Infosys®

Results for the Second Quarter ended September 30, 2003

INVESTOR EARNINGS CALL

10 October, 2003 - 6:00 p.m. (IST), 8:30 a.m. (ET)

Operator: Good morning ladies and gentlemen and welcome to the Infosys Technologies Investor Conference Call for quarter ended 30 September 2003. At this time, all participants are in a listen only mode. Later we will conduct a question and answer session. This call is being recorded at the request of Infosys Technologies. Participants who have objections to such recording may disconnect at this time. I would now like to turn the call over to Mr. P.R. Ganapathy, Investor Relations Officer. Mr. Ganapathy, you may begin sir.

P.R. Ganapathy: Thank you very much Monica. Good morning and hello ladies and gentlemen, thank you for joining us to discuss the results of the quarter ended September 30th which is the second quarter of our fiscal year 2003-2004. I do hope you have all had a chance to take a look at our press releases and the fact sheet that we've uploaded to our web sheet, www.infosys.com. I have with me to discuss the results for the quarter and our prospects for the quarters ahead, from a conference room in Bangalore, India, Nandan Nilekani, President and CEO of Infosys and members of his senior management team. We will begin with a short comment by some of them on the results of the quarter and then I will open it up for your questions. Before I hand over the call to Mr. Nilekani, I have a duty to perform in reminding you that anything we say about the future is a forward-looking statement and must therefore be read in conjunction with the risks that we face. A detailed statement of these risks is available with our SEC filings at www.sec.gov. With that I now turn the call over to Mr. Nandan Nilekani, President and CEO of Infosys Technologies. Sir, please begin.

Nandan Nilekani: Thank you Guns and I'd like to welcome all of you to this earnings call. Let me briefly go over some of the highlights. The revenues for the second quarter came in at $250.77 million which is up 38.21% from the corresponding quarter in the last fiscal and earnings per ADS has increased from $0.36 to $0.49 per ADS corresponding quarter. This quarter we have added 29 new clients and we have had a gross addition of 2,845 employees for Infosys and Progeon. We have given our guidance for the next quarter and the year. For the quarter we have given guidance of $258 million to $260.2 million and consolidated earnings per ADS of $0.50. For the year we have given a guidance of between $1.08 billion to $1.15 billion and earnings per ADS of $1.95. Hence, our revised guidance for the year provides for our revenue to exceed $1 billion dollars in this financial year.

Our growth continues to be strong. We believe that offshoring is becoming mainstream. We believe that more corporations across the world are looking at offshoring and using the global delivery model to help in reducing costs and improving productivity and bringing a higher quality of performance. Infosys as the brand and market leader in this market is really poised to take advantage of this incoming trend of outsourcing. We are also seeing pricing stability in the last quarter. In fact, we have had improvement in our price productivity –onsite price productivity has gone up by 1.4%. Offshore price productivity has gone up by 2.2% and on a blended basis there is no change because this quarter, another significant achievement is that the onsite/offshore ratio has changed and the onsite effort has gone down from 34.4% to 32.6%. So I think it has been a good quarter. We have been able to revise our targets. We have been able to grow. We have been able to get some price stability and I think we are well poised both to grow and differentiate our business. With this I will request my colleague Kris Gopalakrishnan to go over some of the highlights and then Mohan to go over the financial numbers.

Kris Gopalakrishnan: Good morning, good evening, everyone, this is Kris Gopalakrishnan. Looking at the geographical split, Europe has seen a slight increase as well as the rest of the world. Looking at service offering, we see that maintenance has gone up in this quarter to 31.6% of revenues compared to 26.9% last quarter. The other services which we introduced over the last few years – other services like package implementation, consulting, testing, engineering services, etc., give us a revenue of about 34.4% this quarter. So definitely our strategy of introducing these new services, expanding the portfolio, expanding the footprint has worked to our advantage. Repeat business continues to be very high at 95%. In terms of verticals, we have seen increased growth from the banking and financial services, as well as in the telecom area. In telecom area this is primarily from the service provider segment. We have seen increase in revenue from clients. The top five clients constitute 24.6% of revenues. The number of million dollar clients, the number of $5 million dollar, the number of $10 million dollar clients, all of these numbers have gone up this quarter. As Nandan already mentioned, the offshore effort has increased to 67.4% compared to 65.6% last quarter, an increase of 1.8% and we have also been able to reduce the number of subcontractors we are using and replace them with our employees. These two factors have actually helped us improve the margins this quarter from an operations perspective. Let me now hand it over to Mohan to continue with the analysis.

Mohandas Pai: Folks, as already said, we grew sequentially by 7.5% to $250.76 million dollars. Our gross margin increased to 43.8% from 43%. The reason for the gross margin increase lay in the decrease in charges paid to subcontractors from 2.4% of revenues to 0.7% of revenues. SG&A was at 15.3% as against 15.1%. The increase was due to a 0.6% increase in provisioning for accounts receivable due more than 180 days. This does not mean that all this portioning is for receivables which have gone sour, it just means that as a matter of policy, any dues more than 180 days gets provided for. If you net off the increase in provision, we are well within our target of reducing SG&A expenses. We also increased amortization of IPR to $3.3 million dollars this quarter from $749,000 previous quarter, an increase of about $2.5 million dollars and the reason was we re-estimated the useful life of an intellectual property and we wrote off $2.5 million dollars. Therefore, our operating income was at 27%, $67 million dollars from 27.5 and if you net off the 1% increase in amortization it would be at about 28%. Non-operating income was at 4.1% because of a favorable exchange difference of $4.9 million dollars and this arose primarily because of the hedges that we had. Therefore, non-operating income grew from 2.3% to 4.1% and tax provisioning increased from 4.8% to 5.3% because of higher taxes on exchange differences. Our guidance for the future do not include any positives or negatives from exchange differences even though we have a forward sale of $139 million. The rupee has appreciated during this quarter by about 2.2% and the rupee has appreciated somewhat since the end of the quarter. So we ended up with $0.49 for this quarter. Total cash on hand as of this quarter end was $474 million dollars. We added to our cash.

