The Infosys Financial Model
T. V. Mohandas Pai,
Director (Finance and Administration) and Chief Financial Officer

P R Ganapathy: And now ladies and gentlemen, it is time to sharpen your pencils and pull out your calculators. We have a session now on the financial model, and Mr. Mohandas Pai, who is familiar to you all, Member of the Board in-charge of Finance and Administration, and CFO, will walk you through some of the intricacies of revenue utilization, capital expenditure, visibility, forecasting, quality of revenues, etc, etc. In his inevitable style he can throw a lot of numbers that are complicated calculations at you, and try and help you understand the model better. Mohan in his modest style will not have told you his achievements, so I will take this opportunity. Those of you who know him well might know some of these things.

He joined Infosys in 1994, prior to which he was an Executive Director with Prakash Leasing. He has been, since he joined Infosys, an important architect of some of its very breakthrough successes in the financial field, such as adoption of some of the leading world class accounting standards and our listing on the NASDAQ. He is a Bachelor of Commerce from St. Joseph's College. He has also a law degree, and he is Fellow Member of the Institute of Chartered Accountants of India. He is also a member of several key committees of the Securities and Exchange Board, as well as various Government of India committees. Without further ado, Mohandas Pai, Director and CFO.

Mohandas Pai: Thank you Guns. Guns is making a pitch for something on my table right now. It is an incentive plan for Guns, I guess.

Ladies and Gentlemen, I will walk you through this financial model. I think, all of you know a lot about the models that we have, the way this company is structured, because information available to you through various analyst reports, through our meetings with you, through the information on the web is exhaustive. We are probably one of the researched companies in this space in terms of modeling. But there are still some areas of analysis that we discover as we go along, as we have tried to find out what exactly makes this company tick; at which point do you put your finger to make sure that you get a 30% net margin, what are implications of a change in the onsite-offshore ratios, with a change in the billing onsite offshore between 270 clients, and things like that, so, I will take you through some of the models, possibly answer some of the questions that you have in mind, and possibly try to make you think a bit more before you ask questions again.

The agenda for this talk is going to be an overview of the financial model, key drivers to the revenue model, the cost structure with emphasis on depreciation and income tax, a rather under-researched area for analysts today, reading the analysts report that we get; managing receivable, this is going to be a more critical as you go along, because the business is all about cash flows.

Narayana Murthy keeps telling us, right from the time I joined in 1994, the cash in the bank is the only reality in the business. So, our aim has been to go on increasing the cash balance in the bank and also answer some of the questions that come with increasing cash balances. Capital expenditures, and why we spend this kind of money, and most of you have had questions on this, you have come to this campus and think wow! You know, but the customer has to pay for it. I want to tell you that it is much better to do what we do, than to hire buildings, and furnish it, and right off the stuff, I will explain to you why. Pro-forma Profit and Loss account and the proposed format, is the issue on which Narayana Murthy and I had a lot of debates, we wanted to change the format of the accounting for the quarter results under Indian GAAP, we were supposed to do this quarter but Narayana Murthy in his wisdom felt that we first must inform our investors as to what we intend to do. If you happen to open the quarterly report that should have been on the table about a week back, in one of the pages we have given the old format, the new format, and how the new ratios will look. This I think is another classical example of how Infosys communicates to investors about what changes are going to come in financial reporting so that you are not caught by surprise.

Management guidance for fiscal 2002, just keep looking at what we are going to guide you towards. Guns has already made a comment in the morning, let me see if I can improve on that, and meeting future challenges that come along. Hang on to your seat belts…

You know all about this, we grew 63% in terms of net revenues under US GAAP in the first quarter this year. Net income grew by 46%, at the EBIDTA levels we have fairly game for the course, but we had a higher amount of taxes this year under US GAAP, basically because of the fact that we had a higher tax liability due to higher profitability. We have a strong financial model. Several analysts in the world have come and told us we probably have one of the most profitable software service companies P&L in the world today.

