“Infosys Management Update Conference Call”

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Moderator

Ladies and gentlemen good day and welcome to the Infosys Management Update Conference Call. As a reminder for the duration of this conference all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Ms. Mitali Ghosh. Thank you and over to you madam.

Mitali Ghosh

Thanks laveena and welcome to everyone. Good afternoon and good evening**.** Essentially, this is a very critical quarter where I think, most investors are trying to get a sense what the early indications of the budget are for next year and in that respect we are very happy to have caught some time from Mr. Pravin Rao who as you know is The Global Head Of Retail Consumer Package Goods, Logistics and Life Sciences and member of executive council at Infosys. This sector which has done extremely well this year and we wanted to update in terms of what is looking right now. So with that I'll hand it over to you Pravin for any opening remarks you might like to make and then we will open it for Q&A.

Pravin Rao

Thanks Mitali. Good morning, good evening and good day to everyone. I will just spend a few minutes talking to you little bit about recapping on Q2 and what we are seeing today in Q3 and then we will have enough time for Q&A. Just to recap we had a good Q2 with a quarter-on-quarter growth of 4.5% or actually 5% on a constant currency basis. Our margin also expanded by 190 basis points largely due to rupee depreciation, on a constant currency basis pricing realization also went up by 100 basis points. We added about 45 clients including 7 fortune 500 clients and about 19 of those client were in some of the focus area where we are investing. And coming back to the current quarter I think the macro environment continues to be challenging and to some extent the negativity and the noise levels have increased in the last few weeks. We have seen continued volatility in the currency; we have seen our clients cautious with their spends. These are reflected in longer deal closure time, lower pace of ramp ups and increased scrutiny on the discretionary projects and large deals. At the beginning of the quarter we had guided for 3.2 to 5.4% quarter-on-quarter growth and based on what we see today we expect to be closer to the low-end for guidance. And overall execution is a similar across verticals and across geographies as well so at least we are not seeing anything significantly difference when compared with other various verticals or geographies. At the same time we're not really seen any major project cancellations or ramp down barring odd ones here and there and pricing is also stable. Though on deal specifics places it continues to be extremely competitive and overall pipeline also decent across verticals and geographies but decision making is slow and reflected in the spend. And overall net –net I have talked broadly about the Infosys perspective but the same thing also applies to the retail. So I'll actually stop here and probably we will getting into Q&A.

Mitali Ghosh

Laveena, if we can start the Q&A, please.

Moderator

Sure madam. We will now begin with the question and answer session. Anyone who wishes to ask a question may press “*” and then “1” on their touchtone telephone. If you wish to remove yourself from the question queue you may press “*” and “2”. Participants are requested to use handsets only while asking the question. Anyone who has a question may press * and 1 at this time. Our first question is from the line of Arjun Karnani from Amiya Capital, please go ahead sir.

Arjun Karnani

Sir, good afternoon. Sir, my question is can we be worried about the long-term marginal implications for the Infosys especially in the event of recent rupee base margin benefits given that the Infosys have become little aggressive with its pricing?

Pravin Rao

No, I think, the overall margin perspective to a large extent we are seeing impact of margin from the currency volatility perspective but when we look at it from a pricing perspective, I think pricing of at least so far been stable, unlike in 2008 during the recession clients used to come back and ask for 10% to 20% cut in prices that so far we are not seeing today and in fact at least looking at my own vertical, the contracts have come up for renewal, we are at least 70% to 80% of the cases we got price increases both on-site and as well as offshore. For to that extent the situation now is different from what we saw during the recessionary period but at the same time the other trends we are seeing that any deal of significant say anything more than 3 or 5 million-dollar, it's now up for competitive bidding and so in those cases, obviously it's not only about solution and to some extent it is about pricing so we have two be probably little more aggressive on pricing but this situation which we are seeing from the beginning of this year and so far we are held good on the margin front. So net- net unless it dramatically changes or clients come back and have for aggressive pricing cuts we believe that we should be able to hold margins and we have anyway enough levers in our control. At this stage, I don't see too much of the in fact at the beginning of the year we had said that the margin dropped by 400 basis points for the year but I think now we have revised the down to probably for the year, margin will be probably as compared to last year will go down by 50-100 basis points. Again to a large extent held by the currency volatility but net-net at best as things stands today the margins will be under pressure, we don't see too much of deterioration at this stage.