Progeon, our business process subsidiary had revenue of $3.7 million dollars as against $2.7 million dollars the previous quarter, an increase of more than 35%. It added 156 people net three clients. Right now it has ten clients with four clients live in terms of BPO work, four clients in transition and two clients in the discovery phase. Progeon has guided for the next quarter at $4 to $4.2 million dollars. Progeon was profitable in this quarter and had a profit of about $260,000. Progeon sticks to its guidance of $16 to $18 million dollars for the entire year. These are our official highlights for this period and if you have any further questions, we would be most delighted to answer.

P.R. Ganapathy: We will now take questions Monica.

Operator: Thank you. We will now begin our question and answer session. If you have a question, you will need to press star-one on your touch-tone phone. You will hear an acknowledgement that you have been placed in cue. If your question has been answered and you wish to be removed from the cue, please press the pound sign. If you are using a speaker phone, please pick up your handset before pressing the numbers. Once again if there are any questions, please press star-one on your touch-tone phone.

Our first question comes from Julio Quinteros from Goldman Sachs, please go ahead.

Julio Quinteros: Good morning or I should say good afternoon, guys. First of all, Nandan, I wanted to ask you real quickly about pricing. The commentary that you made about pricing suggests a fairly stable outlook for the rest of fiscal 04. I guess my question is -- as it relates to pricing, can you talk a little bit about the renegotiation cycles and how that would impact pricing in fiscal 04 and as it relates to renegotiation cycles, what makes you so confident that pricing will not further deteriorate or show any pressure in fiscal 04?

Nandan Nilekani: I think first of all, you know I think this whole pricing renegotiation has taken on a far bigger dimension in people's minds than it should. We have several hundred customers and only about 15 of them have actually renegotiated prices in the last six months. What happens though is that typically the renegotiations that happen, happen when the volume with the customer goes up and to that extent because they tend to be larger customers, the impact is something that you feel. So it's really more of that.

I think that what happened in the past was that we had a certain amount of prices which were not reflective of the current market environment, so they had gone a little out of sync and clearly these were all customers who had been with us for quite some time and who had a fairly large volume of business and they rightfully said that they deserve to get a better deal on the prices and we rightfully believed that in interest of a long term relationship we should give them that benefit, so that is how it happened. So I think to that extent a lot of that "bubble pricing" if you wish has been removed from the system and therefore I think the prices have now come to a more quiet and equilibrium point. To that extent, we feel that it is really, we have essentially absorbed the removal of some bubble pricing in the system and I think the key thing is that we have been able to bring it down to a more moderate level and therefore I think going forward it is not really a straight-line kind of thing, it was really an adjustment of something that was happening.

The second thing I think is that I think the Indian players in general are becoming more price disciplined. I think people are beginning to realize that this outsourcing is going to happen and there is going to be plenty of demand and everybody is going to get his piece of action. So there is no point in going and shooting yourself in the foot as some people have done in the last year or so. I think they will learn quite bitterly that it is not a good way to do it. So I think people are observing more pricing discipline so that is the second point which gives us confidence.

The third point generally I think is that based on the macroeconomic indicators, based on the fact that most economists expect three to four to five percent, three to five percent growth of the US GDP in the second half, hopefully there will be more IT spending, demand will go up. It's not like it was earlier when really the focus was on cost cutting. So I think these are all the indicators that we have which leads us to conclude that we will have price stability going forward.

I think the important point is that people have to realize is that in spite of achieving pricing at a lower price point, I mean price in realization terms, in spite of fairly dramatic appreciation of the rupee, we have been able to reconstruct our business model, move stuff offshore, reduce our costs, become more efficient and still deliver a decent margin in this environment and that is really the key thing that we need to all recognize.

Julio Quinteros: Great and one follow up question for Kris. Can you give us a sense from an operational perspective on what the impact has been of the arrival of MNCs in India if any at this point in time and just kind of your perspective over the next twelve months…what this means to wage pressure if anything?

Kris Gopalakrishnan: We have increased our salaries this year. We have increased this primarily as variable component. That is the employee benefits as well as the company benefits if we do well and we are protected if there is a downturn and things like that. That has been the philosophy over the last two years for the company and we continue to implement that. We have seen some increase in attrition in the last quarter. It has gone up from 7.6 the last quarter to 9.1. But most of this is in the two to five year experience range and traditionally this has been the group which looks at higher education, looks at making a transition after having some experience and things like that. So we are able to manage that. Infosys has added 2,025 employees last quarter, net; gross about 2,500. So attrition of about 500 people which is a significant number and if you look at the last half year, we have added about 4,000 employees. So if you then look at what the MNCs have as a number of employees in India, you know we have grown actually faster than many of their total strength itself. So that shows that we are seeing volume growth, we are able to attract employees and we are able to grow.

Julio Quinteros: Great, thank you. I am going to let Mohan off the hook this time and I will come back to you personally.

