress increasingly relies on complex optimization work in order to advance enterprise innovation.

Cyber threats are proliferating and cyber hygiene and resiliency are as important as ever to companies and their Boards.

5G, AI and data optimization are co-evolving in ways that will likely drive technological development and investment for the remainder of this decade. This includes both the machine learning associated with managed infrastructure services and companies' operational and go-to-market uses of AI.

Organizations are looking to better tailor their employees' tech experiences in order to drive productivity and engagement.

And lastly, companies are optimizing, automating and engaging with service providers to save money in today's more restrained economic environment.

Each of these trends play to our strengths. They present Kyndryl with opportunities in both managed services and advisory work and position us for sustainable, profitable growth. We are working with our customers around the world to address these macro trends through our practices, through our scale and established presence in lower cost markets, through innovation driven by Kyndryl Bridge, Kyndryl Vital and Kyndryl Consult and through our global alliances with leading technology companies. We are very excited about how technology is evolving and the role Kyndryl is playing in that evolution.

As I mentioned, our alliances are an important element of our business transformation. With our freedom of action as an independent company, we've built an ecosystem that is more relevant to our customers and allows us to provide higher value services that we weren't able to provide before. Our longstanding relationship with IBM continues to be important but so are our significantly expanded top tier alliances with Microsoft, AWS, Google, Cisco, Dell, Oracle, Red Hat, SAP, VMware and many others.

We're building on these relationships and seizing new growth opportunities often with our existing customers. Over the last year, we've co-created and launched new capabilities with our alliance partners and doubled our hyperscaler-related deal pipeline. In November, we hosted our first ever Alliance Leadership Summit, where our senior leaders and our alliance partners engaged in collaborative discussions to accelerate joint go-to-market opportunities and joint business outcomes. Our customer base and our credibility with our customers make us a highly sought after partner and we've chosen our technology alliances intentionally.

This past quarter, we expanded our relationship with AWS to support their new security solution tailored for industry and company specific needs. To accelerate cloud transformation projects, we're helping our customers leverage our relationship with Microsoft and Dell to implement and manage integrated hybrid cloud solutions. And we've been collaborating with Intel to design and implement private 5G networks for joint customers.

In recent months, we've also given our customers and our alliance partners more clarity on how we'll collaborate and surface innovation. We've branded these efforts Kyndryl Bridge, Kyndryl Vital and Kyndryl Consult.

Kyndryl Bridge, our open integration platform, is at the core of our technology strategy and transforming the way that we deliver our services. It enables us to scale modern systems management capabilities, integrating operational data, our intellectual property, our solution and partner offerings and insights through integrated AI operations. As a result, Kyndryl Bridge is how we help our customers manage modernization across their complex global IT estates.

Since our launch in late September, we've already onboarded nearly 500 customer accounts to integrated AI ops that are at the core of Kyndryl Bridge.

Kyndryl Vital redefines how we engage with customers and co-create innovative solutions through a design-led approach. Our ability to be an objective expert across an array of technologies allows us to advise and collaborate with customers in ways we could not when we were an IBM captive. And our Vital methodology provides the foundation for a personalized result-oriented environment to solve and create solutions in an easy-to-consume way.

And Kyndryl Consult ties it all together, using Bridge and Vital to highlight our capabilities and our differentiation as we provide our customers with ways to handle their most vexing technology challenges and make it easier for them to do business with us. Year-to-date, Kyndryl Consult signings have increased 32% in constant currency compared to the prior year period, and they now account for approximately 12% of our revenue.

With Bridge, Vital and Consult, customers are telling us that Kyndryl is showing up differently for them. This is creating opportunities for us to capture some of the larger addressable market now available to us and to grow our share of wallet with our customers.

When I look back on Kyndryl's transformation to date, 2022 was a period of transition and building as we began to rewire our new firm. With that strong foundation, our progress continues. We're building a purpose-driven company and committed to being a strong corporate citizen.

In December, we announced our long-term target to reduce our overall carbon emissions to net zero by 2040 and committed to at least a 50% reduction by 2030 following science-based frameworks. Our decarbonization plan aligns with our business strategies because we see opportunities to consolidate our legacy real estate and data center footprint as well as our supply chain to more sustainable infrastructures.

