"Impact of Recent Crisis in Europe on Infosys"

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Moderator Ladies and gentlemen, good evening and welcome to the Conference Call on the impact of recent troubles in Europe on Infosys and the Indian IT Service industry in general hosted by Kotak Securities Limited. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode and there will an opportunity for you to ask questions at the end of today's presentation. Should you need any assistance during this conference call, please signal an operator by pressing * and 0 on your touch-tone telephones. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Kawaljeet Saluja of Kotak Securities Limited. Thank you and over to you sir.

Kawaljeet Saluja Thanks Farah. Hi everyone. This is Kawaljeet here from Kotak Institutional Equities. We are pleased to host this call on behalf of Infosys Technologies. The objective of this call is to discuss the impact of recent developments in Europe on Infosys Technologies and India IT Services in general.

To discuss this, we have with us B. G. Srinivas, Member of Executive Council of Infosys and heads the European geography in addition to heading couple of vertical and service lines as well and we also have with us Sudhir Chaturvedi, the Head of Infosys for UK and Head of manufacturing BU in Europe. We are also joined by Sandeep Mahindroo on the call. Please note that the duration of the call will be 45 minutes and the call will be restricted to discussion of Europe business. For anything general, you may actually get in touch with Sandeep directly. I will now invite BG to start off with the brief overview of the European practice for Infosys and then we will start off with Q&A. Over to you.

B. G. Srinivas Thank you. Good evening and good morning to all of you on the call. Thanks for joining in. Of course, in the last couple of months Europe has really in many ways, not naturally for the right reason, gathering attention and it is not surprising that we are all today on the call trying to understand what is happening more with respect to the business impact of the challenges at least some of the countries in Europe are facing and looming debt crisis which is going to impact most countries in Western Europe, but fundamentally from a business perspective as we see it, this challenge or the larger crisis is yet to impact businesses fundamentally. There are some early signs that there could be a slowdown because of this, but we are not necessarily seeing that kind of slowdown impact our client businesses. Cutting across sectors quickly, financial services to some degree, we do believe could get impacted if debt crisis in both Greece and Spain worsens and there could be a cascading impact, but for now, we are seeing at least the financial services in UK not much impacted. The business continues as usual.

There is focus on vendor consolidation; there is focus on legacy modernization, post merger integration and also addressing some of the regulatory requirements the banks are faced with. As far as the financial services in UK are concerned, business is as usual. I should say as of now, we are watching this very closely. Other sectors - Energy & Utilities is relatively stable and steady, no big jumps, no new big initiatives, but at the same time, there is a thrust for looking into ways to optimize energy and Smart Grid implementation, primarily more so in the Nordics is picking up. We continued to add clients in the Energy & Utilities sector in Europe. Insurance sector again is pretty steady, not too much of the change as of now. We have added two clients in the insurance in the last 4 months. Again, no major shift in direction either way. The Retail sector is cutting across Europe but more so in UK. We are seeing marginal upswing in terms of the consumer demand, but it is still too early to conclude whether this is sustainable. Of course, in UK particularly the government is taking lot of measures to actually cut back on the debt, so the implications could lead to some change in consumer behavior is what we are perceiving but from our interactions with our clients the opportunities pipeline continues to be good. We work with 7 of the large Retailers in Europe on order management initiatives, on business intelligence and also a focus on multi-channel commerce, digital marketing, understanding their consumer behavior and trying to assess what kind of consumer patterns are evolving, assessing what consumers are spending and we continue to see growth in this sector.

Manufacturing has been slow in the recovery process. The sector has been slow, but definitely we are seeing early signs of recovery. At least the shrinkage in terms of demand for the sector has reduced. The investments in manufacturing sector are on two fronts0 one is in terms of consolidation of their landscape and that process continues. IT landscape consolidation also involves a fair bit of process reengineering and initiatives run for year or two that is the duration of these engagements. Those initiatives are continuing specifically on sectors within manufacturing. The high-tech sector has recovered faster than the others, auto sector is again slowly recovering. There are efforts to focus on dealer management systems where investments are happening. Also, they are trying to catch up on the spending which is definitely lagging in the last 18 months. This is very much brief across the sectors.

