INFOSYS ANALYST MEET

FINANCIAL HIGHLIGHTS

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CORPORATE PARTICIPANTS

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V. Balakrishnan

Good morning friends. Let me talk to you about the boring thing - financial highlights.

In the last quarter, we had done well; our revenues grew by 10.2% sequentially. This happened after the second quarter in 2008, at that time we grew by double digits. In constant currency, the revenue grew by 9.3%. The EPS came out very well, much high than the guidance. The operating margins went up. Typically in a year, in the first quarter we gave the wage increases. To some extent, it impacts the margin and operating margin comes back in the later quarters when it gets normalized. The volume growth came out very well - 7.2%. The overall revenue productivity went up by 3.2%. We have seen very strong growth in some of the discretionary spend and we had especially seen a good uptake in consulting and enterprise solutions. That to some extent explains the increase in pricing. We added 14,264 employees last quarter.

At the start of the year, we talked about 16-18% growth. The first two quarters came much better than what we expected and especially the second quarter where we had seen a double digit growth after a long time. Consequently we increased the guidance for the full year. For the full year, we are talking about a 24-25% increase in revenue growth. We are going to add 40,000 employees. In the beginning of the year we said 30,000 employees. Overall, we are seeing good business momentum coming on our way.

Today, we are in a very interesting environment. We have 3 big challenges. One is economic uncertainty in all the geographies where we are operating, whether it is Europe, U.S., or Asia. All over the world, the growth is going to be very slow. It is going to be volatile. To that extent, you will see greater uncertainty and unpredictability in our business. The challenge today is that there is a business momentum in the short-term. We are seeing strong volume growth coming in but the challenge for us is to predict two quarters down the line because clients are not confident about the environment. In U.S., the corporates are sitting on $2.2 tn of cash but nobody is investing because the confidence levels are very low. To that extent, planning becomes very difficult. Do we see the current momentum and make all the investment and prepare for the growth or because there is an uncertainty we fine tune our investment? That is the biggest challenge for all of us. But we are investing. We are making sure that we are not leaving any growth on the table. We had increased the hiring numbers. We are making all the investments whether in sales and marketing or solutions and making sure that we are getting the growth but we have to live with this volatility and uncertainty for some time. The world is not going to change in the near future. Second biggest challenge is the currency volatility. Most of the currencies are moving 10-15% each quarter. It is not each year, it is each quarter. To that extent, the ability to predict the dollar revenues, the ability to predict operating margins becomes much more difficult and any change in the currency rates could have a material impact both on revenues and margins. We have to make sure that we manage the currency volatility much more efficiently. The third biggest challenge is the regulatory changes. All over the world, there is economic uncertainty. To that extent, unemployment rates are very high. The governments could become more protective, could bring in legislations which could impact the visa regime or the minimum wage regime. It is not only in US, even in Europe we are seeing some of the governments reacting on this front. We have to live with these 3 great challenges. At the same time, still make sure that we make the right investment and we get the growth.

Our aim is to have high quality growth. Period. We are not going to trade-off the revenues for the margins. There is no trade-off in the business. We are not just going to go behind volume growth and get the revenues. We want high quality growth which means superior revenue growth, superior operating margin and the best revenue productivity in the industry.

If you look at the numbers, over the years, our operating margin remained within the narrow band. It was 27.8% in fiscal 06, 29.3% in the latest first half year and last year it was 30.4%. It is irrespective of how the pricing moved over the year, irrespective of how the exchange behaved over the years. We have seen the currency (INR) at 39.50 to the USD, we have seen the currency at 52 to the USD and we make sure the variability in the operating margins is limited because we have multiple levers on the cost side and we also focus on high quality growth. We make sure that we get the best revenue productivity. It could be one of the biggest buffers on the margins.