Operator: Thank you. Our next question comes from Amit Khurana from Birla SunLife Securities, please go ahead.

Amit Khurana: Yes hi, good evening. Could you give us a sense of, in terms of numbers or in terms of percentages, the kind of recruitments which were done in the last quarter?

Hema Ravichandar: This is Hema here. We have on a net basis, we have added 2025 in this quarter. On the gross basis we have added 2595.

Amit Khurana: I am sorry, let me clarify this. I am looking at it in terms of laterals and fresher recruitments.

Hema Ravichandar: Of the software professionals who joined us, out of 2,533 software professionals joined us of which 2,200 were freshers and 325 were laterals.

Amit Khurana: Okay now a follow up to this. Interacting with the others, one gets a feeling that the employees in the band of three to five years have been the most vulnerable in the larger Indian IT companies especially with these MNCs setting up shop. Is this something that you would have experienced internally?

Hema Ravichandar: Kris mentioned just before me, attrition traditionally has been in the two to five year segment and yes, those are the people who have been quitting to join either higher studies, to do higher studies or to join another company. The pattern is the same.

Amit Khurana: Okay my last question is addressed to Basab. Can you give us a sense whether there is an exploration at our end to try and explain explore variable pricing based on Rupee: Dollar parity? Is this something that we have tried and what has been the experience from the client perspective?

Basab Pradhan: Well, you see with the pricing currency, most of our clients are in developed markets with convertible currencies and they are far more comfortable with being billed in their own currency. So it is really not very likely for us to be able to negotiate a Rupee billing kind of a framework.

Amit Khurana: My question was not in terms of Rupee billing, it was in terms of variable pricing, with the appreciation or depreciation benefits or losses being shared between you and the client. We heard some deals happening on the BPO front, but is that something happening on software services as well?

Basab Pradhan: No, it is not happening and part of their discomfort with a currency that is not their home market currency is precisely the changes in value and not just the convertibility, but also the exchange rate risk, and so on. I mean they do not really track the Rupee actively, so it is not likely that they will. Yes, it is not likely that they will accept a… any kind of, whether it is a rupee billing or any kind of variability linked to the rupee.

Amit Khurana: Okay, fine, thank you.

Operator: Thank you, our next question comes from David Grossman from Thomas [Weisel] Partners, please go ahead with your question.

David Grossman: Thank you. I have a couple of questions. First on the, you know Nandan in the context of your pricing comments, I think last quarter we talked about margins degrading about 100 to 150 basis points throughout the fiscal year. I guess what you are seeing in pricing, do you still think that you will see that kind of drop and likewise do you still think that you will see about 1% sequential decline of pricing throughout the balance of the year?

Mohan Pai: David, I am Mohan here. What we are saying now is that we have not seen a drop in pricing in this quarter and pricing will be in a narrow band; there has been some stability in the pricing. We may not see a steep drop, but there is stability, it does not mean that it does not go down 0.5% from where we are now. But the trend is not downward; the trend is more towards the flat line.

David Grossman: And what would then the implications be for the margin guidance that you talked about three months ago? Would we expect margins then not to drop the 100 to 150 basis points by the end of the year?

Mohan Pai: Well, we estimate that the margin which is now, for the half year, at something like 27.2%, would remain in the band of maybe about 26.9 to 27.4% in a 0.5% band.

David Grossman: Okay and then just in terms of the volume growth, you know it looks like you have had again strong sequential volume growth in the 10% range… are you anticipating based on the stability you have in the pipeline that you can maintain that through the balance of the year?

Mohan Pai: Yes, we are anticipating strong growth, but we must remember that this quarter is a quarter where Christmas comes in, New Year comes in, and to that extent, some billing hours would be impacted in December. In January, February and March, it is traditionally when people start the New Year in our markets, the new billing cycle starts, new budgets are open, so it is quite possible in the first month there could be some softness. So we are seeing strong growth, but prefer to be cautious in our guidance.

David Grossman: Okay and just one last question. I guess in terms of your comments about some kind of nonrecurring item in SG&A amortization, so is the net kind of nonrecurring impact on the quarter $5 million dollars of foreign currency less the $2.5 million dollars of the amortization?

Mohan Pai: The amortization next quarter won't be $2.5 million dollars. To that extent I think, from whatever we have seen now, there may not be an impact. We have not factored in a $5 million dollar increase in other income and an increase in the taxation level for the next quarter. So the growth that we see, which should give us profits of flat or maybe one cent more compared to this quarter after stripping off some of these one time events.

David Grossman: Okay great, thank you.

Operator: Thank you. Our next question comes from Moshe Katri from SG Cowen, please go ahead.

Moshe Katri: Thanks. I have a couple of small questions here. So just to clarify on the re-pricing process, should we assume that the process is completed by now, that is point number one? Point number two, you have had a turnover rate up-tick here in the quarter, slightly up from last quarter and maybe you can address that as well. Then finally, you did talk a bit about amortization of intangible assets that did have a pretty big spike this quarter, it is about $3 million as you said. I mean obviously if you normalize this item your operating margin would have jumped to 28%. Maybe you can talk a bit more about this and then should we assume that this spike is a one-time event and should be back to the normalized levels going forward? Thanks.