In terms of specific countries of operation, the Continent continues to be slow, again nothing new about it. It has always been so. We had envisaged that Europe recovery process will be slower than the US and will come with a lag and that is predictably happening there, again no surprises there. We are not seeing any large mega deals out there, the average deal sizes have definitely come down in the last 15 months, so that does not change much. In terms of client dialogs with respect to specific opportunities, those continue. The current crisis has not subsequently slowed down any kind of business uptakes that we are reading as of now though we are closely watching these particular activities here in Europe. We are still cautious about what could happen, but for the moment, we are not seeing too much of rub off effect because of the larger debt crisis with respect to our activities and our traction with business opportunities with our clients. Okay.

Kawaljeet Saluja Okay Farah, you can start the Q&A.

Moderator Sure sir. Thank you very much. Ladies and gentlemen, we will now begin with the question-and-answer session. First question comes from the line of Emmanuel Elango from Kotak Mutual Fund. Please go ahead.

Emmanuel Elango Sir I just wanted to understand this lower growth that you are expecting in Europe, is it due to some specific geography or vertical or is it across the board you are facing?

B. G. Srinivas Here, the first part of your question, you are talking of lower growth, is it?

Emmanuel Elango Yeah. In Europe, when you say that it is not as strong as US or other parts of the world, is it anything related to some specific country or geography in Europe or vertical?

B. G. Srinivas It is by and large across**.** I mean this is again in relative terms to the US. The Europe overall looks to be slower and that is not particular to a sector as such. Of course in terms of activity levels, financial services continue to lead and there is also a pick-up of activity in manufacturing, retail. In these three sectors, we are seeing more traction. Telecom is a little mixed. It is still a little slower than the other sectors. Energy & utilities, pharma, healthcare seems to be pretty at this point in time.

Emmanuel Elango Okay, but manufacturing and retail, you are seeing good traction. Is that what you are saying?

B. G. Srinivas Financial services, retail, and manufacturing in that order.

Emmanuel Elango Okay, and sir you recently have appointed country heads in France and Germany, is that right?

B. G. Srinivas That is right. We will continue to focus on developing the Continental market significantly and in that context, the big bets are on Germany and France and these are the two biggest markets outside UK, though from an outsourcing trend perspective it is still early days, but we do believe that markets will open up in the next 2 to 3 years. We will definitely be in a better position, to actually leverage. We have already set up front offices, we continue to hire local talent. So in spite of this slow uptake in business demand, our investments are happening upfront and that will continue.

Emmanuel Elango Okay, so these two people are basically local talent you hired to grow the business there?

B. G. Srinivas Yeah. See, it is not just about that we have hired the country heads who have significant exposure to the local markets, they have large consulting - IT outsourcing and strategy consulting background, but apart from that the team we are hiring is in both sales and delivery. Delivery roles include program management, senior tech architects and consultants and of course in the sales force again, we have pretty senior locals in these two markets.

Emmanuel Elango Thank you.

Moderator Thank you. The next question comes from the line of Ashish Kumar from Arohi Asset Management. Please go ahead.

Ashish Kumar Thank you mam. Hi, this is Ashish from Arohi. Mr. Srinivas, as a senior member of Infosys, you must have observed closely the slowdown in the US that happened in 2008 and with the benefit of hindsight , if you look at customer action, which preceded the eventual slowdown in business, can you highlight to us what those customer actions are which could be categorized as leading indicator?