A strong balance sheet with zero debt. Vary many of you have asked us why is it that we do not have debt. Well, you know, if you have debt, you've got to pay it back. And paying it back does create sleepless nights. Narayana Murthy has said that you lose a billion dollars than lose one nights sleep, I think that is a very good statement to make, we prefer to be debt free. But the technical answer is when in a high growth technology oriented business, you do not want to add a financial risk to what is already a highly business risk. Our job as management is to minimize risks and maximize revenues. So, we have to try every which way to minimize risk. Bill Gates said that he wants to have cash in the balance sheet to pay all his expenses for two years; we only have it for a year. So, we still have a long way to go.

And high quality of earnings, I think if you look at the Infy balance sheet and P&L, you will notice the high quality of earnings compared to anybody else, I will explain that as you go along.

We have led the way in most areas in following accounting standards around the world, to make sure that our balance is strong, robust, provide for all known liabilities and possibly some unknown liabilities, no contingent liabilities, amortize all our assets, so assets remains fresh, and have a strong cash flow, make sure that your cash flow is positive every quarter, pay dividends out of strong surplus cash and keep adding to cash. If you look at all these things, you will find the quality of earnings to be qualitative difference from most of the corporations.

Capital expenditure is financed by internal generation of the funds not by borrowings, and we have a cash balance of $134 million, as on June 30, 2001. A strong financial model because we have robust offshore model, the offshore model has a higher margin than the onsite model. We do have some work onsite, but onsite does have a lower gross margin and a lower net margin than offshore, in offshore the margins are higher though on a per capita basis what you earn in terms of profitability per person both onsite and offshore has a similar numbers. But in terms on percentages, the percentages vary. So, depending upon the onsite offshore mix, you will see a different kind of percentage. But I will take you through the model and you will find out that the last seven or eight quarters, even though the onsite ratio went up from 25% to something like 36%, in terms of efforts our net margin did not come down. What is this magic due to, I will explain it to you as we go along.

The offshore model also ensures, a flexible organization that can make smooth technology transitions, we have gone through three transitions so far, the first transition has been from mainframe to the client server era, on the client server era than we had the Y2K phenomenon come through, then we had the internet phenomenon come through. Through all these we were able to reconfigure, to train our people in a very cost effective manner. And if you look at the companies around the world who were stars in 1999, stars in 2000, were stars today, some of them were not able to do it, because they didn't have the capability to offshore model.

Then, we have this slack needed to take care of new opportunities. Let us say a large multinational client comes to India and says, I am going to give you 2000 person-years of work. Presto! Nandan will sign the contract and we will start everything, we have everything in place today. So, we have built a strategic bench, strategic because it is available to us as and when you need it, and we have absorbed the cost over the last one and half years, and we did not hurt the margins. Now that is the mystery of where the extra 40% increase in per capita revenues last year went.

We made sure that the money that we earned was ploughed back into marketing, ploughed back into training, ploughed back into quality systems, ploughed back into our SETLabs, into R&D, ploughed back to make the company inherently strong. So, later when the excess of this per capita revenue going up wears off, you see the benefits flowing through the bottom line. We have a long-term relationship model with clients. We have not dealt with one, we are a relationship-based company, in the last seven years, possibly one or two large customers we have broken relationship with, not many. Like Nandan said, we have 84 million dollar customers. And this provides us enhanced revenue visibility because we are a part of the client.

I remember a very well known client who became a client about five years ago, immediately after losing GE, they went through very bad times, when times were bad we stood by them, so today they swear by us. Because relationship is ultimately two ways. You have to work with client, you have to satisfy them, you must not charge them extra, you must deliver continuing value, and they will stay with you and you will become the preferred partner with them.

Financial discipline: It is extremely difficult to spend money in Infosys. If you have a budget you can spend it, but you work so hard, you don't have money, you don't have time to spend the money. And if you don't have a budget, believe me, it is difficult to spend because if you want to spend a single penny above your budget, you have to do what is called a five year analysis, which our strategic planning department does, they go into ten different areas to find out the impact, next year and the five years later, then it has to go to the Managing Director for a sign off and it has to pass through us and all of us are searching questions. By the time the process is finished, unless it is very strategic, important for the company, people do get a bit tired.