Mohan Pai: Well let me answer the last question first. Well, next quarter we could see the impact of an appreciating Rupee, but to that extent operating profits may be impacted and that impact would lead to a downward spiral. That will be offset possibly by lesser amortization. Amortization came because of a reduction in the useful life and that would lead to some amount of amortization in the next quarter, but not to the same extent as this quarter from whatever we see at this point in time. So there will be some two accentuating facts. In this quarter we had a $2.3 million dollars provision for accounts receivable which was a one time thing because of increases in dues of more than 180 days and part of the dues have already been collected, but to that extent we may not see such a steep increase. If you net off all of these transactions along with exchange differences as we have done in our model, then we would get an estimated earnings per share of about $0.50 and that is exactly what we have said.

But the key, the key point to watch out for the next quarter would be the Rupee appreciation. We have about $139 million dollars in forward sales, that is 46.67% or thereabouts and that should afford us some protection. Twenty percent of our receivables are in currencies other than the dollar. If the dollar were to depreciate, and the rupee were to appreciate, it will also mean that 20% also goes up, so to that extent there is some kind of a natural set-off against the Rupee appreciating, but we need to watch out how steep the Rupee appreciation could be and that is the key issue that we cannot predict.

Moshe Katri: So from a dollar basis, the amortization of intangible item could actually come down on a sequential basis next quarter?

Male Speaker: Yes.

Moshe Katri: Okay can you address the other two issues?

Mohan Pai: Can you ask it again please?

Moshe Katri: Sure.

Mohan Pai: Basab will answer about pricing and I think there was another question about attrition, right?

Moshe Katri: Yes.

Mohan Pai: Hema will answer that.

Basab: This is Basab Pradhan. On the pricing, re-pricing question, I think the contract period end is, while they are towards the end of the year and they do offer an opportunity to ask for price decreases and for us to ask for price increases, but really our plan has the option at any time to ask for a rate increase or for us to actually go and ask for a rate increase…I am sorry the other way around. If rates get out of sync with what the market reality is and that is precisely what happened in the past two quarters, the impact of which has been felt in the past two quarters, our current rates are very much in line with the market rates and that is why we do not expect, or we expect prices to really stabilize.

Moshe Katri: Okay and then can you talk a bit about turnover, I think it had a minor spike, maybe a spike on a sequential basis as well?

Hema Ravichandar: Hi this is Hema here. Our turnover last quarter was 7.9%, this quarter it is 9.1%. We have seen similar trends in the past years as well. Quarter one and quarter two are big periods for turnover primarily because of some of the reasons for which we had turnover. One of which very significantly is higher studies and that is this period of time when people go for higher studies. The reasons for turnover, the top three really are higher studies, moving to another company or better opportunities and of course personal reasons like wanting to move closer to home location, etc. Those same trends as were in the past continue.

Moshe Katri: So we should not really worry about this trend because it is a seasonal trend more than anything?

Hema Ravichandar: Yes.

Moshe Katri: Okay, thanks.

Operator: Thank you. Our next question comes from Bhuvnesh Singh from CSFB, please go ahead.

Bhuvnesh Singh: Hi sir, congratulations on good result. Sir, on our business side I was wondering whether, what is the trend that you are seeing, are we getting more business now from strategic offshoring contracts, more RFP based business or is it still the regular sales model that salespeople go and get the business, as such? Is there some change over there?

Basab Pradhan: This is Basab. Our channels of revenue generation continue to be the same. We obviously get a lot of our business through offshore outsourcing, strategic sourcing kind of initiatives that our clients launch, as well as from in the solution space where we are offering a technology solution to a business problem. I think what has happened over the last few quarters… really the nature of it has not changed much, but the increased interest in the global delivery model whether it applies to offshore outsourcing or to solutions based, that increased interest has led to greater demand for our services and that is the result of which you are seeing.

Bhuvnesh Singh: Also can you put a percentage to that figure, that is, how much percentage is coming from strategic sourcing and RFP, vs. the rest?

Basab Pradhan: No, really it is not easily differentiable. We sort of, you know under the strategic sourcing umbrella we offer a lot of solutions when we get into an account on a solution platform, we always try to make it into a strategic sourcing account. So we really do not tag our business that way, but we know that they are different in the way they are sold and bought, that is about it.

Bhuvnesh Singh: And also in this quarter we saw that maintenance picked up significantly while development, consulting, this business remained weak, any explanation of that, why this happened or is it just the quarter on quarter fluctuation?

Basab Pradhan: You know more or less quarter on quarter changes, but I think the only thing that you might see which is a trend is more related to the fact that our clients are spending less money in a down economy on “change-the-business” kind of work which is application development, package implementation and reengineering. Package implementation side is doing well, but the application development, where we are fairly strong we have been historically strong, because of lower spends in that area, that is not growing as rapidly as maintenance where our clients are looking at reducing the spend to run the business because that does not add a competitive advantage to the company.

Bhuvnesh Singh: If I remember correctly, management has once said in earlier calls, that maintenance has greater pricing pressure as compared to development work. With this shift in business, what exactly is our stand now?

Basab Pradhan: Well you know strategically we are not moving into maintenance, it just so happens that our clients are more interested in those kinds of services. So it is not our strategic intention to move more into maintenance and the result that you are seeing is not because of that. But to the rest of your question, we are able to, even in maintenance, through methodologies and processes that allow us to offshore more, we are able to eke out a higher margin and we continue to use other techniques that can better our margins on the maintenance side.

Bhuvnesh Singh: Okay, this question is to Mr. Pai. Sir, I wonder if you can give us our Capex spend for the rest of the year?

