# Infosys Limited

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**Ed Caso**

Good morning, everyone. I'm Ed Caso, the analyst covering the IT and BPO services sector, if we haven't met before. It's my pleasure to introduce the Management of Infosys, Rajiv Bansal, who is Chief Financial Officer. I actually go way back with Infosys, visiting your campus in 1998 when there were two buildings. I believe the main campus now has 40-some buildings.

**Rajiv Bansal**

I mean, I lost count. I think it's 50-plus, if I'm not mistaken.

**Ed Caso**

It's very depressing when you ride to do the tour and they say these are the heritage buildings. And I remember it was two brick buildings and volleyball court. The Company's come a long, long way. Congratulations. It's going, I guess, through another evolution at the moment that we should dig in a little bit on.

So, maybe we can start with the – where do you see the market, your end market today, both from a – sort of a run business, a maintenance business, as well as from a discretionary spend business?

**Rajiv Bansal**

Sure. The demand environment has improved, in fact, it improved as we speak and if something needs to improve, I think, if I compare between what we saw four to six quarters back to now, is much, much better. I think, if you look at the growth numbers of all – of Infosys and all the other companies. I think we have started seeing all around growth across verticals, across geographies and that is almost after about two to three years we are seeing all around growth. Environment is definitely looking much, much better across the verticals, across geographies as I speak.

The decision to spend, which has kind of disappeared from the market in the last two to three years, seems to be coming back. Still very early signs of same saying that yes it is back and it is going to be like that for many, many quarters. But I think the CIOs and the IT departments have started talking about investing in large transformational deals, about their changing the IT landscape and how they are going to contribute to the business. I think the discussions are encouraging. Discussions are happening in the right manner. But, we'll have to see them to be able to transfer into budget and the spend for next year, but we think the early signs are very, very encouraging.

**Ed Caso**

Can you differentiate between North America and Europe, if you see any differences? Particularly if you're seeing any revival in Europe and maybe how Infosys is maybe approaching that market differently?

**Rajiv Bansal**

Well, in terms of the environment, I think the US is definitely looking much, much better than Europe right now. I think – and that is visible in the numbers for all of us. So, US definitely would be the first to look at discretionary spend and looking at spending more money on some of the large transformation deals.

Europe is – I think they have figured the way to manage their own crisis. And now I think the clients are far more comfortable investing. So, they are happening, but not many large transformational deal kind of stuff happening. There is more in terms of ADM space and the large outsourcing deals.
But, Europe provides a huge opportunity. Because if you look at UK, the Continental Europe part, their IT outsourcing is still very, very small, whether it's over in Germany. Germany has opened up in a big way in the last many, many years, but it's still a very huge opportunity. France is a huge opportunity. Nordics is a huge opportunity. And our acquisition of Lodestone last year, the fact it gives us a lead in that and it has served in positioning us in that space very well.

Lodestone, the European consulting company based out of Zurich, most of their revenues come from Germany and Switzerland. And that is one area where we are seeing a lot of traction. We are seeing a lot of opportunities for us because we have now a very strong consulting arm, which was kind of missing. We had a very strong consulting arm, but primarily driven out of US, but we have a strong US.

So I think Europe provides a good opportunity, but US will continue to beat the IT spending.

**Ed Caso**

It seems like one of the special things about Infosys is they have a very broad base of revenues from geography vertical offerings. Can we talk a little bit from the vertical perspective? Which verticals are working and why and which ones are maybe a little soft right now.

**Rajiv Bansal**

The financial sector is definitely the most encouraging right now. And if you look at our revenue profile, about 34% of our revenues come from financial services sector. And rightly so because the financial services sector continues to be the larger spenders of IT. Because if you look at most of the large financial institutions and banks, they work on multiple technologies. They have their core banking, which has been kind of adopted many, many decades back. They have different applications and different platforms. And in a lot of places, they don't have even have a source code. So they continue to spend a large amount of money on maintaining and updating those applications. So, that'll continue.