So, enhanced amortization ensures technology is current, so we have an amortization program of two years for technology; it makes sure that we write off our stuff. If you have worked on the campus, all the workstations have zero value in the books. Last year I think we wrote off Rs. 30 Crores, less than 5000 rupees, and that means in future you don't have to amortize that. If you look at the balance sheet today, end of June 30, we will have Rs. 250 Crores in technology and in plant and machinery and furniture, which is just about, may be one and half years, 1.75 years depreciation, after that what? We will have land, buildings, all real assets, A/R, cash in the bank, nothing else in the balance sheet, this shows the strength of the balance sheet.

Comparative lower proportions of the fixed costs: We have optimized the G&A cost. If you look at the competition on the globe, you will find that operating margins, the gross margin is about 46 to 53% for most companies, including us, but when it comes to SG&A most of the competition in the developed countries have 30%, we have 13 to 14%, that is because the S is abroad but the G&A is in India. And you have seen the front page Economic Times and seen what Narayana Murthy gets paid and what the poor CFO gets paid. So, you know how cost competitive we are and how optimize the G&A.

High quality of accounting: Again I want to stress on this, because I think personally, so do a lot of people in this room, that this is one of the things that one must look for in companies, because company has to be financially conservative and aggressive in its business approach. You have to go get the business, you have to pound the payment, you have to sell, when it comes to finances you have to provide for every known liability that accounting standard allows you to do and become inherently conservative and build the balance sheet, because that is your ultimate strength. And balance sheet is ultimately a test of credibility. So, in terms of revenue recognition, we have adopted the most stringent norms in the world, we have something called unearned revenue, revenue we received in advance of our actual billing, because clients do pay you in advance for fixed price contracts and those contracts that did not deliver value, we put it under unearned revenues.

We have provisions made for bad and doubtful debts, provisions made for post-sale customer support, provisions made for our gratuity liability under US GAAP which is higher than Indian GAAP, and then we have provided for all other known liabilities, both to employees and across, like provisions made for leave etc., which have just become part of the accounting standards right now. And then, when you come close to the bottom line, we work in about 26 countries around the world, and in 11 countries we pay full tax. We have taken the stand that whichever country you work, you have a work permit, you have a permanent establishment. If you have a permanent establishment you source all income to that country and you pay full tax on a transfer-pricing basis. We made transfer-pricing studies in all these countries by the Big 5, so that our transfer pricing or our accounting is in tune with the national norms, so that we don't have any problems anywhere, and we pay tax all over. Ultimately, we pay more tax to Uncle Sam than to poor India. So, that is why some of you might have noticed we keep a cash in the bank and earn some interest, to pass a little bit of tax to be paid here in the corporate level, and most of you have said that put it in, some people have said that put it in Gilt Funds and earn something tax free, but we think we do have some kind of obligation.

Now, employment practices too, most countries say that if you want to work and bill, you must have a visa, a work permit, rather than any other kind of visa and in most countries we have these work permits, wherever work permits are available, and we have made sure that most employees have them, so we comply totally. For example, just this year, the H1-B visas in the US were changed to say that, if you want to make sure that your client does not have you give you a letter to say that they have not removed people in the last 90 days, in the next 90 days, etc., you have to pay a minimum of $5000, all told to the employee. So, we are paying $5000 to everybody as a minimum, the cost to the company comes to something like $6000 per person month, basically because you have to pay an unemployment tax and all kind of taxes. And we have made sure that we comply. In Germany for instance you have to pay a minimum of 100,000 Deutsch Mark for every work permit person that goes there. So, the cost of compliance is a little high, and is all inbuilt in the model, and that is why we have 4.5% to 4.7%of revenues as taxes compared to most of the companies who have taxes as you have seen.

We have a low risk from litigation and other issues, I do not remember that in the last 20 years that this company has been run, any client putting a case against us for non-performance and non-delivery. Most clients sometimes do complain that our people work too hard, they work on Saturdays Sundays, deliver value, they want them to have a holiday. But we have mitigated the risk from litigation to make sure that the clients are satisfied, and if you look at contingent liabilities, it is almost zero. But we think that all this is necessary for a sustained business.