Arjun Karnani

Okay and sir given the kind of global environment and the macro uncertainty, do we see lot of competitive intensity in the industry?

Pravin Rao

Actually there is been consolidation. In the last few years post the recession there has been consolidation today on an overall if you look at globally there are about seven or eight Tier 1 players in this space and we have Accenture, IBM and Deloitte then we have companies like Infosys, TCS, Wipro, Cognizant and to some extent sometimes an infrastructure deals we across HCL. In our European context we sometimes come across Capgemini or Aldata so there are largely there are 7 to 10 players which are involved in most of the deals. Most of the clients today have to standardized on their partners so they typically work only with three or four preferred vendors and more often than not, I mean sometimes in one area either there would give certain functional areas to each of these partner or sometimes we are seeing clients earmarked one vendor for doing maintenance but for development and other things they probably leave it out to the other preferred vendor. So in that sense the competition has narrowed down and it has been intense because I think there are only few players and each one is trying to compete aggressively and historically as I said earlier about couple of years back if you have working in a particular area by and large any new development in that area, you would have mostly got sole sourced but in today's environment I think particularly if it is significant anything more than 3 to 5 million, clients are bidding it out. To that extent I think, the competitive intensity has relatively increased as compared to maybe 2-3 years back.

Arjun Karnani

Okay, thank you so much. That is all from my side. Thank you so much.

Moderator

Our next question is from the line of Anupam Tiwari from Principal Mutual Fund. Please go ahead sir.

Anupam Tiwari

Good afternoon everybody. Sir, can you share some details about the differentiating work or say the kind of nature of work that you are doing in Europe especially in the healthcare segment? Is there any new opportunity coming up, situation that is changing?

Pravin Rao

I think, if I look at Life Sciences segment the Pharma companies, today Pharma companies almost all major Pharma companies are under tremendous top line pressure because most of their blockbusters drugs have come out of patent, like for example recently you would have seen news about Lipitor which was the major patented drug for Pfizer but it recently came out of patents and earlier Pfizer used to do some $15 bn-$20 bn annually on this drug alone but now they are expecting at least about 5 to 7 billion drop in the top line and primarily because of this drug has now become generic. Likewise most of the companies, if you look at Pharma companies worldwide they are all struggling, because there is no other major drugs in the pipeline of the blockbuster drug. So what we are seeing today is suddenly these companies have become much more focused on operational efficiency because historically they used to have lot of money to spend and they used to spend and invest a lot in R&D and other areas. Now with the top line under pressure they have now started looking at operating more efficiently so they have started looking at vendor consolidation, they have started looking at standardizing their package foot print, they have started looking at off shoring and out sourcing in a much bigger, much more strategically than in the past. So these are some of the things that we are seeing in Life sciences sector not only in Europe but even across the world.

Anupam Tiwari

But is it right to assume or say conclude that the kind of off shoring or IT penetration in terms of services and all that, is more in US Pharma companies rather than European Pharma companies?

Pravin Rao

Yes, I mean, that statement is relatively true across not necessarily only for Pharma but across vertical. Today I think the outsourcing and off shoring is much more mature in North America as compared to Europe. In Europe I think in English-speaking countries like UK are some of the countries like Nordics or Benelux we are seeing much more leverage of off shoring whereas when you look at continental Europe particularly the big market like France and German still the degree of off shoring and outsourcing, I mean, they do outsource but I don't think their off shored in a big way. Even during recession period when one would have expected much higher extent of off shoring from these countries which have not really happened so to that extent yes, the statement is correct. But our sense is these countries given their economic recession and there needs to be more efficient and need to cut cost it is a matter of time before they start looking at outsourcing and off shoring in a much more strategic way.

Anupam Tiwari

Can you sir, give us a broadly say kind of size of opportunity that you see in health care especially in Europe in next 3 to 4 years and also if you can share some of your thoughts on because these companies have been little secretive because of their patent products and their domain knowledge. So is this a big challenge in doing a complete outsourcing kind of deal?