We have several margin levers. One is the revenue growth. That is the biggest lever we will have because when we grow faster, it enables us to get better value for money on the G&A cost and the scalability still gives a benefit on the margin side. Price increases of course, if you get better revenue productivity it can act as a larger buffer on the margins and we also get G&A cost benefit because we make sure that most of the G&A operations we do it in India, to that extent the benefit is there. The onsite-offshore mix - when we do work offshore in India, the gross margins are somewhere between 70-75%. When we do it onsite that is outside India, it could be around 30%. So the more work you do offshore, it gives us benefit on the margins. Employee utilization – if we increase the utilization, that will be more favorable to the margins. Every 1% movement in utilization could impact the margins by app 40 basis points. We always hear the story that India, the wages are going up, so Indian salary and overseas salary is going to normalize. That is not going to happen in our lifetime. Even though in India, the wages are growing somewhere between 10-15%, the average per capita cost for us offshore, it is not going up in that proportion. It hardly goes up by 6-8% because we have the pyramid structure where we add lot of people in the bottom of the pyramid and bring them up quickly. We invest lot of money in the training of our employees. We get the best people, train them, give them opportunity to grow. To that extent, the pyramid structure itself acts as a great buffer for us on the margin. In India, if people start getting $12,000-13,000 per month as salary, India will be one of the largest economies in the world and all the employees can go in the private jet to their campus, not in their car. So I think the argument that Indian wages and overseas wages going to normalize is without merit, it is not going to happen in the near future. We have the variable composition structure which rewards the employees to do well and also helps us to minimize the impact on the margins when growth comes down.

I think quality of earnings is very important. We often hear that some of the other companies in industry are catching up on the margins. I think it is a long way to go. You have to look at the quality of earnings because everybody can get some margins or report some margin. Profit is a matter of opinion. Cash is a reality. I think you have to go into details and look at the quality of earnings. We do not capitalize any of the R&D costs. We charge off everything. Our depreciation policy is one of the most conservative depreciation policies in the whole industry. Software cost: we do not capitalize, we just amortize. We provide for all accounts receivables more than 180 days. So if you look at the quality of accounting policies we follow and look at the quality of the earnings, I do not think any company in the industry can match us.

We have a very strong balance sheet. We ended the last quarter with $3.9 bn of cash. If you look at our balance sheet, cash and cash equivalents is 57% of our revenues, account receivable is 14%. The rest of the other assets do not matter. We do not have any capitalized R&D costs. We have some goodwill but that is only 3% of the balance sheet. You would not see this kind of a clean balance sheet in any part of the world. This is one of the best balance sheets you can see with 57% of the assets in cash and cash equivalents and 0 debt. We earn around 35% return on capital employed, our return on invested capital excluding cash is close to 75%. Cash and cash equivalents is $3.9 bn. Our free cash flow generation is close to 20% of revenues. In which part of world you will find a company which generates such a high cash flow, high returns, 0 debts, huge cash? Our dividend policy is to pay up to 30% of our net profit as dividend every year. We balance our requirements of cash because we always said that we want to have next one years of expense as cash to give us comfort in running the business. We pay up to 30% of net profit as dividend. Our policy is to earn at least twice the cost of capital as return on capital employed. Our cost of capital is something around 14%. We want earn thrice the cost of capital as return on invested capital (excluding cash). We are earning much more than that. So we balanced all this and we also require cash to make sure we do not miss any opportunity in the market place. I think the technology industry is changing so fast. We will always see some opportunity to deploy cash and we are retaining some part of the cash for that. If at some part of time, we believe that we have excess cash we always returned to the shareholders. Even recently, we had given a $ 0.67 cents one-time 30th year special dividend for all the shareholders.