What are the key drivers of revenue? Billed effort volume, onsite-offshore mix, per capita onsite offshore revenues, mix of services and products revenues, products are at 3% now, I think overall for the company is 4.5 to 5%, so not much of a swing item. If you look at this chart, this is a chart which shows you, please study it very carefully, you will see it in the web if you have more time, and if you look at this chart, you will find that total billed effort has gone up quarter upon quarter upon quarter, volumes have gone up, volumes have never come down in the last nine quarters.

Revenues have gone up. There has been a sequential growth in billed effort, and sequential growth in revenues. The difference between the sequential growth in billed effort and sequential growth in revenues, is due to the per capita revenues growing up. And wherever, the sequential revenue growth has been higher than the growth in billed effort, per capita revenues have gone up, whereas they have been lower, you see the per capita revenues coming down. So, in the last two quarters, Q4 and Q1, we have seen the sequential growth in revenue being slightly less than the sequential growth in billed effort, there seems to be some kind of a plateau effect, because if you look at the fourth quarter the billed effort grew by 9.1% and sequential growth in revenue was 5.1%. Now it is 2.5% because we had a dip in offshore revenues due to the dot-com and the Internet business coming down as a percentage of revenues. But this is a very nice chart to see. If you look at the billed effort mix and look at the effect in the gross margin, this is exactly what I said in the first part of my talk, onsite efforts 28.9% Q1, gross margin 48%, onsite effort goes up to 36.8%, a large jump, 47.7% is gross margin. Now, we come to 31.2%, gross margin is 47.6%, this is called yield-management system, which Phaneesh keeps talking about each quarter. Just as an airline fills its capacity, we also have a yield-management system, which Phaneesh works on his PC to make sure the mix of price, mix of projects is in tune with what we require. We also manage our bench very well, by keeping the bench in India so that our costs are not very high.

Per capita onsite and offshore rates: You will see that onsite rates is going up, except in one quarter, Q3 of fiscal 2000, it came down by 0.8%, it was flat in Q4 of 2000, then it galloped in Q1, it went up at a steep pace in Q2, came down slightly to 2.1%, was negative in Q4, and positive in Q1. So, in the last 9 quarters, onsite revenues have been negative some quarters positive most quarters, offshore revenues have been negative in the last two quarters positive most other quarters, so the growth has somewhat tapered off. Now if you look at the venture capital revenue, you will find the phenomenon here, that when we had a growth in revenues in Q1 of fiscal 2000, you had a growth in offshore revenue for the 11%, onsite 11%, venture funded revenue and e-commerce was 28%, it went up to 31%, has been coming steadily down, and venture capital revenues have been disappeared, it is just 5% today, very small, e-commerce revenues have also come down. We see the gross margin in e-commerce has been higher. So this is the reason. If you look at the offshore revenue, we have comeback basically to Q1 of fiscal 2001, so the impact of increase took place from that point of time and then it tapered off.

Drivers of per capita revenue – Pricing: We had the policy of getting a pricing higher than the pricing for the previous client last year. Now the pricing has become very price sensitive. I want to tell you emphatically that we have not reduced our rates when we quote. We don't reduce the rates when we quote. We quote at a good rate, but what happens is that when the customer starts the negotiation process, if the gap between you and number two, who is chosen is very high, they necessarily come and tell you, please look at a much more aggressive pricing because we cannot justify a higher premium than x% to our higher ups. So, we quote the proper rates, but in the negotiations sometimes comes down because of volume, because of market condition, etc.

So, mix of revenues between existing and new clients, last year the new client came in a substantially higher rates, the client who had in '95, who came to us in '94, if you look at their rates today, they are lower than the clients who came to us may be 2000 or 2001. So, clients who came in at different years have different kind of rates. Depending upon the mix of the business between all this, the per capita revenues go up and down.

Employee productivity: Which I think our quality people spoke about that. In terms of productivity for fixed price contracts.