And today their drivers are very different. Today I think that regulatory compliance is a big thing. They have their challenges. So you'll see them consolidating their IT windows and re-looking at how they'll do more cost optimizing and driving their behavior to release the valuable dollars for them to invest in the compliances, regulatory and other things.
So, I think this space will be exciting. I think it's – a lot will depend on how competitive you are. Because today in a large outsourcing deals in the financial sector are very, very price competitive as again it used to be in the past. I think banks are – these are primarily driven by the desire of the banks to cut their costs on IT spending.

In retail, I think retail is very, very exciting right now. Again, primarily because I think they are adopting new technology in terms of their ability to reach their clients, their consumers. Digital consumer experiences, mobility, is going to drive the way that – investment in the retail sector is going to happen on the IT side.

Manufacturing, still pretty slow. I think manufacturing clients move their manufacturing facilities to China long back and that helped them cut their costs, their manufacturing costs. But today, I think they are seeing their cost structures going up. They are seeing China with the cost have gone up. The labor costs are very high and they're not able to get the benefit anymore and they're looking at IT in a big way in terms of their ability to change the supply chain, get the savings out of and run a very efficient supply chain management.

So, I think very exciting opportunity in all the areas, but I think financial sector is essentially in the forefront. Retail will be next. Manufacturing, again. So there is quite good opportunities, but a little slow.

Telecom continues to be very, very challenging. I don't see telecom changing in a big way and definitely nit for us too. And I think that healthcare is a good – big opportunity, but Infosys very small play in healthcare. The competition is way ahead of us. But again, our growth rate in healthcare has been pretty encouraging for us. But, I think that's one area we probably will have to catch up in a big way.

**Ed Caso**

Any particular area within healthcare that you're focused on?

**Rajiv Bansal**

Right now it is more in terms of the government business and exchanges. But I think – as an industry, that is something that we have not done any big investment or done anything great. So we're open to any kind of opportunities in that space. We're also looking at –we were looking very actively for some acquisition in that space which would give us a head start. So I think as segment it’s small for us.

**Ed Caso**

So we've got geography, vertical and the third is service offerings. A few years ago the company started Infosys 3.0 and a big part of it was to get your non-linear growth up to do more sort of packages that you can resell, more sort of newer technology efforts. And a lot of that ties into retail. Can you update us on where that is and how that has – and maybe morph that question into how has the strategy changed now that Mr. Murthy has returned.

**Rajiv Bansal**

No. I think our strategy, it means the same. I think our strategy has not changed in any way after Mr. Murthy's return. I think we believe that it is the right strategy and eventually all the players will move towards that. Because when we started to talk about it two, three years back and look where this industry's is going and what has driven the growth of this industry in the last 10 years, it was finally cost arbitrage. In the late '90s and early 2000’s you'd go to the client and tell them, look, if they're not open to outsourcing, if you outsource we able to get to 30%, 40% cost benefit and it helped them invest money into where they need to invest. I think that was a good selling story.

But, if we look at what has happened in the last 10 years, our pricing points with the clients have remained flat. Between 2000 and 2013, if you look at the published most of the large companies, the price points have remained the same. At the same time, the wage pressures have started hitting because the offshore wages have gone up by 60% to 70% over the last 13 years. The onsite wages have gone up about 20% to 25% in the last 13 years. And there's only so much that you can pass on to the client in terms of your cost benefit because when your price remains flat, then you're going to see your cost pressures going up. Your ability to invest back in the business is going to get impacted.

Secondly, what we're also seeing is the industry has seen the kind of growth it has seen in the last so many years, I think to some extent, even if the demand environment continues to be good, the ability of industry to grow would get challenged by the scalability issues. I think you would see your supply side challenges becoming much bigger as we speak.

Today India produces about 900,000 to a million engineers, but half of them are not even employable by the industry because they are not English-speaking engineers. It's very important in this industry to be able to speak English because you are in front of the client. You want to talk to the client to understand what they need to do, the scoping, the requirements gathering, the knowledge transfer. So, if you look at the employable base, there's only about 400,000 to 500,000 engineers.

Now, if we look at the large IT companies alone, they are hiring about 200,000 engineers. And if this industry continues growing at the pace at which it should, about 14%, 15%, you would see them hiring 300,000 to 400,000 engineers. Then there are other industries in the space hiring. India, too, growing about 4.5% to 5%. A lot of industries are doing well in India. So the demand for these engineers is very, very high. And you will see this driving up the cost structures and the ability to hire.