Pravin Rao

No, I don't think, I mean, when you look at I once again take the example of a Pharma company and when we look at the life cycle, there are some parts of the life cycle which probably more domain intensive for instance some in the initial phase of discovery and clinical trials and other things, there I think it's probably heavily domain intensive but there would also be technology at play there. Why, IT companies like us take a while to get into the domain side but at least from a technology side we can definitely add value but beyond that thing the rest of the life cycle, if you look at manufacturing, if you look at supply chain, if you look at sales and marketing and other things, these are similar to any other CPG companies kind of thing. So that is where I think, we can bring in a lot more expertise, not only from our expertise within the Pharma industry but also we cross and leverage our expertise in the CPG industries. And today one of the areas where that companies continues to invest a lot is in the areas of marketing and today we see a shift from marketing fronts from the traditional media to the digital media and this we have seen last 1 to 2 year. But the way that they are doing it is very fragmented and so typically wanted to launch or ad campaigns, you engage an ad agencies, you engage your hosting providers to launch the campaign and so on and they actually multiply, when they want to launch the same ad in different regions or when they want to do it across different brands they reinvent the whole thing. So with recent these companies end up working with some 20-30 ad agencies, 20-30 hosting providers and they hardly use any digital assets. So one of the things where these companies have started investing and where we have also an IP in the area of digital marketing, so they have started investing in these areas, they have started building tools and the platform specific to digital reviews and much quicker launching of the ads and other things, so that is one example. So I think these companies will continue to invest in areas of sales and marketing, they will continue to invest in supply chain; they will continue to standardize their ERP footprint and so on. So these are the areas where we are seeing a lot of spend. Many of these areas are as I said, they have the domain knowledge not only in the Pharma perspective from related industry perspective and we definitely have the technical knowledge and that's where we can add value.

Anupam Tiwari

Sir, if we can ask one more question mainly on the retail side. Obviously, US is looking into much better shape but there is a pressure and most of the large retailers and if you see couple of them are actually under stress and there could be a chance in Europe that they would be under more due risk in the near future. So how you are seeing this scenario in your retail segment and if you can be more specific in terms of what is happening in Europe and what is happening in US that would be great?

Pravin Rao

I think both Europe and US if you look at the retailer per se, most of the retailers by in large are doing well. Their sales are showing moderate growth, probably their profitability is at their best ever but what we are seeing is because of all the noise in the environment, underline macroeconomic indicators, they are being very cautious in their spend again when you break down the retail, I mean, when you look at specialty retailer, high end retailer, they are doing extremely well that perhaps having the best, I mean, these are the companies like Nordstroms and other. When we look at grocery supermarket then here I think is probably these are very low margin business, so in this space I think, companies are struggling to some extent and as well as low margin and they are under intense pressure. But when you look at departmental stores and other things some of them are doing well and some of them, probably couple of them are struggling so it is a mixed bag here but ne- net overall if you look at it from a sector prospective both in North America and Europe by and large mostly retailers are doing reasonably well, they are seeing growth and unlike in costs we are hardly seen any retailer go bust because we have hardly seen any retailer fights for bankruptcy or anything in the last 12-18 month or so. So to that extent I think, the situation is lot different from what we saw during the recession. It is just that they are being very cautious in their spend, having a very short-term outlook investments, they are committing their money only for short to medium term, they don't want to commit for long-term and we are not even seen budget cut so far at least from this year we are not seen budget cuts. Budget will remain same but the spending patterns have changed. So spending pattern is more uniform, spending pattern is more on a quarterly basis kind of thing so that is the difference we are seeing as compared to the recessionary years.

Anupam Tiwari

Okay and if may ask you just to understand it little more, apart from the normal outsourcing work, what are the other value added jobs that you are providing to retailers and these providers on supply chain and logistics?