2023 will be a year of acceleration. We will continue to execute our strategy to drive profitable growth. We expect to make significant progress on our three-A’s initiatives as this is our fastest path to growing our business and delivering more value to our customers, employees and shareholders.

We will lean into the opportunities associated with a tougher macro climate and companies’ enhanced focus on managing costs, which aligns with what we do. And we'll continue to operate with our new mission, serving our customers in what we call the Kyndryl Way, being restless, empathetic and devoted in our pursuit of operational, strategic and financial progress.

Looking beyond 2023, when most, if not all, of our separation-related expenses and costs are behind us, we'll be driving our business toward sustainable revenue growth, significant margin expansion and meaningful cash flow growth. We are committed to maintaining a strong investment-grade balance sheet, and will seek opportunities to further strengthen our credit profile. Given the nature of our business, and once we've made clear progress in strengthening our margins, we'd expect to be positioned to ask our Board to evaluate returning capital to shareholders.

We have the right strategy in place to do this, and I'm confident we have the right leadership, talent, know-how and partnerships to execute and transform our business.

Now with that, I'll hand over to David to take you through our results and our outlook.

David Wyshner^ Thanks, Martin, and hello, everyone. Today, I'd like to discuss our quarterly results, our balance sheet and liquidity, the importance of our three-A’s initiatives and our outlook.

Our financial results for the quarter ended December 31, our fiscal third quarter, reflect progress on our top line growth efforts, external factors such as currency movements and sequential margin expansion. In the quarter, we generated revenue of $4.3 billion, which represents a 2% increase in constant currency from our pro forma results a year ago, led by 19% growth in Kyndryl Consult and increased seasonal factors this year, including amounts related to customer contracts with minimum annual revenue commitments and seasonal variances in volumes. Demand for our services has remained resilient amid increased global macro uncertainty.

Kyndryl Consult signings and revenue were both at record levels, with Consult representing 20% of our total signings and 12% of our total revenue. Consult signings translate into revenue at a faster pace, given that they're more in-year project-based work compared to our long-term managed services activities.

Adjusted EBITDA in the quarter was $580 million. This represents an adjusted EBITDA margin of 13.5%. The year-over-year decline in our adjusted EBITDA margin compared to pro forma 2021 results was primarily due to currency, partially offset by higher revenue and benefits from our three-As.

Adjusted pretax loss was $4 million.

Currency movements had a negative year-over-year impact of $90 million on adjusted pretax income. As we've mentioned before, currency is having a significant impact on us because we have dollar-denominated costs in our global operations in addition to having international earnings. And our currency hedges in various contractual protections haven't fully offset the effects of the unprecedented dollar strengthening that occurred in 2022.

Higher revenue and progress on our three-As helped to offset currency impacts and inflationary cost pressures.

Among our geographic segments, we delivered year-over-year constant currency pro forma revenue growth in 3 of our 4 segments. And our strongest margins were again in Japan and the United States. Changes in exchange rates and how various IBM-related costs are impacting each of our segments under our commercial agreement with IBM complicate year-over-year margin comparisons by segment.

We address our customers' needs not only through our geographic operating segments, but also through our 6 global practices: Cloud, Applications, Data & AI, Security & Resiliency, Network & Edge, Digital Workplace and Core Enterprise. Our business mix continues to evolve to reflect demand, with most of our signings, including Kyndryl Consult signings, coming from Cloud, Apps/Data & AI, Security and other growth areas.

In short, if it weren't for currency movements this quarter, we'd be reporting year-over-year revenue growth and positive pretax margins. On a reported basis, however, currency is masking the operational progress we're making. And as I mentioned, while significant macro uncertainty persists, we continue to see broad-based demand for digital transformation and infrastructure services.

Turning to our cash flow and balance sheet. We generated adjusted free cash flow of $407 million in the 9 months ended December 31. We've provided a bridge from our adjusted pretax loss to our free cash flow so far this year. Our gross capital expenditures have been $711 million year-to-date, and we've received $20 million of proceeds from asset dispositions. Our capex has been somewhat front-loaded this fiscal year. Working capital is contributing to cash flow as we've stepped up our management of both receivables and payables globally.

Our financial position remains strong. Our cash balance at December 31 was $2.0 billion. This is above the September 30 level despite our anticipated but significant use of cash for transaction-related payments in the quarter. Our cash balance, combined with available debt capacity under committed borrowing facilities, gave us more than $5 billion of liquidity at quarter end.

