

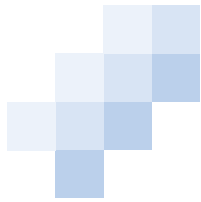
Mohandas Pai

Ganapathy: Now the final theme address is by Mohan Pai, member of the Board in charge of Finance and Administration, and CFO of the company. He will talk about how we lived up to the expectations of the financial marketplace, especially in this challenging and very volatile environment.

Mohan Pai: Thank you Guns. Folks, it is nice to talk to all of you once again in one room as opposed to speaking to you individually, and I have been battle scarred, battle hardened, tempered with all the questions you have asked. So I do hope you will be kind to me today.

'Living up to the promise', I think is important that the concept is understood in its context, that whenever you make a promise you must always live up to it. When you make a promise, you must have the odds in your favor. Never have the odds against you. As a finance person, I would always say that manage your risk, make sure that you can live it up. Don't be conservative, it does not mean that you promise peanuts and try to achieve more than that, that is not it. Promise what you can achieve, stretch yourself, go forward, because every time even if you go forward, and fall in your feet in a controlled manner, you are still six feet ahead, something like me. But the key issue is always live up to the promise and don't make false promises. Have something on your side, so that you have an ability to give a pleasant surprise and not a nasty surprise. Because people trust you. And investment is all about trust. Investment is all about confidence. Investment is all about belief, and you must have the trust of people and trust is won over a long period of time, but trust can be lost in a short jiffy. I gave a talk a couple of days ago in Delhi, on the role of the CFO and I said the CFO is both a creator and the destroyer - Brahma and Shiva. You know why, we have seen this impact what CFOs can do, innovatively, right? When things go well, you can be very creative and when things go badly, you destroy yourself and destroy many things else. So you need to be inherently conservative, you need to inherently have the odds in your favor. Last year we made a promise and our promise was based upon a concept of profitability, sustainability, and de-risking, on corporate governance, transparency in reporting. So I am going to take you through all these issues, and I am also going to talk to you about some current issues that are agitating your minds, our minds, all round the world. CFOs and CEOs are now made more accountable. They have to swear an oath, and if they do something wrong, the last year's salary and bonuses are going to be lost as also any stock options that they have exercised. So I guess promises are going to be kept more often now.

The environment was bad last year. A reduction in technology spending, ROI finally came into the fore. I remember the last four years, whenever you traveled to Europe, people said ROI and ROI, and when we went to the US, they said growth, growth, and growth. So in some parts of the world, revenues became a euphemism or a substitute for profitability. Whereas the more conservative part of the world, people still remember some concept they were taught in college called ROI. In the back of the mind, they were shaken up and they were wondering, is ROI for real? Is it something that you aim for because market moved on revenues; and revenues could be vaporware. But ROI is always critical, and why is ROI critical? I keep giving the example, McKinsey & Company made a study about five years ago. They asked a question - why does the United States keep having a higher per capita income year after year despite the budget deficit, despite a trade deficit, and despite the fact that the US economy was not doing so well despite the boom, the indicators were not so good. And they looked at Japan, they looked at Germany, and tried to find the difference. They found that labor productivity in all these countries were mostly similar, maybe Japan was slightly higher, Germany was slightly higher in some ways, but capital productivity in the United States was the highest at 14-15%. Whereas Japan, the capital productivity was 2 or 3 %, Germany 4 or 5%, and this had to do with the way the financial system was configured. This had to do with the efficiency of the capital markets. This had to do with the market for corporate control. So the financial system made sure that capital allocative efficiencies were very very high, capital is allocated to the unit which they thought gave the best returns. At the



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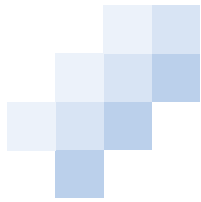
last few years, all of us traditional people were wondering, is it really true, is the market very efficient? The market is efficient. It requires some more time. Not in a short term, but in the medium term to long run. So ROI becomes very important and we have seen it happening to our clients.