B. G. Srinivas Yeah. That is a good question. Only hope I have is that we could actually predict what is likely to come, but nevertheless what we are doing currently as we see these early signs of slowdown. We are looking at how this is impacting our client's businesses. In fact in the next 2-3 weeks, we will be looking at all our top 25 clients in Europe and looking at what is happening in terms of larger macroeconomic change, how is it impacting our clients business. In this context, the again the early signs as we saw in 2008 what happened which was led by the financial services sector. So, we are looking at the banks and the exposure these banks have, more so the European banks, have exposure both to Greece and Spain. So that is definitely carried by the European banks and largely the European Union which stepped in to bail out from Germany and France primarily. They have in a way bailed themselves out, bailed their own banks out, but that is definitely an early indicator like it has happened in 2008, but the government in spite of the challenges, it is not like the US. Here we have to get a bind of several key countries and they have to sell this within their own countries, within their own parliament and the government. In spite of all these challenges, they have definitely taken a bold step and settling it at right time and our view is that these challenges will not go away. The early step-in by the government has definitely swayed the fears. It is what happened in 2008. If the government had stepped in rather early, may be things would have turned out differently. Here an early intervention the hope is things should not turn out as bad as it happened in 2008. Other indicators definitely are consumer pattern and then the consumer demand, that is again something we are closely watching. More so, because of so much of speculations out there. We don't know whether any of the current challenges, any sparks would trigger a rapid downfall. That is something again which should be closely watched. I don't have a view onto what the trigger could be, but today the markets are in a little bit of state of flux and it is very easy to see panic set in the current environment. The other part to watch out also is the exports. While the currency impact has been favorable to the countries in the Euro zone for exports and we are seeing that the client's business demands in US as well as in Emerging Markets picking up, if the exports however, drop in a couple of weeks or months, that is another sign I would watch out for.

Ashish Kumar Thank you Mr. Srinivas. I have another question. When you feel or see if no one can predict with 100% accuracy and I am sure even you along you're your colleagues in India do as thorough a job as can be done. Hypothetically speaking, in case there is an eventual slowdown, how flexible is our recruitment engine? I believe that there is a talk that we could offer up to 30,000 jobs as campuses and lateral this year. In case of a slowdown, how far can this be pushed out?

B. G. Srinivas Well, that flexibility continues. Again we are assuming the worst-case scenario that US will also slowdown which is unlikely at this point in time but eventually if that happens, we do our recruitment plan on a rolling quarter basis. We plan for the full year and the campus offers go much ahead of time. Lateral recruitment is happening every quarter. So, cutting back on the entire lateral recruitment task can be done within month notice, that is not a problem. Campus hiring of course would have been made much in advance more than a year or so, but then the joining dates and training dates are flexible and that is something we can plan depending on the business intake.

Ashish Kumar Okay, got you. Thank you so much.

Moderator Thank you Mr. Kumar. The next question comes from the line of Nischay Goel from Mousse Partners. Please go ahead.

Nischay Goel Yeah, thanks. Actually, just a follow-up to your last answer; have you actually received feedbacks from clients in manufacturing who might be benefiting because of the euro declining in value?

B. G. Srinivas It is too early to say yes. It is common sense to note that it will make them more competitive and primarily so because most of the manufacturing clients are dependent on the US market more so in terms of their global footprint but we have not seen any major signs because of that. There is lot of activity. Definitely it would help the exports in manufacturing, but we haven't seen signs either negative or positive at this point in time.

Nischay Goel Fair enough. And do you have any major exposure to Spanish banks or the banking sector in Spain in general?

B. G. Srinivas No, not in Spain, not in Greece, not directly. Like I said, if at all there is any major impact of other banks getting hit, primarily they are again the Continent banks. Our exposure to financial services is much more UK-centric as of now.

Nischay Goel Okay and this is a rather basic question. Could you just break out what percentage of your revenues come in Euros and Pounds and what is the expected impact on the revenue growth and also on margin expansion because of the rupee-dollar change?

B. G. Srinivas Sure, the pounds exposure is about 9.2%, the Euro exposure 6.9%. There is definitely a marginal impact on revenue because when we gave our guidance we expected the GBP-USD to be 1.51 and Euro-USD to be 1.35. So it depends how this month will end. At the spot rates, currently we have seen already there is an impact, but we will have to see at the end of the month what the end result would be in respect to GBP and USD and then Euro to USD. We had assumed 1.51 and 1.35.

Nischay Goel And you don't necessarily have any hedges in place against the Pound or the Euro?

B. G. Srinivas No, we primarily hedge on the receivables. We do not focus on covering the top lines.

Nischay Goel Okay alright.