Mohan Pai: As far as Capex goes, we have said earlier that we would be spending between $80 to $100 million dollars. Now we want to up that to between $100 to $120 million dollars because we added on more people than we had budgeted at the beginning of the year and we allocated more funds for creating more seats. You could see that we have about 7,500 seats under construction and we have to spend substantially… we are operating at near 100% in terms of seat utilization and we prefer to be at about 75%-80% at any point of time.

Bhuvnesh Singh: And Sir, how much of this $120 million you have already spent in the first two quarters?

Mohan Pai: What is the question?

Bhuvnesh Singh: Of this Capex spend for the full year, how much have you already spent?

Mohan Pai: We have spent about Rs. 128 crores in the first two quarters. We spent Rs. 68 crores in the second quarter. In terms of dollars, we spent about $15 million dollars in the second quarter, $12.4 million dollars in the first quarter. The cumulative we spent about $27.4 million dollars.

Bhuvnesh Singh: Thanks.

Operator: Thank you our next question comes from Andrew Steinerman from Bear Stearns, please go ahead.

Andrew Steinerman: Thanks so much. Nandan, I wanted to jump into your point number three before about that the Indian players are becoming more price disciplined. I was wondering, are you making the observation that some of your competitors are becoming more price disciplined or is Infosys leading the way with more disciplined metrics on what type of work Infosys is willing to take on and what type of work we are willing to walk away from?

Nandan Nilekani: I think Infosys by and large has always been much more price disciplined than anyone else. What we have done of course in that area is bring in a little more process and other disciplines. But by and large, Infosys has been price disciplined. Our view has been that in the last one year, several of the companies have really not been so focused on the pricing and our sense is that they have taken business at rates below what are advisable. I think the impact of that, they are beginning to feel and I think they have also put in much more stringent processes on the pricing front. So really, I was referring not so much to ourselves, but to our competitors.

Also I think people are realizing that this offshore thing is now mainstream and there is a lot of business coming down the pike. So there is no need to throw yourself at the customer in terms of pricing and you can observe some discipline. So I think, that is the other thing -- a realization that it is coming. So I think if the top Indian companies price disciplined, it will definitely contribute to stability.

Andrew Steinerman: But do you find that Infosys is walking away from a fair amount of business that it does not feel is in the company's interest or that is not the case?

Nandan Nilekani: We are absolutely walking away if we feel the deal is not worth it.

Andrew Steinerman: Okay and is that something that has been true for the last couple of years or more true now?

Nandan Nilekani: No… I think we have always been a little more picky than most people, but I think… I would say maybe it is a little more now in the last few months.

Andrew Steinerman: Okay, thanks for all of your comments, I appreciate it.

Operator: Thank you. Our next question comes from Kevin Merritt from the Fiduciary Trust, please go ahead.

Kevin Merritt: Thank you, good evening. I was wondering if you could comment a little bit on competitive dynamics and specifically your win rate within package implementation. That business seems to be going very well for you while we are seeing the U.S. folks struggle and any specifics you could offer in terms of who you are doing better against and any kind of abnormal actions, pricing wise, you are seeing by the competitors, thanks.

Basab Pradhan: Okay this is Basab. Let's see -- on the package implementation side, you know our business is growing as a percentage of our revenue, as well as quarter on quarter, quite rapidly. Most of it is driven by wins that are fairly large, significant implementations / rollouts, globally, from major Fortune 1000 companies. Our ability to be able to propose a solution that combines a domain understanding, a functional understanding, as well as our understanding of that package – SAP, Oracle or whatever that package is, is increasing as we get more experience with these kinds of projects and as we hire people who have these experiences in the past. So I would say this is going to get better and better in our ability to compete and win against the big system integrators is certainly going to increase in the future.

Kevin Merritt: And just a quick follow up. Could you talk about your interest, if it is an interest in moving into some of the large-scale outsourcing deals? There was a comment made on the earlier call about -- at this point you were not necessarily going after P&G-type outsourcing deals like we saw a few months ago, is that a goal at this point for the next year or two?

Kris Gopalakrishnan: No, we are participating in some of those bids. We will not go whole hog in the sense that we will not take a lot of them, but definitely want to test the waters, we want to do one or two of these and understand the dynamics of it, how it works, how to bid for those, how to manage those, how it impacts the margins and things like that.

We see this as the next opportunity to increase our penetration into these large accounts.

Nandan Nilekani: Also, I think there is a lot of disenchantment with the old model of outsourcing -- you know, where companies just hand over the keys of the kingdom to an IT company and then abdicate their strategic direction and they have this 500-page contract and everything has to be negotiated.

I think people are realizing that no company can afford to outsource its basic IT strategy, its management, its alignment with business and what is required is selective outsourcing of different functions or tasks, but not really the whole caboodle.

I think this so-called second-generation outsourcing is now taking a lot of interest and we are finding many, many of our customers are actually begin with the whole idea of doing total outsourcing are now coming back and saying that does not work for us, we have to do it on a selective out-tasking basis. So I think the whole model… there is a new generation of outsourcing which is coming which is based on a much more open architecture of outsourcing and which is heavily based on using global delivery and that is where we play.

Kevin Merritt: My final question just related to your comment there. Within Progeon who are you seeing most often competitively?

Akshaya Bhargava: I am sorry could you repeat that question please?

Kevin Merritt: Within your Progeon activities, who are you seeing most frequently in terms of competition?