Revenue forecasting: How do we forecast our revenues? How do we manage finances in this company? We have a rolling plan for 5 years. It is a 5 year model, which has got about 250 to 300 variables, we take everything in the sun and make it a model, which works only on may be a PC 833 MHz capacity, which only the planning department knows how to operate possibly. So the 5 year model, we have a firm plan for the next 2 years which we handle, to make sure that 2 years is a good time to have rather reasonable visibility. Five years is a perspective plan, 2 years is a firm plan, and we have a firm budget for this fiscal year, a budget cast in stone, which you cannot shake. Updated at regular intervals, every quarter we do the due diligence update in the budgets to make sure that we rearrange costs, in case we find that the cost are showing an upward trend, we do some cutting in discretionary spending. That is why you will see that this year in the first quarter the costs have been rather down.

System based: We have yield management system. We have what is called as billing performance indicator, the production department or the delivery people who manage the project put in the system as to what the likely billing is going to be, by client, by project. May be 600 or 700 projects, 270 clients, everything is there. Then we have a column which Phaneesh's people put as to the likely revenues that comes from the visibility that is shared by the marketing team, we see both and both of them gets updated every 10-15 days. So going forward, we have firm billing in hand as well as potential business, and make a gap analysis to see how deep the gap is or how shallow the gap is, to come to a kind of figure. And based on those figures, we are able to give you quarterly projections. We are system based. So, this is how the system works.

The cost structure: If you look at the cost structure, cost of revenues have been fluctuating in the narrow band of 350 to 400 basis points, from 51.9% to 56%, is come down 52.4%. But the cost of revenues is after allowing for depreciation. You must factor that when you compare us with the American companies, because for us cost of revenue includes depreciation, if it is 5% to 6%. Selling and marketing expenses have been at 6.3 to 5.5, is 4.5% to 5% running now. G&A expenses too has been a narrow band, but G&A includes almost a one percentage the last four quarters for provisions for bad and doubtful debts. So if you look at the gross margins, they have been in a narrow band. Operating margins too has been between 31% to 33%, in fourth quarter of fiscal 2000, it came down 28.1% because we had make a provision for some gratuity expenses, so gross margin is also down, and the slack.

You see the slack here, the impact of the slack has been rather well managed, when the slack is the bench, if you have a 25.2% bench in Q3, you had a operating margin of 30%, when it came down to 14%, and went up to 32.9%, then the bench up to 19.5, 32.9,now the bench is 27-26%, come down, operating margin is still high. Now this is a secret of the model. You have this bench, which can be sold, and which gives you revenue and if you sell it offshore, the revenue comes straight to the bottom line. So, inherently built ability to take on any adverse circumstances.

Personnel cost: The personnel cost depends upon the proportion of onsite to offshore, and addition to onsite-offshore personnel, and impact of salary hike, we have said that the salaries went up by 25-30% offshore, till this year, and this year has gone up by 15%, and onsite has gone up by 4-6% partly because of compliance cost.

Utilization of billing and software personnel includes gratuity and leave. If you look at the total personnel cost, this is only for the production, this is under the new format, and you will find that we have managed to keep it within a certain range. Even though it went up to 42% in this quarter, 42 is including G&A plus production, but production has been 39.4%, is gone up by 4% points in Q1, Q4 of last year was slightly down because of reversal of some bonus provisions to the marketing staff, so you must look at the trend for the last three quarters.

Employee utilization levels: You can see the correlation between utilization and gross margin. You see the gross margin has been rather steady, despite the utilization coming down from 75.8 to 64.9%, once again managing the strategic bench and taking care of the high per capita revenue increases that we got last year. Last year out of the 100% increase in the revenues, 60% came from volumes, 40% came from price. The price impact has to wear off before we really get impacted at the next margin level. Because typically, our cost increases come to may be 7-8% a year, in terms of the requirement of revenue productivity increase.

Understanding utilization: This is the definition that we have. Utilization including the trainees means billed employees as a proportion of total delivery people. Utilization excluding trainees means we remove the people in training, because they undergo a 14 weeks training and then they are allocated to the projects, so we remove them, and so we keep both these indices because it is a good mix to see. And calculated available capacity, now, when you calculate the total billed effort or the total billable effort, believe you me, we take into account the leave, the leave is not discounted, training is not discounted, that means, we take 12 months work, we don't take 11 months work like many of the companies in the developed markets. So, if you take utilization 75%, you must factor in the leave which you have something like 8.3%. Across the organization 30-35% utilization of the leave does take place every year. But we show it as a part of the bench, and we do it for the reasons that we want do develop high productivity, that we want to be very transparent.