Sandeep Mahindroo Hi, this is Sandeep here. I can just add we have approximately 10% of our hedges which are in the Euro or GBP as of March-10. Approximately 10%

Nischay Goel I am sorry Sandeep. You said 10% are against the euro?

Sandeep Mahindroo 10% of our overall hedges as of March-10 were either in GBP or in euro.

Nischay Goel Okay, alright. And Sandeep, can you give an idea about what kind of an impact this rupee-dollar rate change or the rupee-dollar rate move is going to have on your margins?

Sandeep Mahindroo It is difficult to put out specific numbers as of now because numbers will depend up on the average rates for the quarter and we still don't know what the average rates are but looking at the spot rate versus what we had assumed in the guidance as BG said, there would be some negative impact on the revenue side. On the margin side, we expect to be okay because rupee also has weakened against the dollar, so net-net the impact that we are looking at is largely on the dollar revenue side.

Nischay Goel Okay, alright. Thank you.

Moderator Thank you Mr. Goel. The next question comes from the line of Rohit Chordia from Kotak Securities Limited. Please go ahead sir.

Rohit Chordia Hi BG, I have a question on breakup of your revenues in Europe, if you could just give us some idea of how does it breakup in terms of key geographies and key verticals and if you could also discuss Infosys' competitive positioning within each of these sub-geographies and sub-verticals versus the Indian competitors, as well as some of the local players that you might see in the European geography?

B. G. Srinivas Okay, I think there are 3 parts to the question. Let me address the geography's place in terms of revenue. Roughly 57-60% of our revenues come from UK. While the rest is from Continental Europe, primarily the big markets in Continental Europe for us are Switzerland, Germany, Denmark, Sweden and France. We do have some percentage of revenue coming from the Nordic region. The 40% -43% is spread across all these countries. In terms of the vertical spread again financial services, manufacturing, telecom, and retail are the big verticals. We also have coverage in Energy & Utilities, both in UK and Continent and pharma and healthcare though they would lag behind in terms of size. In terms of the service lines, again the significant percentage coming from package implementation and consulting, about 26 to 27%, ADM services about 40%, and the rest again spread out between IT services which includes infrastructure management, system integration work, testing validation services, etc..

Rohit Chordia Yeah BG, could you also discuss Infosys competitive positioning in some of these verticals in Europe versus the Indian competitors as well as against MNCs and local competition?

B. G. Srinivas Primarily in Europe, we do encounter the global SIs more often.. In UK particularly, of course, most of the Tier-1 offshore competitions are also strong, but again restricted to few sectors. In package implementation, business transformation engagements in the continent, again we are facing global SIs rather than Indian offshore vendors and none of them have a strong base in either Germany, France or any of the Continent specific countries. The European players, the Tier-1 players are very region centric, so we do encounter them. In France, it is Capgemini more often, In Germany T- Systems, Logica, Atos Origin cuts across the other geographies in Europe. So there are primarily global SIs and major European players which we encounter.

Rohit Chordia Sure, in terms of change in competitive positioning, what do you say, you have gained over competition over the past 2 to 3 years? I mean I recall a couple of instances, a few large deals where Infosys actually lost out, you have actually lost market share in Europe. You were losing market share for some time and that seems to have been stalled over the past couple of quarters where you have done well. So what actually did not go right for you and how did you change that?

B. G. Srinivas Overall, our investment in Europe and our competitive positioning in Europe continues to be strong. The shrinkage which you have witnessed in the last may be 15 months is primarily because of two reasons. One is during the crisis, the financial sector in UK got hit and the growth declined but more importantly, in one of our largest clients in the telecom sector in UK there was a rapid shrinkage. It was close to 10% of our global revenue it is come down to now less than 5%. So that shrinkage of these two sectors which happened in the last 15-18 months have not been really offset by the other growth we have seen in the Continent and that is why in real terms while we continue to improve our competitive positioning in terms of outcomes, in terms of growth rates, there has been a challenge because of the rapid shrinkage which impacted us. Now that shrinkage has stabilized and we continue to see growth build up across sectors, both in UK and Continent and that is how we have seen in the last two quarters, uptake in the growth within Europe. So in the short-term to medium-term whereas overall Europe will continue to be slow, we will continue to invest inspite of that because we do believe our positioning is strengthening. While there are not too many large deals out there and some of the deals are simply not viable and sustainable in the long-run which we will definitely choose not to participate, but otherwise we continue to win medium-sized deals. We won recently a SaaS deal, we won a major business transformation engagement fighting both the global SIs as well as local European players. This deal particularly is about $65 million plus, again it is in consulting and transformation. In Germany, we won a $28 million deal on a SAP, a global template roll-out through our German client. We are winning these kinds of deals. More importantly our positioning in Europe on the Continent as a value added player continues to increase and we do not envisage any major slowdown not withstanding what is happening in the global market place and more so in Europe. If there are no shocks, we will continue to see growth in the coming quarters.