Pravin Rao

We are not only working, today we have to end to end foot print so historically we would have focused more on the operational side where we have would have given them any cost efficiency and labor arbitrage and other things on their application development maintenance but today we have significant presence on their transformation side as well what we call growing their business and as well from the innovation side. So in fact, when I look at my vertical about 40 to 41% of my revenues comes from consulting, package implementation, system integration so which is much higher than even at Infosys level. So when we look at retailers, today they are spending money on reaching up their online presence because the online sales is expanding at a much rapid pace then store and today consumer spending more online than at store and we have more than half a dozen online. We are working with major retailers, more than half a dozen retailers on their multichannel initiatives. Retailers are also today spending, investing the social media because today consumers are listening more to what is happening in the Face book or twitter of the world, what people are saying and they have been influenced by these by what people are saying they are rather than being influenced by the advertised by the retailers or the CPG companies. So retailers are also trying to have that presence there and increase their share. So Infosys as IT have a product called social edge, which allows retailers to integrate with the Face book and other social media and also we give insight about what consumers are talking about the brand, what is their sentiment and so on. So similarly, retailers are investing a lot in business analytics and intelligence, again we have some IP, lot of thought leadership in this space. So I can give many more examples, so today we are operating, we are not only helping clients to improve their operational efficiencies by doing more off shoring and moving, taking things out of their mainframe into some of the lower cost Microsoft kind of technologies but we are also helping them drive revenues, helping them differentiate from their competitors and so on. And our foot prints and our scale of services are much vaster than what we had 4-5 years back.

Anupam Tiwari

But would it be correct to say that the durability or the duration of these contracts would be significantly lower or maybe these would be one time kind of effort so as compared to your normal ADM deals?

Pravin Rao

These are definitely discretionary things, you are absolutely right in the sense that these are not sticky things or anything but today when you look at it, today clients are actually not cutting down on the discretionary spend, their overall budget remains same, what they are doing this they are cutting on their Opex side and they are reinvesting back in the discretionary side. Today clients don't have any option but to get the nice share, at least in my vertical they have to continue to invest in these areas because that is where consumers behavior are same and that is where consumer is getting influence and the client don't invest, they will fall behind and then actually start losing their market share. So, classic example is historically in retail particularly being the low margin business, IT would have been considered as a cost center. So whenever we have bad economic times or recession first thing a CEO would have done is cut IT costs but today even during the recession also there has been significant change. Today people are using IT as strategic so we do not hear about any cuts in IT budgets or anything. All we are seeing is much more pressure on the Opex side, on the business accretion side, where as the discretion spend still continues. At the same time they are obviously, much more scrutiny where to invest because they have a half a dozen initiatives but they want to prioritize and invest in where they are able to get that much return on investment and quicker time to value but other than that we are not seeing anything. So to that extent I think, things are much fundamentally much different from what you would have seen in the sector may be three - four years back.

Mitali Ghosh

Pravin, if I can just interrupt and then we can also check if there are other people in the queue, this is Mitali, just wanted to follow up on what you just mentioned because like you said you are seeing a fair amount of transformational kind of projects and strategic kind of projects. Yet I think, when you started the call you did mention that a discretionary spend you were seeing some slowness in. So how should we read this for next year because could it be next year you would see some cuts in discretionary spending and therefore may be discretionary spending would not grow as much and therefore some of the comments you just made are they more relevant for this year and then if you can just quantify bit in terms of maybe some of what you are classifying as discretionary?

Pravin Rao

See, this year the overall budget has been more or less on an average and there have been few ups and downs but we are not seeing any drastic budget cuts. So only there has been shift in spending, instead of spending more on the business as usual, with typical opex side typically depending on the client varies anywhere from 40% to 60 or 70% of the client spend. So my plans are actually being very aggressive on that they are demanding more from less, they are actually cutting costs there and then they are trying to funnel this investment on the discretionary side. Now at discretionary side while there is an intent to spend, there are the bunch of initiatives but historically in a good year maybe clients would have invested in all those programs, discretionary programs today they are being very selective where they want to invest number one, and number two when they make an investment decision they are typically 18 to 24 months life cycle of each of these programs or projects but today clients invest only for the first phase of the project, it may last for one or two quarter or something so in that sense they are being very choosy, they are being very selective in each of the discretionary projects, they want to fund and they are also committing expense only for quarter or two quarter at a time, they are not really doing it for the 18-24 months full life cycle of the project. So the idea is, when cut out things go bad they are able to slow down on some of these things dramatically cancel or pull back so that is the difference we are seeing this time around. In terms of next year it is early days but the sense we get is at least one school of thought is maybe this is going to be the trend of the future in which case you will have to live with this volatility for the next few years. So probably clients will get used to it and this may be the kind of pattern and they will be probably be more short-to-medium term in their spending outlook rather than making long-term commitments and they will probably learn to live with this volatility. So at this stage this is early in the budgeting cycle so we will get to know more about it only in the January or in the February but at least unless things dramatically change at least what I see in my vertical, what my clients were saying, probably they may expect a repeat of this year next year as well.

