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Ed Caso:

Good morning, everyone.
This is Ed Caso, the IT services analyst for Wells Fargo. It's my pleasure to introduce the management of Infosys, Dr. **Vishal Sikka**, Chief Executive Officer, and Ranganath Mavinakere, Chief Financial Officer.

Ed Caso:

Thank you. So, thrilled to have you all here in New York with us

Vishal Sikka:

Good to be here, Ed.

Ed Caso:

Hopefully you're not off some flight from some foreign country, and that you're fresh and ready to go. Do you have any introductory comments that you want to make? Okay.

Vishal Sikka:

No, no. We just landed from the foreign country of California, five hours ago.

Ed Caso:

I want to spend the time really in two areas, the first area being, is the industry, the sector, the global-delivery IT services, BPO sector, going through secular changes, cyclical changes, both, and what degree?

And the other big question I want to drive into is, how is Infosys uniquely approaching that market? What's your differentiation in the market? So, maybe first talk a little bit about the cyclical, it's mostly headwinds at this point, but talk about the cyclical headwinds, how you're addressing them, and when maybe we might see the end of that.

Vishal Sikka:

Sure. And that's a great point, Ed. So, there are always cyclical things, quarterly things. So, for example, we're in the middle of a quarter that is traditionally a weaker one because of the holidays and furloughs and things of this nature, and there are always cyclical things going on, and there are structural things that are outside forces, like elections, and Brexit, and oil prices and so forth. And my stance always is that we overstate the impact of these big things, not we at Infosys, but generally we in the industry. But then there is the structural change that is happening in our industry, and that is because of automation and that is because of what is going on in the overall dynamic the business dynamic, which is that, with the pervasive automation and digitization of business, the nature of our very business is changing. And the big response to that has to be a structural one that is based on a deep embrace of artificial intelligence and automation, and a deep embrace of innovation as a result of that.

And this is what we have been doing, and it's quite different from what other companies are doing. So, the downward pricing pressure that you see across the industry is a result of that bigger change. You could say that is the secular change, the structural change that is happening in our industry.

Ed Caso:

Now, one of your competitors yesterday said that there wasn't pricing pressure, and I think they were talking more on a total cost of ownership kind of concept. Emphasis seems to have been more consistent that there is pricing pressure. Is that a legacy of where you're coming from? Just a different view on what pricing

Vishal Sikka:

No. We talk about it, and it's a different view on the underlying reality. If you look at the time and materials work, you can see that the billing rates are by and large the same. Whereas if you look at in fixed price, there is no doubt, across the industry there is a very significant shift. And similarly, the total cost of ownership of project transformations, of landscape transformations, the expectations that customers have on pricing is clearly declining sharply. We have customers where all our competitors are present in conversations, where they come and clearly tell us, together, that their expectations are that the prices have to come down significantly, because they are under the pressure.

And every day, the reality becomes steeper and more severe by the day, because of the digital transformers, the disruptors, operate on a very different set of economics, and these are disrupting all the traditional industries, which puts the regular businesses under a severe price pressure, and then that translates downstream into the pressure on. So, there is in my mind, absolutely no doubt that there is a change happening.

Ed Caso:

So, I don't want to let you off too quickly on cyclical here. Maybe talk a little bit about the banking vertical broadly defined, financial services vertical. What are you seeing? Any ease that might be coming in the big banks and insurance?

Vishal Sikka:

Well, we have to see how, in light of the elections, things change from a banking point of view, from the regulatory point of view, and so forth. So, I think over the next few months we have to wait and watch what happens to the overall climate. However, generally, the regulatory pressure, the burden on the banks has been increasing steadily over the last few years. And the response to that is the need of technology that helps them overcome many of these issues.

So, in particular, the cost pressure on the banks, the regulatory pressure, both from a perspective of investing and dealing with that, as well as the kind of technologies that you need -- I mean, if you look at some of the recent work that has happened in the anti-money-laundering area, the burden of proof is no longer around demonstrating that things are clean, but also demonstrating the absence of the evidence of money laundering and things like that. So, we require sophisticated technology; the ability to do reasoning and inference, to help banks achieve these kinds of results. Or, you have to invest in huge numbers of people to do that.