Greater outsourcing of technology and offshore becoming mainstream, explained challenging pricing environment. I think Nandan made a point. Life is all about comparisons. Life is not about absolutes. There are no absolutes. It is all about comparisons. You know if the market grows X, and you grow more than X, you look good. The market grows X and you come down, you look bad. There is nothing like an absolute rate of growth. It is all relative, and within this, the pricing environment affects different people differently. Rationalization of vendors and custom preferences, I think Kris spoke about that, and so we have continued on our job of continuing to execute flawlessly without diluting our core values. We have not been carried away in the boom or in the downturn. Are we in a state of despondency? We are still very aggressive, still very energetic, and still get up in the morning with a lot of energy to come and go bang our head against the wall.

Promises vs. performance. Look at this, first quarter we made a promise last year. We achieved more. Second quarter we made a promise, achieved slightly more. Third quarter we squeaked through. And fourth quarter we are just there. So growth rather tapered off, quarter upon quarter, and the second, third, and fourth quarter were very relatively flat. So when we stood up on I think the 11th of April last year, I made a promise of 30%. I know that all of you were disappointed. I know that all of you felt that is the story over. The story was not over. The story was more real. And we achieved that despite September 11. We did not know that. No body knew it. We achieved that despite some tension on the borders. Did we know that? We did not know it. We achieved that despite downturns. Three years ago, last three two years we were asked the question - if the US goes in a recession, what is going to happen to you guys? We said US goes in a recession, we will see more outsourcing. And last year we were wondering, is it going to be true at all? Because we had clients, business did not ramp up. So on April 10, when we stood up and said, we are going to grow 17-20%, some people asked - is the story over? The story was not over. We have done all the right things. We have made the investment, we hired more people, we tightened our belts. I lost 5 kgs. But the results were not showing. So when we stood up on that point of time, you know the growth that we thought is going to come later in the year, looked more back-ended, because the first quarter was supposed to be flat. We did not know at that point of time that the growth is going to be rapid. We saw the growth in May and June. So we had 156. Good growth, good revenues, projects took off, but more on-site work, the margins were flat.

Now what about this quarter? We said the quarter is going to be flat because we said that at point of time that we did not know the impact of the travel advisory, the travel advisory was in force. I know the travel advisories are gone. We are seeing an increase in people coming visiting us, increase in the level of interest, we are seeing projects coming in and we are very confident we will meet our numbers for this quarter too. I am restraining myself. Now if you look at these annual figures you will find that both under Indian GAAP and the US GAAP we made a promise that we will achieve that on an annualized basis. We are right there. Tweaking the numbers somewhat last year but I think we are there. How do we do it last year? I think how we did is important. I know some of you got the story, but let me reiterate because I think some of the questions there we need to answer so that you could catch on to the model.

We have a relationship model which gives a good insight into client's plan. People said PSPD model, 100%, 30% gone, that the model does not work. Does it really work? Can you guys, how come you guys came down so much? Well the model works, but there is something called a market, and we are all subject to the market. You, us, everybody else in this world is subject to something called the market, right. The market is all about economic growth, about long term growth, and so and so. So, repeat business still remains because we are relationship driven, we are not deal driven, and we saw that. Clients came back and said,