Rohit Chordia Sure. Just one more question from my side. How would you compare the deal dynamics and client behavior, let us say in Europe as compared to your US clients and is there are any unique challenges to working in Europe. I am sure it is different in UK versus Continental Europe, if you could just help us understand some of that?

B. G. Srinivas Let me request Sudhir to respond to that.

Sudhir Chaturvedi Actually in terms of differences between US and Europe, there are two levels which you can look at. One is from an outsourcing perspective, in Europe the labor laws around people takeover etc., play a very significant role in deal structuring and the eventual deal dynamics. So that is very different from what happens in the US though US also has been moving in that direction, but not necessarily constrained by that legally as we are in Europe. So that is for the entire outsourcing space, especially the large deal space that gives a completely different form to those sorts of deals. The other aspect on all other deals is really there are differences in the speed in decision making. The US is renowned in its ability to move faster and decides quicker but that is really I think in my opinion partly a question of some cultural aspect but most of it is also a question of some maturity in global sourcing of services. That, as BG mentioned earlier, that is picking up. Finally the European players especially in Continental Europe, they have very large internal IT set-ups and many of these are actually companies in their own right, either subsidiaries or internal units which are P&L units and that itself, in some cases, we actually compete with these companies or partner with these people. That dynamic is something we don’t see in the US. So these are the kind of big differences from our market behavior perspective. Within UK and Continental Europe, UK mirrors the US more in decision-making but the IT departments are not as P&L-oriented as they are in the Continent. They are much more open to working in a partner-based model. So other than that, the UK model is in some other aspects similar to the Continental European model.

Rohit Chordia Alright. Thanks BG. Thanks Sudhir.

Moderator Thank you. The next question comes from the line of Manish Gunwani from ICICI Prudential. Please go ahead.

Manish Gunwani Yeah, hi. A pretty basic question again. I just wanted to check in terms of matrix like onsite to offshore issue and revenue productivity from man-month. Is there a significant difference between Europe and US business?

B. G. Srinivas No, offshore-onsite ratios for similar service lines, there is no difference as such.

Manish Gunwani Okay.

B. G. Srinivas Revenue productivity is marginally higher as compared to US for similar service line.

Manish Gunwani And what about margin, any qualitative?

B. G. Srinivas Margin will be more or less on par because while RP is higher, so is the cost structure.

Manish Gunwani Okay. Thanks.

Moderator Thank you. The next question is the follow-up from the line of Nischay Goel from Mousse Partners. Please go ahead.

Nischay Goel Okay, just another broad question. I believe you had mentioned before, I think someone had asked you about first signs of issues because of a broader financial crisis and you had said that there is no one way of assessing the signs but you just have to have closer contact with your clients. From everything you've said today, it does not really seem like there is any kind of a crisis. I mean what you have really spoken about seems to be gradual improvement in most verticals and just how Infosys is generally penetrating Europe better. I am just wondering this crisis has been around for at least 3 months now. I am wondering if there are any clients who had issues or where you have seen this crisis, have these issues impacted if not your existing clients, potential clients who are in the pipeline?