And so what is going to happen is, when we sat back and thought about where this industry is going to go and what are the challenges which are going to be in front of us say five years down the line, we felt that our growth will get constrained because of the hiring challenges and some of it will break the model between hiring and our revenue growth. And that's what we believed.

Now, we want to increase our revenue share from consulting and system integration because that helps you improve the price point. It breaks linearity to some extent. You're talking to the client at different level you can actually link more and more of your revenues to outcome based pricing. You do more and more production platform tools, innovation, reusability, property improvement and some of these areas are going to be break linearity.

So, I believe that Infosys 3.0 is the right strategy in the medium to long term. Mr. Murthy, when he came back and he looked at where we are and where we need to go, he also fundamentally believes that is the right thing to do and we need to continue the journey.

Now, what happened in the last two or three years when we road on this strategy, I think probably finding in hindsight the timing was wrong because we had just come out of the financial crisis. There was a flush of budgets and you saw all the Indian IT industry and we grew about 26% that year. But I think we didn't expect the discretionary spend disappeared from the market. And a lot of these changes that we're talking about, moving up the value chain or products and platforms spend require discretionary spend to happen. So the discretionary spending didn’t happen. I think from there this didn’t looks light so exciting from outside.

At the same time, I think to some extent we weren't wrong we focus on this whole Infosys 3.0 and discretionary spending. We somehow were not as aggressive on the bread and butter ADM business. There were a lot of large opportunities in that space which, after the financial crisis, I think became more and more competitive. The price points started coming down. Price became the key driver for decision making. And from there, we did adopt ourselves. And I think that certainly missed the businesses.

But, I think in the long term, Infosys 3.0 strategy is the right strategy. It will reposition ourselves.

And as I was saying, if the discretionary spend starts coming back, I think we would be in very strong with it, do more of the journey very fast and also change our earning profile.

**Ed Caso**

So the legacy business, the ADM, apps development, maintenance, outsourcing, commoditizing. So, what steps are you taking? I know you're bringing some people back to India to reduce the average cost structure. Is there more cloud technology? Is there more –are you taking people out of the equation and putting more technology in? I mean, what steps are you doing to sort of stabilize the – sort of the annuity part of your revenue stream?

**Rajiv Bansal**

Well, the really main thing – well, Infosys historically has always come under the pricing premium with our clients. If you compare us to the competition, we are always about 10% to 15% more expensive than the competition and the clients gave us that pricing premium of the quality that we delivered.

Now, what has happened in this space is lot of decision moving from the CIOs to the procurement to the CFOs, I think pricing is becoming a critical thing. Our cost structure today is based on the pricing premium that we used to get so we have to relook at our cost structure. When we are looking at cost optimization, it is not primarily from the perspective of improving the bottom line, but it is also to make us more cost competitive to win some of these large deals.

Now, there are many, many things that you can do. You see today we operate at about 30% to 31% onsite effort mix. About 18 years back we were operating at 35% and 36% effort mix onsite. There is a potential to reduce this further and it would require you to go back and go to the client board and see how much you can offshore further, but there's definitely an opportunity to much more and go back to about 25% to 26%, which is really the cost structure.

So today I think we are more focused on project-level productivity benefit and some of the productivity benefit gets passed to the client. But today we are looking at something called individual productivity, which I think nobody in the industry does. So I think our focus is going to be in relooking at the staffing models, the onshore / offshore mix, the kind of role issues that we have, the quality and productivity, individual productivity, reusability, tools, solutions, which will drive lower effort.

**Ed Caso**

If I have my math right, Infosys has creative concentration of systems integration work than some of your peers, which generally implies more of an onsite capability. And I know there's been some significant efforts to bring – again, mixing the body count back towards the lower-cost India model, including, I think, taking almost all of your marketing structure and big chunks of your sales structure back to India. So, I mean, how far can you go with sort of the geographic location aspect of – to sort of stabilize the margin a little bit?

**Rajiv Bansal**

Well, again, if you look at – talking about system integration implementation, if you go back and look at '99 and 2000, we used to be at about 60% onsite effort on package implementation. Today we're running at about 33% to 34% onsite effort mix so we have brought it down from 60% to 30% or 33% without impacting the client. And this has helped us deliver better margins and pass on better cost benefits to the client.