Other direct costs: These are the costs that you see in our P&L account. If you look at this chart, a lot of figures, but just see the bottom line, direct costs of 15.3%, 16.8, what has been going up and down, are possibly the salary cost or the other foreign travel cost of the software for own use. Cumulatively, not much of a difference except in the first quarter of this year, the total cost has come to 13%. We have been able to make a deep cuts in the costing structure, and the impact is being felt here.

Sales and marketing costs: They include the salaries, the bonus, and things like that. For the sales staff, we have a mix of a fixed cost salary, plus a bonus. We are trying to make as much of their compensation variable as possible. We have had it for the sales staff and for the consulting staff as far the rest of the company, we had it partly this year and hopefully should keep going up. If you look at the sales and the marketing cost, as compared to the relationship that we have, the beauty of the relationship model is your S&M cost keeps coming down. So, we have increased the number of clients and the relationship model ensures that our selling and SG&A cost is typically at 5 to may be 4.5%, going up to 5.5%, with a discretionary spend of 0.5 to 1%. Repeat business percentage has been something that keeps making sure that the cost is under control.

G&A expenses is a matter of detail. If you look at the G&A expenses, now this is very interesting, if you dissect the G&A expenses, you will find that excluding provisions for debtors they have been fairly in a normal band, not much fluctuation, but including provisions, they have gone up to 9.5% in Q2, 9.2%, 9.6%. So, out of the 9.6% G&A expenses, 1.1% is due to provisions for our debtors, our accounts receivable. Why we are doing that, I will explain to you.

Now, this is a nice chart to see. What is proportion of support staff to the rest of the company? That means all of us have been working harder. Last year we worked 11 hours, this year 12 hours, next year 13 hours, and after that we have stay at home. We don't see much room for improvement. So, there were 14.3% of us non-billable poor folks, is been brought on to 9.8%, Nandan refuses to sign any indent for a non-billable person, extremely difficult to get an additional hand. So, we have to become more productive, work smarter, improve our systems, become more cost conscious.

Depreciation and income tax: We have an aggressive amortization schedule. Write off buildings in 15 years, why? You go to that building there, red building, is called the heritage block, why? Five years is heritage, five years you don't exist, you are history, but we have got to write it off, so we write off in 15 years, even though most people write buildings in 30 years. Plant and machinery, generators, UPS and other equipments in 5 years. Computer equipments, everything in 2 years. And furniture and fixtures, 5 years, excluding work stations, which is done off immediately. Vehicle, 5 years. For the whole company we have just one car, just because you have to have some vehicle at least, then of course we have a couple of vans and one vehicle for the facility department, and two of those electric vehicles, outside, to ferry important visitors, apart from that just one car, we don't have any cars, we don't believe having cars, company owned cars, they are a pain.

Depreciation of our assets is proportionally charged depending upon capitalization, capital expenditure incurred on R&D is totally amortized immediately, and individual assets less than Rs. 5000 charged off immediately. The drivers for depreciation, you see the percentage going up and down, number of newer software development centers capitalized during the period, days of capitalization, proportion of items less than Rs. 5000, and investment in technology assets, is a complex mix of all that. We have a model, which takes into account all this mix. If you look at this chart, depreciation is 5.5% Q1, went up to 6.7% out of which 2.4% was in assets less than 5000, it was steeped out in Q4 of fiscal 2000 to just 4.3%, and as against 5.1% in the first quarter. In this quarter it is 5.3% excluding 100% items. So, the excess depreciation is because of this charging of these 100% items, which I think is a very important point, because you don't have any assets in your books, which are standing there for a long period of time.