I see that as a set of tremendous opportunities in banks. Of course, every once in a while you run into a situation where you have a lot of work going on, and then that work comes under pressure, and then we suffer on a short-term basis, like happened in our case with one of our clients, and so on. But generally, I see that there is tremendous opportunity in banking. And you have seen in our performance over the last few quarters that our financial services verticals have consistently been the driver of our growth for our company, in fact.

Ed Caso:

Has the intense focus of banks on cost reduction and continued regulatory redirection of money - has that changed the interest level in fintech? I mean, are they still pushing ahead with all the sort of digital phenomena?

Vishal Sikka:

Yes.

Ed Caso:

Is that still happening?

Vishal Sikka:

Oh, absolutely.

Ed Caso:

You haven't seen them dial back the emphasis?

Vishal Sikka:

No, no, no. Absolutely not. In fact, the need for new technologies, I mean, if you just look at blockchain, for example, or the digital currency area, we had a huge thing happen, day before yesterday in India, where the prime minister basically very abruptly ended the two large-denomination bills and took them out of circulation. And that is a massive thing. And that shifts a lot of the opportunities towards digital currencies and digital trust mechanisms. So, the need for enabling banks to, at the very least, embrace blockchain as an enabling technology for trust, is massive.

And it gets more and more acute by the day. If you look at, in the light of the presidential elections, what happened with the Bitcoin world, it's quite extraordinary, the rate at which the Bitcoin investment started to just jump following the elections, and so on. So, I think, similarly, when you look at cybersecurity or regulatory compliance with new technologies, or the embrace of cloud technologies without compromise on the banking regulations, these are all tremendous opportunities for a well-educated company to deliver on.

Ed Caso:

I want to flip back and forth between, is this sort of the market, and the positioning. Help us understand how you, I mean, you took on a great franchise that was sort of lost its way. And you've done some tremendous things here. How have you redirected the front end of your organization, the client-touching part of your organization in the context of how the market has shifted to be more digital, and more business change?

Vishal Sikka:

We are still in the middle of that, Ed. We are not even close to finishing on that dimension, on the client dimension yet. But we have made very significant progress there. So, there are two parts to that, to the overall transformation. The first one is, how we have transformed the internal workforce and the internal processes and the work that we do. And the second one is the transformation of the front end, the engagement and so forth.

And that comes back to your original question about what's going on in the industry. The steep nature of the disruption that we see in every industry, including our industry, tells us that we have to follow a dual path. We have to embrace automation. See, if we look at the kinds of jobs that got added in the last 16 years in the IT services industry, these are primarily jobs in infrastructure management, in verification, and BPO things like this. We were always good at application development and maintenance, which are more cognitive, human kinds of things, even to this day. Whereas infrastructure management, verification and lots of BPO kinds of jobs are things that can be more readily, more easily automated. So, automation is at the heart of the transformation of our industry. The use of artificial intelligence technology, to do this. So, we have to embrace that.

So, the big move that we have made in our company in the last two years is that dual embrace of this automation, coupled with innovation. It cannot just be one. It has to be that we use automation as a mechanism to improve our productivity, so that people can be liberated to be more innovative, and they can exercise their imagination, their creativity, to do new things.

So, close to two years ago, we launched the program for grassroots innovations, where in every single project in the company we do something innovative, and we embrace automation to amplify ourselves; but we also do something innovative for the client. Because these teams are constantly in touch with the client. That's why we call this thing Zero Distance, because they are continually touching the client.

The results of this have been extraordinary. I mean, we have close to 100% coverage of that, every project has a Zero Distance idea. It has actually also become a driver of revenue growth, and Ravi, who is sitting here, he heads our delivery organizations; it's been incredible, under his leadership, how this transformation has happened.

On the front-end side; so, the innovation part how do we enable that at a massive scale? We have done that by teaching design thinking. We have now trained more than 120,000 people on design on design thinking. And it is a systematic mechanism of greeting people, problem-finding, identifying opportunities, and empathy, and engaging in rapid prototyping and things like that.

That same design thinking is at the heart of the transformation of the client side as well. So, we have done that by transforming our sales organization to also embrace design thinking to engage in clients, whether it is an ongoing engagement with clients or in large deals. We have transformed the large deals process, so if you see our large deal performance in the last few quarters, that reflects the fact that we have now crossed $1 billion in the last two quarters, or getting close to that. I think we did more than $1 billion last quarter, and also in the quarter before, and this number has steadily been going up. And the performance has been going quite well.