Now, can we take the 30% down to 25% or 24%? Yes, we can. But we have to go back to the drawing board and reinvent our delivery model, which is what we have to do today. Because if we have to be competitive on the price, if we're seeing the scalability issue coming up, if we are seeing the price point's going to be under pressure, we have to keep reinventing ourselves. So it is very – it is a possibility and it is possible to do that, to reduce it.

We talk about the marketing structure being offshore. We are telling the clients that we – you can move offshore and you can seamlessly work. I think we are looking at how to offshore our own services to some extent; our support functions. Now, if I have a large marketing team sitting in US and Europe and I'm seeing how much can it be offshored and how I work an offshore it internally. So, I think what we are doing is not in terms of destructing the quality or speed of doing things, but to work with the client in terms of the off-shoring to do internally.

Now, you have to understand what has happened at Infosys. Infosys was a very, very successful company, growing 30% to 35% a year on average, 30% operating margin. There was actually nothing which was pushing us to change. We just continued to do the same thing over and over again and we were growing 30% to 35%. I think somewhere some of the costs have got inflated. Flap got built. We have not reinvented our delivery model. We have not looked at our role structure the way we should have looked at. With our structure today, we should have looked at it and reinvented in many years.

And I think with Mr. Murthy coming back there's a lot of focus in some of these areas, looking at the fundamentals of what has gone wrong. And it's not about something which would give us benefit in the current quarter or the current year. I think a lot of investors and analysts told us, okay, your problem is a margin – cut your margin, reducing your pricing and you'll win a large share amount of business and you're back to growth. But last year we cut our pricing down to 4% but we didn't see the growth. If it was so easy, then everybody would start cutting prices to get the good growth.

But, I think the whole idea is to look at how to build a stronger Infosys in the next medium to long term, the next three to five years. And for that, you have to go back to the drawing board and look at the fundamentals of your planning, your predictability, your delivery model, your quality and productivity, your sales engine, and that is what we are doing.

What we are also doing, very important, is that we are telling the investors and the analysts don't look at us on a quarter-to-quarter basis right now. We have been very focused on quarterly performance in the past. And so, to some extent, we have not been able to invest the way we should have invested in some other things in which we are investing now. So right now we are looking at how to improve our margin profile, how to get industry-leading growth in the medium to long term. So that – we are going to take some tough decisions. We are taking tough decision this year and we're investing money back in the business to ensure that we have a far more secure future. But, if I'm going to be under continuous pressures of a quarterly performance, then I would not be able to invest that kind of money.

So I think today, if we look at the last three quarters, our operating margins are flat at 23.5% in spite of rupee depreciation in a big way. I think primarily because we are putting the money back in the business. If we don't do it today then it'll be too late. So, we have to make those investments. We are making those investments. And I think the clearly articulating thing that this is for good along with investments and we know what we are doing. If the investments start giving us results we would come out much, much stronger and that is what the focus is right now.

**Ed Caso**

Now, you had a very nice tailwind with currency for several quarters now. I assume you took advantage of that to maybe accelerate some investments. Is that a fair comment?

**Rajiv Bansal**

Absolutely. See, the rupee depreciated by about 11% this quarter. In a normal sense, it should improve my margins by about 2.5%. But, we invested back to the business.

Now, what is happening at Infosys, our growth rates are low. It has a big impact on the employee morale and our attrition level are still too high than what we would be comfortable with. And the strength of our whole business model is employees. Employees are the biggest assets of the corporation.

Now, with the last year's growth being low, we didn't give the wage hike in April. Now the industry is doing well. India still has inflation of about 7.5% to 8%. Now, we have to pay our employees what is inflation-linked hike. We have to give them that thing. Because the Company didn't do well, we cut down the variable pay. We didn't pay them the variable pay which is the employment letter. Now again, it's when the Company is not doing well, it's not that nobody else is doing well. There were accounts which grew 40%, 30% last year also. Those guys would expect 100% payout or 150% payout.