Our debt maturities are well laddered from late 2024 to 2041. We had no borrowings outstanding under our revolving credit facility, and our net debt at quarter end was $1.2 billion. As a result, our net leverage sits well within our target range. We are rated investment grade by Moody's, Fitch and S&P. And we're happy to have the overhang associated with IBM's sale of its retained stake in Kyndryl behind us.

On the topic of capital allocation, our top priorities are to maintain strong liquidity, remain investment grade and re-invest in our business. As we've said before, we view being investment grade as a commercial imperative given the importance of this to our customers, many of whom operate in regulated industries. We're using the free cash flow we're generating this year to fund spin-related cash outlays, including required systems migrations.

As Martin indicated, Kyndryl's business characteristics, combined with the contributions that we expect from our three-A initiatives over the medium term, should allow us to expand our margins. And that ultimately should allow us and our Board to consider regularly returning capital to shareholders, all while remaining investment grade.

For fiscal year 2023, we're raising our revenue outlook and reaffirming our margin outlook from what we provided last quarter.

We're increasing our constant currency revenue growth outlook by 0.5 point to reflect the strength we saw in the third quarter and growth in Kyndryl Consult.

And we're increasing our reported revenue outlook that will also reflect currency movements.

On a reported basis, currency is impacting our top line by more than 7 points year-over-year, and we're now projecting fiscal 2023 revenue of $16.8 billion to $17.0 billion, which compares to our previous guidance of $16.3 billion to $16.5 billion. Currency movements have impacted our projected adjusted pretax margin by roughly 150 basis points year-over-year.

As we head into our fiscal fourth quarter, we're driving operational progress to mitigate external headwinds. On the positive side, and importantly, we continue to grow the P&L benefits that our three-A initiatives are providing, and we're managing costs carefully. On the flip side, currency and energy cost pressures remain, the seasonal uplift in revenue we had in Q3 won't repeat in Q4, and our IBM software costs increased with the start of the new calendar year. In aggregate, these items point us toward the mid-point of our full year guidance.

Our focus is on delivering the benefits we anticipated from our three-A initiatives, while we invest to drive innovation and future growth.

From a cash flow perspective, we're now projecting roughly $800 million of gross capital expenditures in fiscal 2023 compared to about $900 million of depreciation expense.

For us, the March quarter is a seasonally soft period for cash flow, driven by the combination of earnings seasonality and required annual software licenses and other prepayments.

Looking ahead, we plan to provide full year fiscal 2024 earnings guidance when we announce our full year fiscal 2023 results in May.

Over the medium term, we remain committed to returning to sustained revenue growth by calendar 2025, delivering significant margin expansion and driving free cash flow growth. We also expect to mitigate the effects of recent currency movements over time, even if exchange rates don't revert back toward historical norms. We have a solid game plan to drive our strategic progress, and this game plan starts with the steps we've already taken to expand our technology partnerships and with the meaningful initiatives we're implementing this year.

As Martin mentioned, we continue to progress on our three-A's initiatives. Our momentum supports our expectation that:

Our Alliances initiative will drive signings, revenue and over time, roughly $200 million in annual pretax income.

Our Advanced Delivery initiative will drive cost savings, equating over time to roughly $600 million in annual pretax income.

And our Accounts initiative will drive annual pretax income of $800 million.

We're also driving growth in Kyndryl Consult and among our global practices, which is incremental to the benefits coming from our three-A’s initiatives, and we see opportunities to control expenses throughout our business. We expect that these efforts over time will contribute roughly $400 million in annual pretax income.

As part of these efforts and with the restrictions in the Employee Matters Agreement related to our spin having expired, we can and will look at potential actions to reduce our expense base and foster increased productivity.

In total, the magnitude of the earnings growth opportunity we're tackling is tremendous, relative to our current margins. Progress on our three-A’s will, therefore, be a central source of value creation for Kyndryl.

And for any investors who have been following the Kyndryl story, I've included an updated version of a slide we first published in May. It's the slide that provides a break-down between our margin-challenged focus accounts and the rest of our business.

As you will recall, our aggregate results obscure the fact that within Kyndryl, we started with a strong $10 billion business, which we refer to as a blueprint for how we want to operate. This blueprint consists of accounts that represent about 60% of our revenue, generate average gross margins north of 20% and reflect our ability to get paid appropriately for the mission-critical services we provide.