Akshaya Bhargava: It is a wide mix. I think in some cases we see Indian companies, but in a number of cases we see global competitors as well. If I look at my pipeline there are at least two deals where we are in the final short list of two names and we are one and the other one is an international company.

Kevin Merritt: Thanks, nice quarter.

Operator: Thank you. Our next question comes from Vinay Datta from UBS, please go ahead.

Vinay Datta: Thank you and congratulations on a great quarter. Most of my questions are answered, but this is just more of a longer term question that my investors are starting to address which is more FY05, FY06. With your hiring rate currently running at… you are adding basically about 40-45% new employees. One to two years out, your base is that much larger and your attrition is going to keep picking up with the MNC competition in the two to five year range. So my question here is what plans does the company have to manage the volume growth that is needed with the quality of people to be hired and is the quality available out there?

Mohan Pai: Let me answer that. Let me try to answer this. I remember about four years ago, five years ago, somebody came and said "Will you be a 10,000 person company?" and we answered to them and said "Look, there is this big company out there as the competition, which is say 60,000 people or 80,000 people" and today we have 20,000 people and we have managed to hire 4,500 people gross in the first half of this year and we have said that we will hire about 3,000 people in the second half, that makes it 7,500.

So we have demonstrated our ability to scale up in terms of hiring people, in terms of training people, in terms of selling, in terms of growing. So, no doubt the base will go up in the future, we cannot talk about figures, but we do think that we have the ability to manage.

As far as the quality of people in India, this year about 275,000 engineering graduates will graduate and the intake in this year in engineering colleges, we are told, is something like 350,000. So, four years hence there may be 325,000 people graduating. There is a huge pool of people. The key is to get good people and to train them. That is a challenge.

Nandan Nilekani: I think what we are trying to do… one of the goals is that while we grow we will also have these employees in a distributed global environment, they are not really all going to be sitting in one place, they will be all over the world in our development centers, mainly our development centers in Europe, in Asia, Australia and so forth, Mauritius, and so on. So in that sense I think there is going to be distribution.

The second thing is that we are also looking at how to create, you know within Infosys creating business units which are really smaller groups and you know, Progeon is a good example of that where we will have multiple leadership teams and our endeavor will be to combine the scale benefits of Infosys which really come from size, brand, longevity, financial muscle and so forth and combine that with the lean smaller business units that are focused on a particular service offering or a particular vertical market and they are empowered to move quickly to address the market and satisfy the customer.

So I think we will evolve models where we combine the strengths of a large company with the nimbleness of a smaller one.

Vinay Datta: Just a follow-up question. Your onshore/offshore mix is substantially increasing, more on the offshore side, is this actually related to any sort of Visa restriction? The additional question to this is -- do you expect in the next, sort of, three to four quarters that your revenues offshore could get up to the 50% plus?

Nandan Nilekani: Well our offshore content is going up because we are doing it consciously and we have been articulating that in these forums for the last three-four quarters, because we believe that with offshore work for our customers, we are able to offer a lower blended rate without sacrificing our profits. So it is a win-win for us and our customers. We are able to manage scalability much better and of course there is also the additional benefit that the visa pressures will be less. So all those factors have played a role in offshoring and I think that is the way to go. What was the second part of the question?

Vinay Datta: Just do you expect mix in terms of revenues to get to 50% plus over the next few quarters?

Nandan Nilekani: Fifty percent?

Vinay Datta: The revenue mix for offshore, using your offshore…

Nandan Nilekani: Yes I think, you can assume that as a ballpark, but at the same time I think, we do not want to take it to the extreme where we lose out on customer intimacy and customer satisfaction. So obviously we will be very watchful on that front.

Vinay Datta: Great thank you so much, congratulations on a great quarter.

Operator: Thank you. Our next question comes from Ashish Thadhani from Brean Murray, please go ahead.

Ashish Thadhani: Yes, good evening, gentlemen and an excellent quarter. Looking at your revenue guidance for December, it would seem to imply a sequential deceleration. Would that be explained by the holiday period that you talked about or is there something unusual in the just concluded quarter?

Mohan Pai: Yes I mean the number of working days that you can bill in this quarter would be less than in the previous quarter because of your onsite billing, and we have factored that in and that reflects our guidance.

Ashish Thadhani: Okay is there any other reason to explain the number or just basically the billing days?

Mohan Pai: Oh… it is just that we are inherently cautious in our guidance because you know the market is… there are uncertainties in the marketplace… you can value these uncertainties, but and there is no way anybody can value all of these uncertainties…

Ashish Thadhani: Understood… and in your guidance is it fair to assume, based on the prior discussion, that you have baked in a flat pricing scenario?

Mohan Pai: Yes.

Ashish Thadhani: Okay… and then one housekeeping item, what sort of effective tax rate should one be using going forward the next few quarters?

Mohan Pai: Well I think we are going by 4.8% of revenues and it has gone up to 5.3% of revenues this quarter for the simple reason that we had a one-time spike in other income and we have not factored in this one-time spike going forward. So if you take this 4.8% of revenues as a benchmark, you come in with something like I think 15.6% on pretax as against 16.6% right now.

Ashish Thadhani: Thank you that is helpful.

Operator: Thank you. Our next question comes from Tripp Chowdhry from Mid-West Research, please go ahead.

Tripp Chowdhry: Hello, I had a quick question for you guys. In turns of package applications, there are maybe various vendors like Oracle, SAP, and People Soft. I was wondering, would you give us a sense about where you are seeing more activity among these package software vendors?