On the sales side and on the other big piece of this, which we are still in the early stages of, is to bring our consulting organization to bear as a tip of the spear. And I see that other companies are also starting to follow this terminology now. They are keen on how, based on design thinking, based on next-generation consulting, we can transform the client engagement process.

The end result of all of this, Ed, is that a couple of days ago we got the early results of our plan survey that we do, feedback. And the customer satisfaction numbers are the highest in the last ten years. And in the senior and mid IT levels, the feedback was always historically good, and that has jumped up by 12 points year on year. The CXO level has jumped up to the highest ever, not just in the last ten years. The CXO level satisfaction. And 2014, when I started this, it was a particularly telling moment at that time, about the state that not only we were in, but also the industry, from the point of view of what clients think about us. And 2014 to '15 our CXO level engagement jumped up by 15 points in that same survey. Now, '15 to '16, it has jumped up by another 7 points.

So, I am very happy with this. Of course, there is a lot more to be done, and like I said, we are still in the early stages of this. But, my goodness, I mean, to get to the all-time high scores on CXO satisfaction, and ten-year high in overall satisfaction, is something that reflects the fact that this has been working well.

Ed Caso:

So, one of the metrics that's appeared since your arrival is that your attrition from industry's worst to probably the industry's best. Maybe part of this is Zero Distance. Now, my understanding of Zero Distance is, you're basically taking your bench and deploying it out, and telling them to be innovative. So, is some of your customer sad stuff is because you're almost overstaffing, and you're overstaffing with people that are trying to bring added innovation and ideas to the client?

Vishal Sikka:

There two different things. There is Zero Distance, which is the idea of innovating within every project, no matter which project it is; which team it is. And there are close to 10,000 projects. To innovate in everything is one of them.

There is a parallel initiative called Zero Bench, which is around deploying the bench to help out in innovating. So, a lot of the Zero Distance ideas that teams come up with, because they don't have the capacity themselves to do the PoCs, or the prototypes. They use the people from the bench. And then, when the client says, yes this is something that makes sense to us, they actually deploy those people who from the bench, who worked on that PoC, onto the productive project. So, that ends up improving the utilization.

So, if you look at, as Ravi talked about recently, the fresher utilization, for example, offshore utilization has gone up significantly, directly as a result of this. We had 82.5% utilization in our Q2, in past quarter. And which is great. Which is, again, high in many years. But in particular, the offshore utilization going up is a direct result of this kind of a thing.

Ed Caso:

I can't let the politicians get away here. The part of the magic of the Indian-based IT industry was that the government the Indian government's been very supportive. As we move more towards automation, which is effectively taking people out and putting software in, the industry should be creating less jobs and be less of a job engine. Is there any risk now that the given that the Indian economy is much stronger and more broad-based, that you lose some of that support that the industry has had historically?

Vishal Sikka:

I don't think so. I think that we have to be the innovation driver, just as we were the jobs drivers before. And in my mind, in the age of automation and the age of artificial intelligence, the future belongs to those who can embrace AI and those who can innovate. As long as we treat AI as an amplifier of our abilities, and innovation as the human frontier where we can deploy our imagination and our creativity to the unknown; to shaping the unknown, to doing problem-finding and innovation, I think that this will continue to be the industry that defines that future growth.

The the IT services industry, in particular the innovation-led IT services industry, is incredibly important to India's future. But it is in fact important to the future of any business. I mean, I am a US citizen. My sense is that we can no longer view our company as; anybody can set up a captive in India now. So, this idea that this is an India-based services industry or an India-based company is something that we have to get away from. Because when I walk around in Bangalore, you see every brand out there; or in Shanghai. I was in Shanghai over the weekend, and that every company is present in every one of these places.

So, it is no longer about an Indian IT outsourcing company, but it is about a company that can deliver a set of values and capabilities that nobody else can; innovation that nobody else can. And when we look at ourselves in that light, I think that there is a tremendous future ahead.

Ed Caso:

Maybe just a quick question for Ranga, to give you a chance to catch your breath.

Ed Caso:

As you move to this more global company, there's been an effort of late to bring in what I would call more traditional executive comp schemes: stock compensation, basically. How broad is that, and do you see the company moving to a pro forma EPS presentation similar to some of your competitors?