Mitali Ghosh

Okay and just the first part that you mentioned that you may also be hearing of those clients are demanding obviously they are trying to achieve more with less and that is driving some amount of commoditization and kind of plain vanilla services. Are you seeing those pressures aggravating as you go into next year?

Pravin Rao

Yes, I think we have started seeing this year and that will continue next year as well, I mean, that space is increasingly tending towards commoditization because to a large extent clients don't value to your superior domain knowledge or clients don't want to give you premium for being understanding the business better, I mean, they are not seeing too much value in this they are saying something they have to invest they are forced to invest keeping the lights on kind of thing so they don't want to spend too much of money there so that area we have started seeing lot of pressure and it will continue to get commoditized.

Mitali Ghosh

Thanks.

Moderator

Our next question is from the line of Anoop Upadhayay from SBI Mutual Fund. Please go ahead sir.

Anoop Upadhayay

Good afternoon sir. Just want to understand your comments on demand better and also to sort of its integrates your comments is that made by the CEO in press earlier in the quarter. He mentioned earlier that it is the last one month which has seen deterioration in overall demand. So is it something that you have also seen and secondly when we interact with other company'sin similar peers like the TCS, Wipro and HCL, they don't seem to be seeing deterioration in the last one month. So is it something client specific that we are seeing or do you think it is more something that is specific to the entire industry?

Pravin Rao

I think the situation has remained to a large extent constant right from the beginning of the year and we are always taken a view that the environment is very uncertain and cautious and the spending pattern will be different clients will make short to medium-term commitment and all that. And if you look Q1 and Q2 not only of Infosys but rest of our peers as well I think when we look at the results it is probably similar to what we have been guiding. People who have been much more positive than us but from an ethical prospective we have probably been more on the similar lines. Now the question is I think part of what our CEO and others have said in this is also related to what we said from guidance prospective for Q3 but the beginning of Q3. I mean when we give the guidance we look at between some sense of statement of facts we look at what is visible, what is the pipe line that we have in front of us but typically at the beginning of the quarter we also have good visibility to 94 or 95% of what we guide so that is why we also give a range of guidance so the remaining 5 to 6% is something we try to make up during the rest of the quarter. So coming off a good Q2, we were much more optimistic about the pipeline and we thought that we would convert more but through the quarter we have seen things pan out much difference from what we thought at the beginning of the quarter and we have seen some of the projects we anticipated to convert this quarter getting pushed out, some of the ramp up that we anticipated would have had happened did not materialize and there have been one or two losses as well. So it is a combination of things which have really not worked out positive for us and so that is why I think in that context I think we said that we would probably be meeting more on the lower end of guidance and then the higher end of the guidance so it is something that we have seen getting into this quarter whether this is something which will continue in the next quarter or so we do not know at this stage and this is something which we are continuously watching and continuously talking to our clients and looking at the pipeline, so we get probably a better sense when we guide for the next quarter but between the beginning of this quarter to date we have seen some changes than what we anticipated in the beginning of the quarter and that is what we have seen and part of it could be our portfolio, portfolio of our accounts but in general that is what we are seeing and it is too early to say whether there is something that will continue in the next quarter that remains to be seen.

Anoop Upadhayay

On sale of patches like that for off-the-shelf products like those for business intelligence which would be I think something that it will retailers would be spending so in the recent past three months or so in the license sales of your partners have you seen any kind of slowdown and they are coming as well? Your license sale seems to be offbeat at least in the last three months.