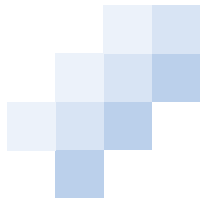


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please cut what your charge us, and we have cut, we cut and we did that. We had the pain. We took the pain and the clients were happy. We did not lose many many clients that we wanted to hang on to. We implement the-state-of-the-art system to give us more visibility into the process - you know so-called pipeline. Because predicting the future became that much more important. We added several large fortune 1000 corporations. We de-risked by having a discipline mix of business. Kris has spoken about that. And then we moved on to quarterly budgeting. From an annualized budget, from a delivery based initiative, to a budget based upon quarterly norms and quarterly numbers to a budget based upon cutting fixed costs and having what we call the stretch. The stretch is that your increases will be variable and the fixed components will not be there for any increase. We moved towards that and believe me last year, every quarter - one month before the quarter end and another quarter end we used to sit and we used to cut costs. Cut, cut, and cut. We had fights inside, people were upset, but we cut and we said look - we have to keep this promise. We have to eat. You know Murthy used to tell me when I joined this company in 1994 that you know, we will eat one meal less but we will keep our promise. And I want to keep my head held high and this philosophy permeates this corporation and we will fight to keep our promise till the bitter end, whatever the end is, but we will keep our promise. So we did that by rising fixed costs and making sure that we will stretch but did not compromise on growth. The growth impetus was there and we were pushing, and everyday we were aggressive in marketing, aggressive in delivery. We had a large bench of 2000 people, we kept our promise to them, we did not let any of them to go, and we trained them and we kept them and we kept up the cheer up. So in the first quarter, when the growth came, we were right there. We were right there and we did it. Now look at us and look at competition, look at the players in the market place. Look at the growth that we had in the first quarter. We did not have to add people; they were all in the system. And last year our model had all that cost built in. So we were billing 6000 people and had may be 8000 people, billable people. We still have a small bench as we enter this quarter. But the bench is diminishing. So if we add people now, it is all going to be a marginal costing, because the system has the capability and the cost to meet a larger revenue number. The system has a capability and the cost to meet a larger number. So the marginal cost for every increase is going to be less than what we had earlier. So cost management lowered fixed costs, 70% total hike we gave last year or something like 15% was variable, 10.5% was variable. In the first quarter we paid 100%, second quarter 68%, of this 10.5% and third and fourth quarter we got 0%. Because there was no growth in the system. And in the fourth quarter there was no sales bonus. So in the first quarter there was a sales bonus. Because our method of competing sales bonus for a sales staff is based on a concept called "expected value". The expected value is based upon the basic cost that we pay people. So if they meet a particular net of number it suddenly becomes much higher and if you go beyond that there is no incremental cost for that. We reduced cost by making sure that we recruit, we brought down, we deferred recruitment. We were deeply hurt by that because we have made a promise to the people. But today we have hired all of them back and they have come back. And they are very happy and I met them, I spoke to them sometimes and told them what a great thing that they are back and they are very happy that we kept our promise. So our reputation in the market place is incredibly high. Because we stood by our people. We think we stood by you, all of you. We think we stood by people and we took all the pain and now we have kept our promise. I think that is extremely important.

Tight control on non-revenue expenses, recruitment for support. Finance - we had, you know 74-75 people. We are 64. Sent all the young, bright chartered accountants to ES, you know enterprise solutions. They are all doing SAP and Oracle today. And I think the day will come when maybe Bala, I and Guns would be only ones around, rest will be outsourced. It will be a great day. So we recruit, we reduced equipment for support, implemented GDM for non-revenue activities and high cost economies. So all the support activities in the markets where we are, in the United Kingdom, in America, we brought it back to India. We have a web-based system to manage our travel costs. Travel is 4% of revenues. We have a web-based system. So you are in the US, go to the web, log in a request, comes here, you know we look at the request, we put it on the web. People compete, travel agents compete to get the rates, look at all the web rates, send the tickets back. Works beautifully. We have saved about \$250,000-



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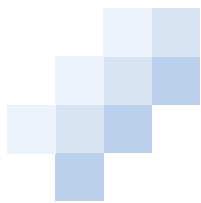
300,000 per quarter. So we reduced discretionary spending. Employee benefits, some of the staff policies were cut, we vacated lease premises etc. So we had a cost cut in the year of 2.4% of revenues but we had 1.1% of revenues because of H1B compliances. We spend about \$1.8-2 million per quarter on the increase in the H1B compliance because if we did not comply you had to get letters from your client that they have not removed people etc, which we did not want to do.