M.D. Ranganath:

I think, coming back to the executive compensation, you know, we took shareholders' approval for up to 1%, the total outstanding shares. And one of the key factors that the board and the nomination committee decided saying that, look, the variability in executive compensations has to be significantly higher, and it should be predominantly aligned with the shareholder interest.

So, if you look at some of the recent compensation changes that we have done for the president and other senior leadership, the cash part is the smallest, the stock part is the biggest, and bulk of the stock part is highly linked to the performance goals of the company. I think that has been a significant shift, if you were to look at in the last one year. Clearly, we want to keep the compensation in line with the market to attract and retain the best talent. At the same time, ensure that the variability is so high, in certain cases as high as 70%, so that it is linked to the company's performance and the investor and shareholders' goals.

So, that significant shift has happened. But on the other part, yes, of course, we continue to publish our EPS, both on the fully diluted, as well as on the reported basis. We'll continue to publish those.

Ed Caso:

Are we on this new comp scheme, is it starting to be embraced or I mean, it was a long time, because of the way the Indian code works, that it was a cash-based comp system. I guess my question is, the Indian press loves you and follows you closely, and they highlight every person that comes and goes. It feels like there's been some turnover, probably more than reality of a normal percentage. I mean, give us a sense. Is the comp system taking hold? Have you stabilized the management team? And do you have the people you want in place?

Vishal Sikka:

The management team actually, if you look at the core management team, it has been extremely stable. Yes, we have lost several people due to performance; due to various other reasons. Yes, I mean, it is something that we wanted it; we wanted to see it that way, and then it shows up in the news, so you don't want to talk about these things publicly, but, you know, since it is in the news, you have to say that a lot of these things were because of performance reasons. And so, we are quite happy with the outcome. We have, of course, brought in talent from the outside as well. And this is a continuous shift. You are never satisfied with where things are, and as circumstances change you continue to make changes.

But I am extremely happy with our management team. I myself, Pravin, Ranga, Ravi, who is sitting here; Deepak, Abdul they're all here. We have the three sales presidents, Sandeep, Mohit and Rajesh. We have a great team. We were together since last two days in California.

I think that, you know, you want a company that is going through such a fundamental transformation from a cost-based model to an innovation-based model, it is going to continue to challenge itself and continue to find the people who have both the ability to comprehend the changes that need to be made, and execute on those. And I feel very blessed with the team that we have. It's a young team. It's a very energetic team, passionate team that is ready to make these things happen.

In terms of attrition, as you mentioned earlier, attrition has come down significantly. In particular, the high-performance attrition and the attrition at the weak and what we call the title-holder level, if people have executive positions, has done extremely well. They are in low single digits. So, 4%-5% title-holder attrition. And high-performance attrition has continued to come down to low single digits. So, that is something that we track very closely. And beyond that, in fact, you want some of the attrition to be a good mechanism to filter out the organization.

Ed Caso:

So, you came in a year or two into a huge change in the industry, from this cost-focused global delivery to this and I'll use the word innovation-oriented market, which is begging for a different business model but I would say a little bit more of a software-ish business model, which is more of your background. But software and the services historically struggle to sort of work under the same umbrella. How are you managing that transition, and still keeping the 50-plus analysts you have happy with hitting the quarterly numbers?

Vishal Sikka:

It is far more difficult than it looks, Ed. The key is to have software and services, meaning, we are a services company. In fact, we are living in times where things around us are all becoming services. These light bulbs are becoming services. You know, the equipment that you have here is becoming a service. So, at this point, to become a product company would sort of miss the point. So, the key is to amplify people's ability with software.

Now, when you look at the pure software business, the transformation of the pure software business, it is a very straightforward script that you take the high-margin cash cow businesses and you freeze those to fund the new things. In our case, the high-margin cash cow business is in fact the one that is under margin pressure. So, if you look at our global delivery organization, it has largely funded the lower-margin BPO and consulting and the lower-margin software the edge business. So, in our case, it is the core business is the one that is under the margin pressure, so the transformation is much more difficult.