Our other roughly $8 billion of focus accounts revenue generates virtually no gross margin and after SG&A expenses is losing money. Our Accounts initiative is all about the opportunity to make our focus accounts look more like the majority blueprint of our business over time by addressing elements of our customer relationships that generate substandard margins.

Over time, if we close even half of the gross margin gap between our focus accounts and our blueprint accounts, we’ll generate the $800 million in incremental earnings that we've targeted from these accounts. That's why our Accounts initiative is a major priority and a major opportunity for us.

To realize this opportunity, we're paying close attention to the margins on signings for both our focus accounts and our blueprint accounts. Since the beginning of our fiscal year, the overall expected gross margin on our signings has been in the low to mid-20s, which means that the pretax margin has been in the mid to high single digits. The December quarter was a continuation of that favorable trend.

We're achieving this exactly as we've intended and as you'd probably expect. In our blueprint accounts, we're delivering increases in expected margins of a point or 2. In our focus account signings, we're dramatically changing our margin profile with the average gross margin moving to the low to mid-20s, which is within a few points of where blueprint accounts operate. In short, our strategy is driving the results we've targeted.

What that also means is that if our P&L for the next few quarters reflected only our recently signed deals, we'd be operating at mid- to high single-digit adjusted pretax margins. But because of the prevalence of multi-year contracts in our business, most of our revenue is still coming from lower-margin pre-spin legacy signings.

As a result, in our aggregate numbers, you can't immediately see the benefits of a higher margins at which we're now pricing contracts. But that will change with time as our business mix increasingly tilts toward more post-spin contracts.

In closing, as an independent company, we're solidifying our position as a cost-effective gold standard provider of essential IT services. We're signing new contracts at higher projected margins. And we're executing on the strategies and initiatives that will drive longer-term progress, future growth and stronger earnings in our business.

With that, Martin and I would be pleased to take your questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) We'll take our first question from Tien-Tsin Huang with JPMorgan.

Tien-Tsin Huang^ I want to ask on the signings front. David you were just commenting on that. The signings were ahead of our expectations here. So can you maybe just elaborate on the better margin profile of the deals. So I know that David just went through some of that but I'm just asking because we get questions from investors all the time about clients focusing on cost cutting, so what does mean for pricing, et cetera? But it sounds like you're getting better pricing and better delivery so can you just square that for us. Thanks.

David Wyshner^ Sure, Tien-Tsin. That's exactly right. On the signings that we have there were $3 billion of signings in the quarter. We're seeing a mix that's similar to our overall business. So far this year roughly 60% of our signings have been in Blueprint accounts, about 40% in Focus accounts. And what we're -- what we're, as I mentioned, what we're doing is keeping the Blueprint accounts similar to where they've been, maybe up a point or two and really driving major progress on the Focus accounts.

And the way we're getting there is by running the plays, as we've called them, that we want to have to make our Focus accounts better. It can involve expanding the scope of relationships, having more Consult business associated with them. Sometimes taking elements of scope out that aren't economic or that won't be economic for us. As well as adjusting pricing to get there.

And then the combination of those actions is producing exactly the sort of impacts we want to have on the margins associated with these accounts. In fact, one of the things we're looking at and tracking internally is how much year one gross margin and how much aggregate gross profit we're signing on our -- on the new contracts that we bring into the fold and add to our backlog. And we're really excited about the gross margin and the gross profit that we're adding with our sales and renewal activities.

Tien-Tsin Huang^ All right. Great. And thanks for going through that. Maybe my follow-up I'll ask on the outlook. You did raise your revenue outlook by $500 million, the margins are the same. How much of the raise in the revenue was from upside to the third quarter versus a raise in the outlook, I heard Consult was doing quite well.

And maybe just any comments on gross margin, which was quite strong in the third quarter. Curious of your thinking on gross margin in the fourth or ahead has changed. I know it takes time to feather in the gross margin changes from signings, but figured I'd ask it up front here. Thanks.

David Wyshner^ Yes, when you look at the revenue raise, the constant currency revenue increases about a half a point at the low end and the high end and the mid-point. So, the majority of the increase is in the absolute dollar forecasted revenue is due to currency, but we're seeing about a half-a-point increase due to operational activity.