Kris Gopalakrishnan: We are seeing actually the major packages like I said SAP, Oracle, PeopleSoft and Seibel, kind of mostly similar growth rates.

Tripp Chowdhry: And in terms of geographies, I know you are having some good presence not only in the U.S., but other parts of the world too. Any sense on where you see some activity level increasing or stagnant or falling off?

Kris Gopalakrishnan: All geographies are growing. But in percentage terms we have seen actually Europe pick up mostly from the UK and in Asia Pacific, Australia is picking up for us.

Tripp Chowdhry: And locally in India itself, there have been some reports that various states in India are embarking on various e-government initiatives, e-citizen initiatives. I was wondering how tightly involved is Infosys with bringing these initiatives to fruition in India?

Kris Gopalakrishnan: In India, Infosys is primarily present to our banking business unit. The banking business unit has a complete range of products for the retail and corporate banking activities called Finnacle. We are involved in some of the e-governance initiatives more as individuals, in more of an advisory capacity rather than from a business venture.

Tripp Chowdhry: Excellent. Thank you all the best.

Operator: Thank you. Our next question comes from Edward Caso from Wachovia, please go ahead.

Ed Caso: Hi, thank you for taking my call. My questions revolve around the changing in the visa limits in the United States, how that may affect your business both a drop in the quantity of H1-B visas and as well as the possibility of typing of the rules of the L1. Is this going to force you to change your business model or raise any issues meeting your guidance for this year?

Kris Gopalakrishnan: Short term, we have sufficient visas and we believe that over the next one-two years this will not have a significant impact. But we are watching the situation because we have come to realize that there may be further legislation in these areas, but short term we do not see this as an impact. We are also looking at how we can increase our recruitment in the local markets, as well as convert some of the visas into permanent residents in the U.S.

Ed Caso: Does this have any… if the applications development part of your business picks up, will the visa issue be a greater concern and could possibly acquisitions in the United States be a way of addressing it?

Kris Gopalakrishnan: If application development picks up it will not have any significant difference because we are able to do a lot of work from India. You know typically we are able to do 70% of the work from India in application development. In terms of acquisitions, we are always looking both in the U.S. as well as in the Europe markets.

Ed Caso: My last question is with regard to the Visa, does it affect companies that are more staffing augmentation oriented as opposed to Infosys, which I think is a little bit more consultative development oriented and will that be a competitive positive for Infosys?

Kris Gopalakrishnan: Yes, we think that it will impact more of the staffing companies than companies like Infosys.

Ed Caso: Great, thank you very much.

Operator: Thank you. Our next question comes from Mayank Tandon from Janney Montgomery Scott, please go ahead.

James Fessel: Hi, this is James Fessel on behalf of Mayank. I had to hop off the call for a second, so I apologize if this was already covered, but I just wanted to ask if you could talk about the discussions in the news that some of the multinational corporations that are your competitors have been offering 50-60% higher salaries at the entry level and 30% higher salaries at sort of the middle management level. I was wondering if you would be able to kind of confirm or deny those ranges and in general if you could provide us with some more color on what you believe wage inflation may look like in the future.

Kris Gopalakrishnan: Yes, in some instances the global SIs are offering higher salaries, that is one way in which they can kind of jumpstart because they don't have the recruitment, they don't have the training engine which is established and set up etc., in India. So if they want to accelerate, that is what they would have to do. It doesn't have a significant impact on Infosys right now. We are looking at how the salaries would move over the years. We have increased the salaries for our employees this year. We have done promotions this year. By and large we have made this increased variable so that if the company does well the employee gets more and if there is a downturn then the company is also protected. So we have moved to much more of a variable pay in this regard.

James Fessel: Thanks. Congratulations on a good quarter.

Operator: We do have a follow up from Moshe Katri from SG Cowan, please go ahead.

Moshe Katri: It has already been answered, thanks.

PR Ganapathy: I will ask a question that came in on the e-mail.

Operator: We actually have no questions in cue at this time.

PR Ganapathy: Okay I will ask a question that came in on the e-mail; this is from Mr. Rajmohan for management.

"Infosys has been talking a lot about end-to-end solutions kind of work. When Accenture was recently questioned on pricing, they mentioned that 80% of the work they do is non-commoditized, solutions-based, which does not have pricing pressure. Broadly where is Infosys at present in terms of percentage of business where it can say that is it in a non commoditized form?"

Kris Gopalakrishnan: Part of the reason for our pricing decline has been that in the last two-three years especially in the internet bubble, Year 2000 peak, etc., there was some bubble pricing and things of that. Now the pricing is more, you know more kind of uniform. It is more market fixed, you know market-led and things like that. So that is part of the reason why there has been a pricing decline. We have seen stability in pricing and we believe that at least in the next six months we believe that prices will be stable.

PR Ganapathy: Okay, thank you.

"Do you think with consolidation happening in the vendor side of the industry there is a possibility over time that the front end will lose its importance? If so, when do you see this happening?"

Kris Gopalakrishnan: Guns, can you just repeat that?

PR Ganapathy: The question is you know with consolidation happening in the vendor side of the industry, is it possible that over time, the front end will lose its importance and execution and delivery will become more important and if so, when do you see that happening?

Nandan Nilekani: It is already happening. I think today in the whole IT industry the focus is on execution excellence and it is about delivering high quality on time with the least number of defects. That is why the change in the market is playing towards the strengths of people like Infosys.