But what should we do there, then? And I get asked this question a lot. I think that most of the industry does not have the ability to build software because they always built custom software. We don't have the ability to build repeatable software for a variety of cases. This is where I think some of our expertise, some of my expertise in building repeatable software becomes relevant. If we only apply automation software to ourselves, we will miss the point. Because very quickly, this economy will be absorbed by the downward spiral. It will be visible to the client, they will want a share of it, and so forth.

Therefore, the way out of this downward spiral is to build software that is in addition to ourselves, it is also for other users. It's not enough to simply build software to improve our own productivity. We have to build software for the other use cases and for the outside use cases. That requires the ability to build general-purpose software, which is not easy.

So, ultimately, the way out of this is a software-plus-people model, where the embrace in the traditional services organization is by using software to improve our productivity and to augment that productivity improvement with innovation from the grassroots, so we can elevate our standing with clients and become more strategic to them, and so on. And in parallel, build that same software that improves our productivity, to go out there and build other use cases on that, which are high-margin, next-generation use cases like the AML, Bitcoin, blockchain, regulatory compliances and artificial intelligence, Internet of Things, the integration of physical/digital; these kinds of high-margin, next-generation, intelligent applications, built on the same automation platform that helps us improve our productivity - that is the way out of this downward spiral. There is no other way.

Ed Caso:

Can we do that vision within the context of sustaining roughly the general margin profile that you're in? Because I hear this vision, and I'm thinking investment. And often investment in your business is lower margins.

Vishal Sikka:

Of course we can.

Ed Caso:

On business. So, are you trying to do the great balancing act here, or do you sense that you really need to sort of make a bold statement?

M.D. Ranganath:

I think, you know, coming to margins, you know, you're absolutely right, I think, as Vishal was saying. We have to look at the way we can do certain short-term levers that we have at our disposal. But at the same time, short-term levers are short-term levers, and we also need to create certain sustainable margin-improvement levers, which can potentially come only from automation.

Now, if you look at the levers that we have; we have been saying this for the last couple of quarters we do believe that some of the four or five operational efficiency parameters that we talk about- for example, one of them is the utilization, right? Utilization consistently, we used to be in late 70s. Since the last five, six quarters, we have been consistently about 80s. In fact, Q2, we touched 82.5, which was one of the highest in the recent quarters.

We do believe that's how did that happen. If you look at 1½ years ago, we had a reorganization of the delivery teams, and that become so fragmented, so the movement of people, fungibility of people was that much harder. So, that helped us in better balance of reach, chain planning, and staffing, et cetera. So, also, at that utilization improved. Likewise, the subcontractor expenses used to be 6.3% of revenue, three, four quarters ago, and we again looked at the efficiency improvements there. That came down one full percentage point. In Q3 it was 5.4%.

On-site effort mix. That's again, it's a huge lever. It used to be in 27. We touched 30 almost, up again in 29. So, that is another lever.

Likewise, the on-site employee costs as a percentage of revenue. We do believe that, look, how do we ensure that higher billing rates are obtained for more expensive roles, and so on and so forth?

So, if we look at these levers, a 1% improvement in utilization gives about 40 basis points. On-site mix, 1%, 50 basis points. So, we have been kind of fully ensuring that the trajectory of these levers is in the right direction.

Now, having said that, these levers, while they're important, but the more sustainable and these levers will help us to some extent offset the pricing pressure that Vishal talked about. So, these productivity and efficiency levers will help us to offset those. However, the more sustainable ones have to come from automation, which is again, you're going back to your point of investment in those. I think that's where we have invested not just in automating some of the low-end pieces offshore in India; it has to happen across the pyramid, both on-site and offshore. That's where the investments are going.

But we do believe that finally operating margin is the derivative of three things. One is the revenue growth itself, and the second one is the pricing, and the third is the operational efficiency. So, we have given the range and we are comfortable with that range. But, yes.

Vishal Sikka:

So, we are comfortable with the range, like Ranga said. We have still levers, as Ranga said, that we can use to improve our performance operationally, and to use that to fund the things that we need. It is not that the things that we need and require massive amounts of investments. Up until the point that we change the go-to-market profile on our software, we won't need large new investments. The software development and innovation development extra work can be done, we believe for now, we believe that we can fund this out of the saving from the existing businesses.

Ed Caso:

Well, we're out of time. I have so many more questions, and we wish you the best in continuing to bring the great franchise back.

Ed Caso:

Thank you.

Vishal Sikka:

Thanks, Ed.