I would say a fair amount of that was in the third quarter, but the Consult piece we expect to play out and favorably influence the fourth quarter as well. The Consult signings have been really strong this year and that should benefit us in the fourth quarter and even as we turn the page into fiscal '24.

I think the margin elements associated with the -- with the signings that we've had will come in over time. Some of the Consult business is, it tends to turn into revenues faster. And those margins will come through.

On the flip side, when we extend a managed services contract sometimes that actually has 6 or 12 months to run on the preexisting contract. And that's often the piece where it's hardest for us to increase the pricing. We end up focusing on the pricing over the duration of the contract extension.

So, if we have to sort of continue or near continue the pricing that's already in place, we'll end up getting some more of the aggregate margin in the later years or the non-first year of the -- of that contract extension. And that's really why the margin improvement associated with signings layers over time.

Martin Schroeter^ Yes, the other thing, Tien-Tsin, and thanks for joining this morning, I'd add to David's from a -- at a high level, I think what to me is particularly encouraging and I've been very impressed with how much this team has gotten done in a short period of time. We have brought high-value offerings to market that really reflect where our customers want to take us, where they want us to help them.

And so, what you're seeing here is a lot of momentum on the signings line because of the role we play in these environments combined with the -- combined with the work this team has done in creating high-value offerings in the practices that we're taking to market. So, this, as David said well, these show up in the -- in the P&L over time, but this momentum is continuing to build as we -- as we get ready to get back to consistent revenue growth.

And as David pointed out, if we just had in the P&L what we signed now, we'd already be at what we have recently signed, we'd already be at a really good profit margin relative to today. So, a lot of what you're seeing is a -- the result of a team working very quickly given the role we play in our customers' environments very quickly to retool, bring to market higher value offerings that make us a solid part of our customers' future and that momentum, I expect, will continue.

Lori Chaitman^ Thanks, Tien-Tsin. Operator, do we have another question in the queue, please?

Operator^ And we will take our next question from Jamie Friedman with Susquehanna.

Jamie Friedman^ Nice results here. Martin, in your prepared remarks at the beginning you had something in the effect of the business being naturally insulated to macro factors. Being that macro is so topical, Martin, I was hoping you could elaborate on that comment.

Martin Schroeter^ Sure. Sure, Jamie. So look, the role we play in our customers' environments, running mission-critical systems does naturally insulate us from sort of the highs and lows, if you will, of a lot of economic activity at the end of the day of business. And remember, we serve the most important companies on their most important mission-critical processes. These businesses have to stay and run their infrastructure seven days a week, 24 hours a day. That’s the nature of what we do.

And so, while customers may have a different view of their economic situation going forward, they still have to run their infrastructure. And, in fact, as the -- as the economies volatility -- as our customers start to plan for that volatility, we sit right at the sort of the heart and the center of how they can be helped most because they look to us to help them become more efficient. They look to us to help them optimize all of which helps them deal with the economic realities of their customers, their end users or the markets in which they operate. So, we have a natural insulation because of what we do.

And in a -- and in a really, I think, a really positive way for us, we tend to thrive in environments where they get really focused on optimizing, they get really focused on productivity because that’s what we do for a living. So, this is a good environment, a good demand environment for us, stable because of what we do today, but a set of capabilities and offerings that can help them navigate what could be a more volatile economic environment.

Jamie Friedman^ Got it. And then for my follow-up, David, this Slide 18 is really quite innovative. And it's really a good practice. So this is the one where you're talking about Blueprints versus the Focus accounts. And I apologize, I don't know this if you disclosed it, but what percentage now of the Focus accounts have you remediated and tried to price? And -- or if you have not disclosed it, is it possible through the disclosures you have to back into it in some way?

David Wyshner^ Sure. Thanks for the comments on Slide 18. I think it's really an important one. And what we really wanted to highlight -- one of the things we really wanted to highlight on this call was the real progress we're making in signing or extending Focus accounts, amending those relationships, in a way that is substantially changing the profitability of Focus accounts and we'll substantially change it going forward. I think it's a really important proof point of execution by our team on the strategy we laid out.

The way I would think about Focus accounts is that a lot of these are multiyear managed services relationships and working through the portfolio of most of the Focus accounts is going to be a 4-year exercise, I think, with maybe a little bit of a tale of a few longer-term accounts that are on there. And we're 9 months into that 4-year exercise. So that would -- the math associated with that would be 20-ish percent.