Provisions for income taxes: The new accounting standard called deferred taxes came because the committee on corporate governance said India should follow all global accounting standards, including consolidation, deferred taxes, segment reporting, related party transaction, etc., but we have always told everybody if you have deferred taxes you get a credit, we got a credit. So, in the first quarter of this year, we took a credit of Rs. 11.5 Crores or so, to our general reserve. Most large corporations in this country had to make a debit provision, we had a credit, and that is because our write off in the book was higher than the write off for tax purposes. Not that it matters for the tax purposes, because we are tax free but, we have a accounting policy, we choose the tax affect accounting and provision is made after considering tax allowances and deferred tax assets are being created under the US GAAP, now under Indian GAAP. So, tax charge depends upon proportion of onsite, proportion of revenues from various countries, proportion of the profit from onsite operations, quantum of other income, pricing, etc. We provide for the tax liability both in India and abroad, all over the world in 11 countries we pay the tax. The tax liability in India is attributed to other income, treasury income, domestic corporations or banking units like Girish, plus any tax attributable to 80HHC companies. We have all our physical units, excluding one or two, under STP scheme, which gives you 10 years tax holiday, and the tax holiday for the heritage building goes away in 2004. From 2005 we have to pay the tax there, but at that point of the time it will be a small proportion of our revenue. The key idea is since the expansion takes place in our newer centers, till 2009 at least out tax liability will go up very gradually from what we have today for Indian tax. It is only after 2010, that we will have a full tax liability for the income in India. Tax liability for abroad, as I said earlier, we pay taxes in all countries where we operate using a visa, because we have permanent establishment, and we deduct direct expenses there and then we allocate head office expenses, based upon person months, and we pay tax in 11 countries today. Tax assessment has been completed in a large number of these countries.

Domestic versus foreign taxes: Slightly choppy, because of the nature of the business, onsite, offshore, the margins then come from onsite, margins from offshore, etc. Effective tax rate 14%, came down to 10%, it has been 10% to 11% last year, in the first quarter this year has gone up to 13.4%, because foreign tax liability has gone up, because the profitability onsite is slightly higher.

Now, this is what I would like to present to you because we are a full tax, fully compliant, global corporation. We are head quartered in India but we are a global corporation, we work in about 26 countries, we employ people of different nationalities, we are listed abroad, outside India, and we pay tax outside India.

Foreign taxes: You can see here, the ratio of foreign tax to onsite revenues has been historically at around 6.5 to 7%, it came down because quite possibly the profitability was lower, is gone up this year again.

Managing receivables: Continuously we monitor receivables. We classify them based upon the risk category. We have something called as past due. If 30 days is the payment, you give 7 days grace, beyond that it is classified past due. And every day a mail goes out to everybody who has to collect and also to Narayana Murthy, and also to Kris, and also to Nandan, and everybody asks questions why is it not collected? Because, when you bill a customer, till you collect, you have a risk, you have a liability, and we want to collect. Because the reality is cash in hand. And we classify all the receivables under different risk categories, high risk, low risk, and medium risk. We have a rating mechanism, which is done internally, and we also make sure that in case of a high-risk category we have a much fatter margin to absorb any variation. Maximum provision for bad debts till last year, has been 0.17% of revenues across the last, may be, 18-19 years. Last year we enhanced to 1.1, because the dot-com phenomenon was there. This year we have been at nearly 1.1% for the first quarter, but we had some slack there. We have a quarterly collection targets on a daily basis, and receivable collection is part of the performance indicators. When our people sell, they get a bonus on sales and also on collection, till they collect, bonus is kept in deferred abeyance.

If you look at this chart, you will find that more than 90 days were 7.4% in Q1, it has been steadily coming down, except a blimp in Q3, and now we have 1.3%. And if you look at the provision made for doubtful AR is been 0.71, 0.11, and in the last year it has been 1% every quarter excluding the first quarter. So, we have brought down the dues more than 90 days, because it is these dues of more than 90 days, which have a chance of going bad. So, 0-30 days has increased in the first quarter and our AR has come to 46 days. Don't expect our days of sale outstanding to be 46 going forward. Forty-six was an extra-ordinary effort, typically it will be about 56-59-60. Because last months billing is not collected, the previous months billing is sent on the 5th of the last month; so may not be collected, that is 60 days. So, we are able to collect the previous months billing to the quarter. So, we are very efficient, but normally it should be not 60 to 70 days or so.