PR Ganapathy: Great, and one last question is:

"Traditionally a lot of the ERP implementations, CRM implementations, have been thought of as being primarily onsite. However, the Infosys model is primarily a global delivery model. Can you talk a little bit about our success in globalizing services in that area?"

Kris Gopalakrishnan: We have been able to offshore about 50% in some cases. The way in which we do this is for example when it comes to bridge programs, when it comes to interface programs, when it comes to data conversion and data transformation programs and we can write them offshore. Once the global template is created then we can support that global template from an offshore location. So, the maintenance of the package can be done from offshore. So over the total lifecycle of the product -- from implementation to support and things like that, we have been able to achieve 50%, you know 50% of the work being done from an offshore location.

PR Ganapathy: Okay great, thank you. Monica, if you have no more questions we will terminate the call at this time.

Operator: Okay there is actually one more question that just popped up. Anupam Thareja from HSBC India, please go ahead.

Anupam Thareja: Hi, thanks. I was actually wondering -- if you look at the business model with our limited wisdom we understand that the higher you move up the value chain which means from application development, maintenance, if you move up to system integration and IT outsourcing, the revenue per employee might go up, but margin per employee might come down because the wage arbitrage reduces as you move up. Will I be correct in this assumption?

Nandan Nilekani: No, when you say the labor arbitrage comes down, are you saying the because more people are onsite, or because the people are higher paid?

Anupam Thareja: Actually both. The work gets more onsite centric because of the closeness of the client required, the larger and more complicated work and also because this cannot incorporate an equal number of freshers, probably.

Nandan Nilekani: Well you know I think we are really, I mean on a global trend basis, we are at the beginning of this globalization of services. Our view that if you take every service and decompose it into its component item in the value chain, every service to different degrees is capable of being "GDMized" [Editor's note: GDM = Global Delivery Model]. For example, today in enterprise services where we do more high end work, it is about 50/50 as opposed to maintenance where it may be 20/80.

So I think there is a lot of room for improvement there and we are convinced that almost all IT services, whether they are high end or low end or medium end, whichever end you want to take it, are amenable to this. So I think there is a lot of cream(?). You are right in saying that some of these newer services may be more onsite centric, but even so, there is enough offshore capacity in them to create a competitive differentiation.

Anupam Thareja: I appreciate that. I apologize for butting in, but I am saying relative to what we do today because I am looking at delta change for our company rather than… I appreciate the fact that there are inefficiencies in the system today that can be offshored away. But relative to us, would I be correct?

Nandan Nilekani: Well I think we have to keep finding that equilibrium point, and it may vary here and there, but I still think it won't be at substantial variance from today's point.

Kris Gopalakrishnan: I just want to add – this is Kris here. If you look at our own services – you know, package implementation is about 13-14%, consulting has gone up to about 5%, and we have been able to maintain the margins and pricing declined across the board was there over the last three-four years, the last two years. So we have been able to maintain the margins actually. So that shows that it has to be managed properly and then you will be able to do this.

Anupam Thareja: Right. Just a follow up question slightly on a different track. We understand the next two quarters guidance on pricing and I understand that commenting on pricing going forward from there may not be appropriate right now. But just to understand the process, when you do your assumptions or when you do your spreadsheet, is it the U.S. tech spend number you look at or is it more internal marketing feedback which gives you the confidence to articulate pricing going forward? Basically what I am coming from is if you look at the general consensus for next year, the CIO polls and some of my competitors, the average increase in tech spend is anywhere between one to three percent. What I am basically trying to understand is, is this kind of tech spend increase that magic number which will likely result in price increase for overall services or is there something more?

Kris Gopalakrishnan: Even though the tech spending may be flat or even declining, we have seen trends like our offshore spend increasing. If we look at the analysts like Gartner or Forrester, you know if you look at the financial analysts like you – all of you are forecasting that also the trend towards offshore is more mainstream and that is where the growth is coming from. When we talk about the pricing itself, it is based on the feedback from our clients… you know when we compare our prices with the market prices, the competitors prices and things like that, you know we feel that there is some stability in the pricing. We have a feeling that our prices will be around a narrow band of where they are today for the rest of the six months in this financial year in our model.

Lakshmikanth Reddy: Sir, this is Lakshmikanth from HSBC. Just one last question from our side. What can actually take prices higher in the current environment? You know we have seen over three, four quarters ago that the prices that were trending downwards and now we are seeing pricing stability. If I were to just try to figure out the next step, some next quarters hence, pricing has to go up, what would drive that? Would it be for instance the ability of the top tier companies to recruit a certain number of people and if they hit a constraint, that we will see a sort of pricing increase… or are people realizing they can only process probably 5,000 people per annum or 10,000 people per annum? If we are getting more work than that then we can charge higher, is that one way that it is going to happen or maybe as Anupam said, maybe the tech spending environment could improve. What, I am just trying to understand, what can actually lead to price increase?

Kris Gopalakrishnan: There are several factors in supply and demand like we said, economy improving, tech spend growing, a major technology change, maybe disruptive technology coming in, technology that requires companies to react, there is a possibility of government regulations requiring tech spend. So there are a lot of possibilities which could increase the price. You know it is difficult to say right now what will happen long term. We are looking at over the next six months right now. So I know actually we have run out of time, so let me thank all of the people who have participated in the call. We really appreciate you showing interest in the company and we really enjoy interacting with you every quarter and looking forward to interacting with you next quarter also. Thank you.

Operator: Thank you and ladies and gentlemen this does conclude our conference call, you may all disconnect and thank you for participating.