So, I think what we have done now is we have changed our philosophy of employees wages. We are saying that we are not going to cut down our investment on the employee wages or the variable payout, the bonus structures to protect our margin. We have to incur this cost. We have to pay our people well. We have to give them good opportunities for growth. And after doing all that, we have to meet our margins, which means I have to push my sales engine, which means I have to go and improve my win rate. I have to look at my cost – like moving us offshore or looking at ways – we have to improve my cost structure. But in the past, if I just keep cutting my employee costs, I would not look at those cost structures.

So, I think today we are very focused on saying that we have to cut costs where it is possible, where it is needed, but we will not cut where it is important. And so we investing back in employees, investing back in sales in a big way. We're investing back in our quality and productivity tools. I think there's a lot of investment happening in our quality and productivity engine today. A lot of investment happening in new technologies today. This is very important to secure our future.

So, I think in the next – in the near term you will see our margin profile being where it is. I think a lot of it is linked to growth. We have seen –in the last four quarters we have seen two good quarters. We have seen one decent quarter or one bad quarter. So there is unpredictability in our performance. There is a kind of choppiness that we are seeing in our growth numbers, which I don't see going away in the near future, unfortunately, though I would like it to go away. But because we need to see at least five to six quarters of good order booking and which would help me – which will help my annuity business to say that I'm out of the woods and will do well

But, I think still then you will see this choppiness. You will see volatility in our performance, but I think we are doing all the right things and investing in the right place. We are taking some tough decisions. We are trying to keep margin profile in a very narrow band right now so that we can come back with a strong industry-leading growth and superior margins.

**Ed Caso**

I'm going to ask one more question, but if anybody in the audience wants to, that's sort of your cue to think about it. Intermediate term, is there a profile of Infosys as far as a desired or a natural, a new natural growth rate and a new natural margin? Are you going to settle out at some level?

**Rajiv Bansal**

No. What we are seeing is that – we're not putting up a number right now, but we are saying that we would take tough decisions even at cost of margins. We will invest if we need to invest. And if it shows up on the margin, we'll stand up and tell the investors saying that, look, this is where we're investing money and this is why we're investing money and this is going to impact our margins.

So I think today we are – the whole idea of coming and talking to everybody is to say that, look, we are going to take those decisions, some of the tough decisions that we have been taking in the last many, many quarters. In terms of growth, we want to reach back to industry growth. Last year we were, like, one third of industry growth. We were, on the one forth, the competition growth. If we look at this year, the industry is growing almost same as last year. The competition is growing almost same as last year. But we have kind of gone from 4.5%, we are getting around 9% to 10% now. So we are definitely catching up, right? But it will take some time before we catch up completely.

But yes, the goal is very clear. We want to get back industry-leading growth, not industry growth, but we want to be in the forefront of the industry in growth and we want superior margins. But unfortunately, both will not happen at the same time. You have to take sacrifice one for other in near term, but ensure that you develop a profile in a manner than we get both over medium to long term.

**Ed Caso**

Anybody? Okay, Gloria. Here comes Gloria, getting her exercise.

**Unidentified Audience**

The first is are you willing to share with us sort of your views on US immigration law going forward and where we stand? And then secondly, as that – depending on the answer to that, do you think the industry will further consolidate after we get through this immigration law one way or the other, either past or back-burnered for some time? Thank you.

**Rajiv Bansal**

I think a lot has already been said about the immigration bill and, honestly, nothing much has moved in the last couple of weeks. And they have a bill in front of the House right now, which doesn’t have outplacement clause, which was in the Senate bill. I think a lot of it is political and between the governments. But our sense is that, to a large extent, we'll have to wait and see how it comes out because if outplacement clause get back to the House bill. But I think from all the conversations that we have had, I think the outplacement replacement laws would not be there, which is a good thing.

So I think that – some of the other things which I believe would be a reality. I think the 50/50, higher visa cost would get through. I think that the kind of time frame they've given to the industry in terms of complying with some of the requirements of the immigration bill is okay. I think each of the companies would be able to figure out a way to meet those requirements and comply with that in the medium to long term. So, I think it's doable.

But again, it's very, very volatile. We really don't know what's going to come out. So I think all of us are looking at multiple ways of saying that, okay, if this gets passed what is our response going to be and if not what response going to be. So everybody's going to come out with that.