I think there are 2 additional things going on. First, the first few months of that, it's a ramp-up period associated with it. And as a result, we may not have had a full 9 months of progress there. On the flip side, we are finding opportunities to make progress on Focus accounts even before they come up for renewal by adding scope, by adding Consult business in there, and that's going to be helpful to us.

And I think that puts us in a position where, over the next 12 months, the opportunity in front of us is to make ideally an outsized amount of progress relative to the overall 4-year play that we're going to have.

Lori Chaitman^ Operator, do we have another question in the queue, please?

Operator^ We do have one final question from Divya Goyal with Scotiabank.

Divya Goyal^ Great quarter. Just talking about the Focus accounts and the Blueprint accounts, I actually was wondering if you could give some color on the specific market, if that is one of the areas we could talk about, where the Focus accounts are somewhat like -- where they're kind of growing? Because when I look at your EBITDA margin, U.S. is in a good shape. It's the principal markets that need a little bit of margin expansion. So would your Focus accounts be in those markets or would that be a thing for later?

Martin Schroeter^ Divya, thanks for calling. Look, the Focus accounts are kind of spread around the world. There's not one location where I'd say that we have the most or the few as it is, it is pretty well spread. So we have opportunity in each of the markets to improve our margin profile.

Now having said that, with them spread, we do have a slightly disproportionate share in Europe, which is what you -- which was a big part of what sits in those primary markets. So slightly more, but nothing that says we don't have opportunity everywhere.

As for sort of the other view of markets, there's obviously a geographic view, right, the country view. But the other side of this, and David talked about this, I thought quite well, the offerings we're bringing in are reflective now of the value we're creating in spaces like cloud management, in spaces like security and resiliency, in spaces like data applications in AI.

So the country is pretty spread slightly disproportionately heavier in Europe and other places. But what we're bringing into these relationships in this -- in a hybrid cloud world, is around the places our customers are going. And now we're getting paid quite well for the value we're creating in, again, data and AI, security and resiliency, et cetera, et cetera, et cetera. So hopefully that adds a little color for you.

Divya Goyal^ That's helpful. We look forward to the progress. If I can shift some gears here and ask a question on your overall debt profile and your expected leverage levels, that would be helpful here.

David Wyshner^ Sure. Our net debt right now is around $1.2 billion, a combination of $3.2 billion of debt, minus $2 billion of cash on the balance sheet. And as we think about it, we really -- we'd like to keep our net leverage in a range of 0 to 1x EBITDA. We're well within that range right now, and we think that's appropriate for the business, particularly now while -- during a period of time, while our margins are still a bit challenged and where we need to make progress. So we've been targeting 0 to 1x leverage and remaining investment grade and continuing to improve our credit profile over time is very important to us.

Martin Schroeter^ All right. Let me -- sorry, operator. Let me just thank everybody for joining us today. As you can tell, I hope from our prepared remarks as well as from the Q&A, we've made an enormous amount of progress in a relatively short period of time, both with the three-A initiative as well as what we've talked about as well in -- for the last year, the plus-plus, which is getting our consulting business to grow much, much faster, which is being successful and focusing, obviously, on expense management as we retool how we do our work and put contemporary systems and contemporary tools in place.

So I feel as confident as I ever have, given all the progress we've made. We are all excited about the opportunity we see ahead. And the role we play in the world in serving our customers' mission-critical systems is one that regardless of the economic environment, is one that is going to need Kyndryl.

So we are excited about the future. Again, thanks for calling. And operator, I'll turn it back to you.

Operator^ This concludes today's Kyndryl Third Quarter 2023 Earnings Call and Webcast.

Forward-Looking Statements

This transcript contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this transcript, including statements concerning the Company’s plans, objectives, goals, beliefs, business strategies, future events, business condition, results of operations, financial position, business outlook and business trends and other non-historical statements are forward-looking statements. Such forward-looking statements often contain words such as “will,” “anticipate,” “predict,” “project,” “contemplate,” “plan,” “forecast,” “estimate,” “expect,” “intend,” “target,” “may,” “should,” “would,” “could,” “seek,” “aim” and other similar words or expressions or the negative thereof or other variations thereon. Forward-looking statements are based on the Company’s current assumptions and beliefs regarding future business and financial performance.

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