B. G. Srinivas It is a very valid question and in fact, I wish I had a different response other than the fact that we have not seen any changes. However, I am not sensing a lot of optimism because of what is happening currently. It is yet to impact our clients and we are internally studying, what is our client's exposure to some of the challenges which we have seen in the market place and some clients who could be potentially impacted. If it goes bad or like I mentioned the Continental European banks and we don't have too much exposure with them yet, so that could be one. Second, is consumer spending again, more so in the Continent, might have an impact but we are yet to see that. Exports are doing reasonably okay at this time. Again unless that gets impacted, we are not seeing any signs, but we will continue to stay in close touch. So any further indicators we should get in the next couple of weeks. So far, things seems to be going okay and there is no renegotiation of whatever projects are running. There is no pulling back in terms of the initiatives. So though their decision making itself is a little bit slow, but dialogues have not stopped and there is a fair degree of stability within the businesses. While outwardly we have lots of fears of what potentially could happen, it is difficult to see it at this time and that is why we are closely watching.

Sudhir Chaturvedi In our case, our exposure to the Portugal, Italy, Ireland, Greece, and Spain is negligible actually, less than 0.5% of our global revenues and the second thing is that we have no public sectors revenues either. So these are the two major reasons why our business is really private sector business in major economies and they are insulated from shock to a certain extent by the US, by Asia, by other Emerging Markets. In any case, many of our clients are primarily export-led clients even though they are of European origin. So as BG said, no project cancellation would give us a signal along those lines and he has already talked about renegotiation. Of course we are seeing a caution in place, that caution we are seeing for about 15-18 months. That caution is continuing. Whereas we were expecting may be in the second half a bigger upsurge in demand, now it is likely, that upsurge is actually more muted or non-existent and things will continue as it is for a while.

Nischay Goel Okay, but this still doesn't affect your guidance, the lack of an upsurge that you were expecting all these days?

B G Srinivas So far no impact

Sudhir Chaturvedi I mean the upsurge in the overall demand environment as BG has already said we had factored in softer growth in Europe

Nischay Goel Okay and so you are also not seeing any kind of pricing push back from the existing clients in Europe and even if it is not material, I am just wondering what is the mood in terms of price hikes or price renegotiations might be?

B. G. Srinivas Pricing continues to be stable though the clients are under cost pressure, so the caution and the consciousness towards pricing continues but again no major changes either upward or downward. We are not obviously seeing price increases across the board. That is not happening. Any upsurge both in terms of newer and larger deals or any significant price movements upward is not happening. At the same time, there is no renegotiation of existing contracts. We are not seeing clients asking for further discount. So I would say to summarize, pricing is stable, but again clients are very cautious.

Nischay Goel Okay, alright. Thank you.

Moderator Thank you. The next question comes from the line of Vineet Thodge from Kotak. Please go ahead.

Vineet Thodge Thank you. BG. Do the recent troubles mean you have to relook at your long term goal of 40% revenues from US, nearly same revenues from Europe, and 20% from the rest of the world?

B. G. Srinivas These are aspirational statements and that is not going to change because we simply look at the overall IT market. The second biggest market outside US will continue to be Europe and there is a significant headroom in terms of the size of the market versus our size and the fact that European client organizations have to go for growth, they have to be competitive and I don't think that it is sustainable if they continue to do what they are doing today by not leveraging services like what we offer and also increasing their focus on technology as a lever to optimize costs and drive revenues. So that is not going to change, so we are not changing our aspiration or our investments in the Europe.

Vineet Thodge Okay. Thank you.

Moderator Sir, there are no further questions at this time.

Kawaljeet Saluja Okay. Thanks everyone for participating in the call. Thanks to Infosys Management as well. BG, do you want to make any concluding comments?

B. G. Srinivas Of course, we will continue to watch this very closely. Like I said we are also carrying out a very close survey with some of our top clients in terms of their exposure and impact and if there is any other indicators, we will be happy to share with you at a later point in time, but for now it is steady. It is slow. We will continue to, inspite of the near-term challenges that Europe is facing, make our investments and our focus in Europe will not change. We will continue to invest and we will continue to look for growth and I do believe personally that in the next 2-3 years, we can do much more here as compared to what we have done in the past.

Kawaljeet Saluja Okay. Thanks.

B. G. Srinivas Thank you.

Moderator Thank you. On behalf of Kotak Securities Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.