Pravin Rao

Sometimes to a large extent it is very difficult to correlate the license sales to the immediate spending because it’s a fact that many of our clients already have bought into SAP, the Oracle or the BI technology and in many cases they are not even implementing many of the features of the package so typically when you are implementing and you have to have something. The typical implementation takes place anywhere from 18 months to 4 years or 5 years kind of thing. So do to that extent one thing is license sales means that clients would continue to invest so that is a positive news but whether it will directly translate into it but it is not at all directly correlated to the spend you see in the immediate quarter because in many of the cases even when the implementation takes over a period of time and so it is difficult to correlate that with quarterly spend. One thing that you can correlate it more in terms of sentiment, I mean if there is a lot of license sales that means that people are continuing to spend and they are not holding back and so that means that possibly good news from the services perspective because clients will probably have money to spend. But it may not directly translate to spend on the particular license.

Moderator

Thank you. We'll take our next question from the line of Paul from Genesis, please go ahead.

Paul Ballantyne

Thank you for making yourself available to us. I wonder if you could expand on something you said in the passing earlier, I think you said one or two things have not worked out for Infosys. Could you elaborate on that? Are these one or two things concentrated in a particular geography or vertical or are they the result of competitive interactions, or is there any pattern behind these one or two things having worked out?

Pravin Rao

We have not seen any specific trend from the vertical or geo-prospective. When I talked about there are two or three things we are seeing. One is we have seen we had anticipated some of the conversion of some of the projects, or some of those have not got materialized which have got pushed out and in many cases it is not a result of the economic environment but it is to some extent a result of the client situation itself. For instance in one case we were expecting to get a large ERP maintenance project conversion this quarter but the implementation actually got delayed and it will get implemented only in the next quarter so naturally implementation is being done by some other service provider and we are the preferred partner on the maintenance side, so obviously we could not convert back and so that got pushed out. So these are nothing to do with the economic situation but we have something to do with the client context. So there are couple of cases where we were expecting some of the ramp up in certain projects that because of the client context, client business itself not doing well so that we can attribute to an economic situation where the ramp ups have got little bit slow down, so it is a combination of factors so what we are saying is, we are not seeing everything related to economy it is a combination, some of the ramp ups have not happened probably due to economic situation. Some of the projects got delayed because of some of the client context nothing to do with the economic situation and we also had one or two losses as well if you would have converted maybe that would have given some uplift. But it is a combination of things we are seeing and we have not seen a pattern in geography wise or industry wise any specific slowdown or something related to a particular or some sectors doing better than the other and there is no pattern in what we have seen in this quarter in the last few weeks.

Paul Ballantyne

When you have said you had one or two client losses is it specific because of competitive tenders to that contracts lower prices or is there any passing out of that client here dissatisfied?

Pravin Rao

No, it is a combination sometime you lose on prices, sometime you lose on solution itself obviously no one wins everything ideally we would want to win everything but sometimes we have lost a few on pricing, we would have lost a few own solution as well not being able to articulate the solution all clients or some of our competitors being able to come back with a better solution or better reference or credentials for a particular piece of work so it is a combination, there are two aspects to our business one is on the ADM on the OpEx side where we are seeing tremendous pressure on pricing and other things so there I think we have to be extremely competitive on pricing apart from the solution. But on the other side of the business which is more consulting the discretionary side it is more consulting package implementation. There I think pricing plays a much lesser role it is more about capabilities, it is more about credentials, it is more about people you put in front of the client for that particular opportunity and there we are seeing less pricing pressure and there I think our ability to win clearly depends our ability to showcase our credentials, put the right people in front of the client and so on.

Paul Ballantyne

Thank you.

Moderator

We do not have any further questions, Mitali would you like to add any comments over here?

Mitali Ghosh

No, I guess that is fine I seen we are running out of time as well so just like to thank you Pravin very much for the time that you have taken to answer our questions and of course the replay of this call and transcripts we will also put up on the Infosys website for further access. Thank you so much Pravin.

Pravin Rao

Thank you very much. Thank you, good day. Bye Bye.

Moderator

With that we conclude the conference. Thank you for joining us. You may now disconnect your lines.