Capital expenditure: We want to provide our employees with world-class facilities. I think, I will go pretty fast. We have done a lease versus buy argument. Let me give you a small thing, our campus has cost us Rs. 2100 a sq. ft., if you want to lease it out, it costs you in any part of the country, Rs. 25-30, may be more, if it is more it is great. If you take the furnishing on the lease, because Rs. 2100 includes furnishing, it will cost you Rs. 15-20. So take Rs.25, take Rs.15, Rs.40 a sq. ft., and it costs us Rs.480 a year per sq. ft.

And if you take Rs. 2100, and if you take 480 as a yield on 2100, that's 24%. Twenty four percent you get, if you build your own structure. You put money in the bank, you get 7-8%, and here you get 24%. And the longevity of the assets is great. When our customers come to this campus, they pay us 10% more because of the campus, they see all the beautiful lawns, the swimming pool, the food courts, happy people, prosperous people, the place where Vampire came and made a speech, the place where Craig Barrett came and planted a tree. They go to the company shop and see the Infosys branded items and say Wow! It is the company we want to work with and they pay us more. Now that is the intangible benefit of this campus.

Now, all our Cape is funded out of internal accruals. This year we have said we are going to spend $80 million, because we have some campuses on hand, we want to build capacity ahead of requirement, because we want to operate at 80-75% utilization. Hitherto we were operating at 100% utilization, we think going forward a company of our size should work at 75 to 80%. If you look at this chart, you have some three or four cardinal principles. Capital expenditure for the quarter should be met out of the cash flows for the quarter. The commitment at the end of the quarter should not be higher than the cash flow of the previous quarter, and we have matched that. And every quarter our cash accumulation should increase. Look at the chart, the figures are small you can see it in print, we have achieved all that.

So, we are going to change our P&L format, and if you look at this format, on my left, is the proposed format, and on my right, is the current format. What we have done is take away other income, which is non-core income, and put it after the operating profits. By doing this we think, it will even out the fluctuation in operating income, because if you look at the last four quarters, we have had foreign exchange fluctuation, income fluctuation, etc., which has distorted the margins. This gives you a better picture. This is how the rest of the world does it, and we have been confirming to the US GAAP, so we want to align US GAAP and Indian GAAP, and follow the functional method of accounting, and this is what we are going to do from this quarter onwards. What are the implications? Net profit remains the same, nothing happens. PBT remains the same, nothing happens. It is only above that there are some slight fluctuations. And if you look at the ratios, most ratios are almost the same, because the base varies, there is a slight increase or decrease. Our gross profit, our depreciation, and our profit before tax, on the proposed format go up slightly. That is because the base were calculated in that is different, because the other income is not there. If other income disappears, and other income is becoming a smaller part of the revenues, in the Q1 of the last year, other income was 4%, in the Q1 of this year it is 2%. That means the quality of the earnings has significantly improved.

Management guidance: Remains the same. For various reasons as told by Guns and every body else, we feel it is good to be conservative. We are seeing challenging times, there is pricing pressure, so we are saying that we have to achieve what we have committed.

Meeting future margin challenges. Salary increases have been lower this year. Onsite and offshore have been lowered. Impact on margins has been lowered. Other costs, our telecommunication cost, travel, have been tightly controlled. And we think we can maintain margins within an acceptable band, by managing costs, improving utilization, converting fixed cost to variable cost. The ideal P&L is everything variable, revenues go up, expenses go up, gross margin remains the same. So, when we do budgeting we always say we want x growth rates, we want a particular margin, that is where the cost is something that is allowed for people to just budget.

In summary, I want to place before you Ladies and Gentlemen, we have a strong financial model, we invest heavily in technology, training, and processes, we have the slack to capture additional opportunities and take care of market requirements, we have a strong and liquid balance sheet without any debts, and we have the ability to invest, last year we invested Rs. 460 Crores, this year about may be Rs. 360 Crores, and it is like a brick and mortar company. We are among, I think, the top 20 private sector investors in fixed assets every year. We are investing for the growth. We have a higher depreciation tires because of technology. We comply with all the tax laws. And thank you very much.

P R Ganapathy: Do you want five minutes to recover from that? We next have a short clip on infrastructure before the tea break. As you well know, Infosys' physical infrastructure has received many bouquet and accolades from a number of visitors and provides us with a significant leverage. We have short clip on infrastructure before we break for tea.