Folks, take a few minutes for this. Because this is a place where I think you could have leverage. Look at this 103-32-20; we have not lost our zeal. We are not lowering numbers so we can keep our promise, no. We are very realistic in whatever we do and we had a very pleasant surprise in 2001 because the large part of that 103% was price growth - 60% was volume growth, 40% was price growth. 40% was price growth in that year. And in 2002 we had 37% volume growth and there is no price growth. The price growth is almost 5% or whatever it is, if you adjust for the mix. And this year, 20% is all volume growth. Price growth, no there could be a price decline. Because the market is still very price sensitive. And if you look at this offshore personal cost 10-11-9%, 11 because we had a bench but on-site has gone up from 26% to 32%, why is that? First, if you look at the mix of business that Kris presented, the mix has become richer towards consulting, towards enterprise solutions, and these are substantially on-site. For example, the consulting division is just breaking even, not making money. But the consulting division gives you an entry into customers and strengthens your model. So you have a set of revenues, you don't make money in the bottom line, but they give you down stream because of the investment that you have to make. You are changing your model to be more and more like a consulting organization. So that is one thing. Second, the per capita cost went up. The per capita cost went up because of the H1B and other issues. And the third, the mix changed, and it becomes more on-site, the mix becomes more on-site for project starts or for what ever it is, then the mix changes. Other costs like depreciation has come down and I think it will remain there or come down in the future. Other costs of revenue like bandwidth cost, and other management costs, travel costs. Travel cost has gone up in first quarter of this year because of project starts, otherwise I think it is stabilized. So gross profits 48-45%. Well it is around a range and if the offshore goes up, it will probably bounce back.

Sales and marketing - We made substantial investment last year and this year because this year we have these bonuses. Plus this year about 60 people moved from production, who were account managers to doing direct marketing. So we have 135 people plus another 60 people. Maybe we will put 30 people more to do direct client interface. Because the complexity of the projects has gone up and people come, they ask you more questions, they don't give you business easily, it requires much more selling, much more giving comfort and that takes time.

General administration expenses - Flat at 8%, is basically what we have got here, stock compensation will continue till 2004, I think October 2004 something it could disappear. So operating income has come down from 33% to 30% and net profit from 32% to 27%, 32-30-27. Now what are the questions you could have - long term margins. Long term, what will be the margins. Long term, the margins would depend upon an offshore-onsite mix. If the mix becomes more onsite, there will be an impact. But is it a secular impact? No. We should bounce back to some normal onsite-offshore ratio. Take the mix in terms of effort. Please don't take in terms of revenue because that could be slightly misleading. Effort is much better thing to do. And future investment. We start new initiatives, we hire people, we train people, we carry out bench for that, and we invest substantially in marketing, there will all be write-offs but benefits will come later.

Tax rates - Because today we pay tax outside India, we are at tax rate impact within India too and that is why we find the tax rate going up. Now when there is pricing pressure, what mitigation measures can we take? When there is pricing pressure, the measures that we can take is to try to bring more work offshore. We are an offshore company. And just like the world is moving towards manufacturing in China (I think Chinese manufacturers could have a major



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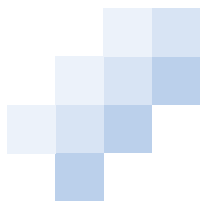
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deflationary impact on the entire manufacturing scene in the world), the services sector is moving towards India. Because India offers the best advantage in terms of quality, in terms of price, anywhere in the world, for this kind of service in such large numbers and which is scalable. So in this pricing pressure, the mitigation will come to moving more work offshore, to a scaling up, getting benefits of economies of scale, productivity increases, making sure that you have repeatability in your processes, making sure that you build up libraries of objects and making sure that your people inherently do much more work within the defined space. I think we are already there; maybe we can squeeze out some things more. These are the three methods by which you can mitigate any likely impact of pricing pressure.

People ask about cash flows. Yes. I will explain that to you, what our philosophy is. But let me give you some statistics, I hope the figures should be around that range. We had \$440 million of revenue in 2001, when we said when we spent \$107 million of capex, that is about 22-23%. Then we went to 545, capex came to 67. This year let us say 636 for argument sake, capex we are saying is about 45. So the percentage of capex to revenues is coming down. The hump in terms of percentage is over, in my opinion, because we have beefed up the infrastructure. Infrastructure is now world class and scalability is not an issue. We probably have capacity of 14,000-14,500 seats today as against a population of 11,000-11,500. And possibly we need little bit money to activate all these seats and I think we are there. And please remember when you are a large corporation with 11,500-12,000 people, and when you want to set up infrastructure for 2000-3000, it takes time. So it is better to have some leeway with you, carry it in a book so that when the growth does come, you can ramp it up. And that is exactly what we found in the first quarter. There has been some criticism on that rent versus buy. Why don't you guys rent it out. You know renting becomes okay if the cost of capital is low, if space is available, infrastructure is viable. Today the cost of infrastructure like this on a rental basis is Rs.51/sqft. We have made enquiries for Progeon. Progeon occupies a building of ours and we charge them 51. Why 51, because that is the market price, that is what it costs us. And with Progeon we have an arms length relationship. So 51 x 12 is about 600 add right and it costs us 2150/sqft. So work out the economics yourself. Should not we do this, what will you do? We do this.