The biggest challenge for us today is the currency. The currency is too volatile. We have close to $556 mn of hedges as of September end. We proactively hedge our exposures. We cannot eliminate this risk. We have to live with this risk, it is a part and parcel of the industry but we try to minimize the risks. We hedge our exposes for up to two quarters at any point of time because we want to take a short-term view of this. Even though the Indian rupee has appreciated against the US dollar in the last one month, it appreciated close to 4.5%. We believe that the currency will remain volatile. It can move both ways. If you look at India, some $22 bn of capital flows has come into the country in the last 6 months. The trade deficit is still very high. India's trade deficit is $13 bn a month. If you compare it with U.S., the U.S. trade deficit is $43 bn a month, but US is 13 times India's economic size. I think any economy which has a high trade deficit and currency benefit is coming mainly because of capital flows, that kind of situation is unsustainable. It has happened 1.5 years back when the rupee went to 39.50 and when the capital flow stopped the Rupee went to 52. So we believe that currency will remain volatile. Other countries have taken some steps to stop the capital flows. We are seeing Thailand taking some steps to control the capital flow, Brazil has taken some steps, South Korea has taken some steps and Japan has come and intervened in the market. So you are going to see some of the emerging markets taking a big step in controlling the capital flows, or coming and supporting the currency because this kind of volatility is unsustainable and that is why we are taking a short-term view. We are hedging our exposures for up to 2 quarters at any point of time. We are not going to take a long-term view. If you take a long-term view, you will get stuck in a very volatile environment like this.

If you look at the currency situation, today 74% of billing happens in dollars. GBP, Euro and Australian dollars is close to 7% each and those currencies are moving faster. We believe that dollars could decline further because they may come out with one more Quantitative Easing which will be negative for the dollar. At the same time, dollar also has the benefit of not having an alternative. You can talk about Euro or Japanese Yen but the dollar is **the currency** for the world. To that extent, you will see some benefit for dollar. So again, the cross currencies are going to be very volatile. We do hedge our cross currency exposure to the extent of the next 2 quarters at any point of time. As I said earlier, we cannot eliminate this risk. We have to minimize this risk. We are seeing currencies at different level. We make sure that we used some of the levers to reduce the impact on the margins. If the currency moves by 5% a year, you can do a lot of things to minimize the impact. If it moves 5% in a month, it become much difficult comes and hurts your margin.

Today what are the two things which could impact our margin? One is the wages; wages of 50% of revenues, the second is the currency. I think wages to some extent, there is a natural equilibrium because if the growth does not come in, we do not need to increase the wages. In a normal year when growth is there, the wage increase happens. To that extent, it offsets the impact because when the growth is there, you can absorb the wage increase. It is not a big issue. But currency is something you have to worry about because any abnormal movement in currency could impact our margin. All the other costs are under control. To that extent, I think we have much more confidence in maintaining the operating margin. Currency is something that we have to watch out, that could have a larger impact.

The other biggest concern is income tax. In India, today we have two tax schemes. One is Software Technology Park Scheme which gives a 10-year tax holiday. That will come to an end this fiscal year unless the government extends it again which I am not sure will happen. Second is Special Economic Zone scheme which gives a 15 year tax holiday - first 5 years 100%, next 5 years 50%, and the balance 5 years to the extent of money you reinvest in the business. Today, app. 19% of our offshore revenues enjoy this tax holiday. Almost all the STP's except one has got out of the tax holiday. So we pay tax on 81% of our revenues. We are one of the top 10 tax payers in India. I saw some report which said that Infosys does not know how to do tax planning. We do not want to do tax evasion. That is the reality. We want to pay the tax as per the regime. We don't want to shift our business from STP to SEZ just to get the benefit. All these are the short term; we do not want to do that. Today 81% of revenues are getting taxed in India. Our effective tax rate today is 26.5%, it will be around 26% to 27%. We have already crossed the hump. When the new tax regime comes in from FY 13, there will not be any material impact on our tax rate. I think we are better off on the tax front.

In conclusion, we are focused on high quality growth - superior growth, high revenue productive and superior margins. We do not want to pride ourselves about being the largest company in the world. We want to pride ourselves about being the best company in the world.

Thank you.