I don't know whether it will result in consolidation. What it will do is it will actually make the industry sit back and think of how vulnerable they are to following regulatory changes. If you look at it, it's $100 billion industry. Our IT industry is a $100 billion industry. And to a large extent, the biggest regulation threat is the visa immigration policy of each of the countries that we operate in and we are very vulnerable to that.

So, I think each one of us and NASSCOM would go back and relook at how to reduce their dependency of visas. Each of the companies could respond in a different manner. It will or could also looking at their delivery models in a completely different manner to see how you can offshore more work. Because unemployment in US among IT is only 2% to 3%. And even if tomorrow you have to comply with the regulation, you should have that many people available to be hired and that to grow 15% to 20% year on year. Right?

So, I think the response is going to be very different because you have to have the people available. That's easy because today companies like Infosys pay comparable wages. We don't have different wages between a deputies and a local hire, so it will not change our cost structure. But if the people are available, if they can work in a GDM model, they can work across time zones, then I think it's a good thing to do.

It also probably result in companies hiring fresher’s from the engineering colleges here, from the business schools here, building up the kind of training infrastructure built in India, train them, and look at more fresher hiring and give them career path in the US. So I think there are many, many ways of doing this and each of the company that want to look at what they want to do.

I don't know whether consolidation would really help. You could acquire a company with certain number of locals to meet the requirement in one time, but that is not going to be a scalable model or to only way to comply with the requirements.

**Ed Caso**

Have the clients stopped asking about the whole controversy around immigration, the agreement you just settled in on, or has the agreement raised the question again and has it impacted your business?

**Rajiv Bansal**

No, no, it has not impacted our business. We have not seen clients coming in asking us about it. I think there have been errors on our I-9 filings which we have corrected now and now we are completely complying with all the requirements and there was – a lot of allegations were denied. We strongly denied all allegations and I-9 errors that we spoke about. And I think from the client perspective, clients have not raised any concerns about any of this stuff.

**Ed Caso**

There's a question in the back.

**Unidentified Audience**

Yes. Could you please remind us generally, just in a nutshell, what are the primary differences between what you offer versus your major competition? Just a broadbased question, but just in a nutshell. Are there a couple of things we can hang onto?

**Rajiv Bansal**

Sure. If you look at our business profile of us with the competition, we are somewhere in-between the large Indian IT player and the global players. Today our – if you look at our business mix, 34% of the business comes from consulting and system integration. And again, if you look at the large Indian IT players it's something about 15% to 18%. So, we are way ahead of them in terms of our capabilities in consulting and system integration space, which is where we have more volatility in Revenues because that is more discretionary spend. And as you see the discretionary spend disappearing, we take the biggest impact. But as the discretionary spend starts coming back, we will probably be in a much stronger position. That's another profile.

On the large ADM space, which is about 50% of our business, we were able to command a pricing premium because of our differentiated service offering. We were the pioneers in the whole global delivery model. We were the first ones to look at this model and see how to move that offshore, how to be able to make work seamlessly across time zones and delivery the in the same value to client, within budget, within the time zone. And that's the reason we have a strong relation with our clients.

But I think over the last couple of years, our ability to differentiate on that space has come down. Competition has caught up to the large ADM space. We have not been able to reinvent ourselves in terms of our differentiate service offering there and that's the reason the whole discussion has moved to price instead of your differentiate service offering.

So on the large bread and butter business, there's not much differentiation today other than the price point. But yet, is it possible to differentiate? Yes, it's possible to differentiate. That is what I was talking about, about what we are trying to do today. But on the other part of it, I think we are way ahead. So today in the large consulting, system integration, new technologies, we compete more with global players than within end-to-end players. So on the large outsourcing needs, we do compete with end-to-end players than the global players.

**Ed Caso**

We have to – we've used up our time. Thank you, Rajiv, very much.

**Rajiv Bansal**

Thank you, Ed.

**Ed Caso**

For joining us today.

**Rajiv Bansal**

Thank you, Ed.  Thanks a lot.  I appreciate it.

**Ed Caso**

Thank you.

**Rajiv Bansal**

Thank you.