People criticized us three years back saying you are spending money on your swimming pool, and are spending money on your golf pitching range. Pitching range costs Rs. 2 lakhs, come on guys; give us a break, two lakhs. Swimming pool, may be Rs. 35 lakhs, but it pays for itself. The maintenance is paid by the employees and because you have this work atmosphere. Because we are a reflection of the work that our clients do. Our clients are in the developed markets. They are not in India. They are used to this kind of environment. They want people working in this environment and they are very confident working in this environment. So when they come here, they say wow, wow, what a wow! And Basab gets more money, there is no competition. You go to city office, look at an office and look out of the window - you see that pollution, that noise and say ha ha, you know the word for that? You know it. So it pays off. All this pays off, believe you me. This place has seen 19 Prime Ministers and Presidents. Now all over the world, you go to China, where a Chinese delegation wants to business with us, they said we know about Infosys. It pays off. It gives us brand equity. Gives brand equity for India, allows us to sell and people feel extremely comfortable, because labour standards are going to be big issues in WTO. People outside are concerned about labour standards, they are concerned about the way you treat people. They do not want to sweat shops, they don't want cheap shops. And this is not expensive, not expensive at all. Show me, this building costs 2500/sqft fully furnished. Show me a like place for 2500 anywhere else.

Liquidity - What you do with the cash, why do you want cash? You know I read a colloquium in the American Institute of Financial Analysts or Financial Journalism or something like that. It was a round table of CFOs and there were these bright young guys who came and said you know capital structure, the capital structure conundrum. When you know that you can increase return on investment or return on equity by having an appropriate capital structure of debt and this, you know debt is cheaper, why is that you guys have more liquidity and more



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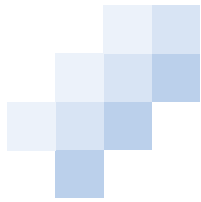
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cash? All of the CFOs said it depends on our perception of risk. We run the business, we understand the risks, and we feel much safer with risk. So set-off between the risk that you perceive in the business is not a technical issue. It is a live issue. We face it everyday. It is a set off between the risk you see in the business and the need for the liquidity, and we are concerned about returns, and we have a philosophy. We want to earn twice the cost of capital on invested capital and twice the cost of capital on capital employed, and we are much better than that. So capital efficiency is key to us. We know markets rewards capital efficiency, market punish people who don't use capital efficiently. So we know that, and we are concerned about that. So what about our cash? Cash depends upon perception of risks, depends upon our investment requirements, depends upon the cash flow the business generates, and depends upon what we think is a surplus. So we have increased our pay offs from 12% to 17%, believe you me, we are concerned. We see that everyday, I ask that question everyday of the week, we are concerned. We discuss that in our board meetings regularly about this and that is a live issue.

Corporate governance - We have an audit committee, we did it much before many other people. Independent directors, they grill us every quarter and our internal auditors and statutory auditors have direct access. Reports can go directly and we have a session whereby they can talk to them independently without us being around. So various accounting issues are done and every quarter, if they have any accounting issues, they discuss about that, they go into details, directly with audit committee. The financial details are adopted by the audit committee before it comes to the final board.

Executive compensation - Our founder directors, I don't like the word promoter. You know founders is better, are excluded from the stock option plan. Voluntarily they have excluded themselves. I remember in 1994, the time when there were preferential offers, right? You remember, right? You know I remember, you know somebody came and suggested why don't you people take preferential offers for yourself, why just dilute? And Murthy said how can I do that? How can I do that - give preferences to myself against all shareholders. We are all the same. We cannot do that. And that basic philosophy has stood by. And we don't give loans to directors, no loans, lowest compensation to the senior management of the industry, come on guys! Bala wants to cut even that salary for two minutes late, because we believe in 'Leadership by Example'. In 'Leadership by Example', we believe that we must stand up as leaders and take the greatest pain that we can. Because if you go talk to somebody and say give them the dream and say guys you must build this company, must build this country, go and get it, we must do the same, right, and we do that. And all of us work the hardest and we do that and I think it is the right thing and our compensation to senior management is not tied to stock options or anything like that. Excluding me and Srinath who got some stock options long time ago, you know others don't get stock options in the board. So it is not tied to that.

Disclosure policies - We operate through branches, we have this branch structure. We don't have subsidiaries. We know consolidation, we know it is going to come and we worked on the SEBI committee to bring consolidation to India. We want disclosure standards to be better, we worked to bring in more accounting standards into this country. We pushed for it in SEBI, pushed for it outside, having demonstrated ourselves the right way to do it. So we don't have this consolidation issue, losses in subsidiaries, profit in the parent company, we don't have the issue. And subsidiaries are created only for business and strategic reasons. We have only have one - Progeon, and that is for a different reason. No material off-Balance Sheet items, no special purpose vehicles, nothing like that, no surprises. And highest disclosure. In case of doubt, Murthy says disclose. Go beyond the statute, stand up before everybody and say this is it. This is what it is, be absolutely honest. Because you know in 1994, Mr. Murthy told me - whenever people come always speak the truth, no stories and he was very clear. It makes good business sense apart from being the way you are. Because all of you go and meet lots of people in this corporation, we hardly know whom you meet, and lot of you have got friends in this corporation, right Bala. Yeah, they come and tell us, you know you won this order somewhere 15-20 millions, and said ha ha, bolo kaha hai! He said it is here, who told you, now you know. Because why - we have chosen the best people in India to work for us, the



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best people are you guys, the best in the country. You are part of the same team. Of course, we maintain secrecy. We make sure that information disseminates to everybody at the same time and we maintain all that. But everybody speaks to everybody, so you know you get that, so we disclose. Transparent reporting, state-of-the-art web site, easy access to management, you can always call us up, you can always meet, but we also have to work sometime, if we cannot meet sometime please forgive us, alright. But you can come anytime, and you can meet, and if you have any problem any time please send a mail to Murthy or Nandan or me or Bala and we will remedy that, don't worry. We can't tell you next quarter's figures. But you can meet us and you can discuss things.

Full compliance with the laws. We have been searching for a strategic acquisition for three years. Like Murthy said, you know acquisition is like falling in love, we just don't go grab somebody, and say you know, come on. Well, I don't know whether it is a good thing that we have not made any acquisition so far. People asked us about that, they keep asking us when are we going to make that big block buster acquisition which is going to double the value? Well I don't know, but we are trying, we have seen 125 corporations we analyzed. Bala heads the team which does all that on a consistent basis. Guns talks about it. But you know we are looking at alliances and organic growth has remained comfortable. Have we lost out? We don't think so. There is a crisis of confidence in the market, like I said earlier, investment is an act of faith and the faith has to be maintained. There are accounting issues in large corporations, disproportionate compensations, questionable off balance sheet, we don't have any of these.

Stock option accounting - I know this is a live issue. There have been debates in the press. There have been many things. We have disclosed FASB 123. We have taken a charge under APB 25 and we have been in the forefront of bringing regulations into India and look, stock options for technology companies are different from stock options for CocaCola. CocaCola is the mainstream. Technology companies have certain characteristics. I will talk to you later, but we don't have time now. So, you know all these arguments and we are debating this issue. Today, for instance, 75% of the options are under water. So what do we do? You want to take a charge? Take a charge for what? What sense does it make? The technical expertise available for this is just not available in the world. Nobody has come out with a methodology and I frankly feel, and so do all of us, that we make a disclosure you people factor and the market factors in. The market factors in the dilution of the equity, the market factors in whatever it wants to. It is all factored in the stock market price. So market will be efficient in the long-term and it is efficient for whatever it is, because it is a market. Well, we complied with it. We certified last quarter two clauses. CFO's and CEO's are endangered species. I am sure that some things will happen in India too. Thank you very much and do you have any questions folks? Thank you folks.

Ganapathy: We will take a small tea break. We will start again here at 11:25 in 15 minutes. Thanks.