Analyst Meet 2019

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Increasing Shareholder Returns

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Good morning and welcome to analyst day. Thank you for taking time to come from various parts of the country to Bengaluru.

Before I start, I would like to make a short personal statement. As to the whistleblower allegation, I have recused myself and respect the process the company is following. I wish to state that in my professional career of 30 years, I have always held myself to the highest standards of integrity and values.

Coming to the presentation, my theme of the day is 'Increasing Shareholder Returns'. Let me just go through the safe harbour, I hope all of you have been through it.

As we started the year, our building blocks of shareholder value creation, we had laid out this in our equity deck. At base of it, the market which we operate in, whether it is from $250 bn or to a trillion dollar, we have a very small size of this market. Therefore as Infosys, we always need to think of ourselves as a challenger, as an entrepreneurial company, to go and increase the market share.

Salil has already talked about the comprehensive and intense client strategy which we have in the last two years and how we are making progress on that. The four pillars of ours Digital strategy which was Scaling Agile Digital which is about re-skilling, which was about energizing the core, and which was about localization, which Pravin has also talked about.

The third layer of cost is about having a strong financial and operating metrics. You have seen some of the figures coming out of Salil's presentation. You will see that later during the day on how we made progress on various financial and operating parameters including relating to cash and shareholder value generation.

You are aware that we announced our new capital allocation policy. A lot of feedback during the past few years about excess cash and returning cash back to the shareholders. We have upped our capital allocation during the year. Finally as the pinnacle of this is how is it all playing out in terms of shareholder returns over this period.

I think underpinning all this is a very strong ESG framework around Environmental, Social and Governance. You are aware of our carbon neutrality objective; a strong corporate social responsibility and the work we do with Infosys foundation and the epitome if at all is a strong corporate governance framework which all of us in Infosys pride ourselves on and which is a bedrock of this company.

Like Nandan mentioned this is the fourth consecutive quarter of double-digit growth. In terms of margins, we have seen the investments and talked about it last year. The investments we made around reskilling, digital, around beefing up our salesforce, around localization. Our operating margins were 20.5% in Q1 at 21.7% in the second quarter. This is a good base for us to improve and look towards margin guidance for the rest of the year.

When we look at the overall margin headwinds in this business, we have two large headwinds which all of us in this industry face. This is something not new which all of us faced over a period of time. One is pricing pressure from clients whether it is part of new deals or it is part of renewals or discounts, so there is always some sort of headwinds on pricing. The second is wage inflation and largely on the offshore side because of interest rate differentials. These are two headwinds largely that the industry faces. So how does the industry and how do we at Infosys look at this and chart our map in terms of how do we look at various cost optimization levers which we have. Many of these are familiar to you and we are looking at many of these in a new lens which I will share today.

The largest part of our cost structure although the effort you saw from Pravin's deck, about 28% of our effort is overseas, what we call as onsite and about 72% is offshore which is largely in India. But the cost structure for all this is inverse. So most of the cost of that 28% is actually salary sitting overseas whereas the offshore salary is a much smaller part. If you need to fix your margins, the biggest lever which you have is how do you continuously look at your onsite salary costs and how do you consistently optimize that. The onsite-offshore mix is something which we continuously work on, projects come with a certain onsite -offshore mix and what we do over a period of time is make sure that we continuously move work from onsite to offshore, we move work to near shore, this could be different for new projects, this could be different for core projects, this could be different for digital projects. This is something which we continuously do and the result is that our onsite mix from nearly 30% in FY17, we are now at 28.2% in the last quarter.

The famous pyramid that everybody asked about. The way we look at it, there is an onsite pyramid where most of the costs lie, it is a top-heavy pyramid. That is number one. Number two is, the bottom end of the offshore pyramid is more like battle ship and that is something which we intend to correct. What are we doing in this regard? One we are increasing the fresher intake at the offshore base, so much more flattening and broad basing the pyramid at the bottom end. This will also help in attrition because we will get more growth opportunities for people from our JL 3s to move up and therefore should also help in attrition so that is number one. Number two as we announced the localization strategy last year and which are centered around the hubs, we believe now that with hiring freshers and college graduates onsite and in the US, we can actually create a full-stack pyramid in onsite as well which is unique in this industry and we are pioneers on this as well. So that will help us both in terms of getting our cost structures much more manageable and like I said, on the offshore side making it much more broad based and which hopefully will also reduce attrition.

Another lever which we have already talked about on the key lever on Automation & Lean. Pravin has already mentioned about it. The crux of this is first we need to fix the processes because there is no point automating a broken process. We do this so well for our clients, we save them millions and millions of dollars and this is something we have to do internally as well. Therefore we have a Lean and Automation team which works cohesively together both in simplifying processes inside the company and at the same time, making sure that we are continuously automating and taking out people from many of these projects and deploying elsewhere.

A favorite question of many analysts is what is this subcon animal? Many projects that you see come with subcon. Why do we have subcons in this industry? This is a phenomenal you see across most of the players. Three big reasons - one is that there is a shorter recruitment time. Clients want resources faster where we may not have the recruitment time to recruit as fast. It could be because certain skill sets, which you want in a certain geography are not available immediately or thirdly this could also be because they are shorter duration projects. If you see these are the reasons why we have subcons. What we are doing differently? Earlier we were looking at this at the wrong end. We were trying to control the number of subcons, we were trying to increase hires and that started telling on our revenues. Now we have really turned the tables in saying, we should actually look at continuously on boarding, replacing and converting subcons, so that we do not have a loss on the topline. Yet we are continuously converting our subcons by either getting new employees in and convert to replacing them or making them as employees. I think this is something we would have seen in Q2 as well that our subcon costs have moderated

Operating leverage - for a size of our company, this is something which should definitely play to our advantage. Are we getting the benefits of scale with our size? Like I mentioned last year, we have made investments around SG&A costs and that is behind us. So in FY19, we were at about 12%, in Q2 FY20 we are at 11.7%, so we are seeing some benefits of scale and synergy there.

The other is utilization. I think this is something which is very important. We have about 84%, 85% utilization, the reality is that because we have portfolio. If you start looking at utilization in the way we measure it, it is across the geographies, it is across services lines, it is across practice units. If N is equal to one, we need to manage our utilization at that level and that is a benefit which we have with large practices. In Application Development, we have large headcount and probably in some other fledging business, we will have a low headcount. But that is the whole idea of our large portfolio where we can balance in both fledging practices as well as have our large practices delivering higher utilizations.

This is a new track we called it under cost optimization this is something which we just started some work on. Pricing has always been at the centre piece of a lot of work the industry does. First is, how do we position ourselves with our clients. The discourse with our client does not have to be the lowest price, because we do not win because of the lowest price. We win because our solutions are delivering the maximum value to our clients and that's the way the discourse should be with our client. How do we ensure that we maximize the value for the client? That is the heart of whatever pitches we do. How are we transforming the client's landscape and delivering them the savings, the revenues which they are looking for and that is what differentiate us.

Coming after that is number one, do we have digital rate cards? Are these nuanced enough to talk about experience, talk about proficiency, talk about skill sets? Are they dispersed across all the sales team, are they part of the sales pitch, do we have a governance structure on the way we manage pricing, do we have guardrails around discounts, do we have pricing analysts? This is a whole list of work stream which we are looking at across the company. This is something we are just looking at to start of it. The idea is not that we are going to get the percentage increases across the board. We just do not want to leave the money on the table on digital skill where there is a lack of talent and skill shortage and that is that we are trying to look at.

These are just some of the levers which we talked about. We have a dedicated program manager now. We have a Senior Vice President who is leading the entire cost optimization track. He works with Ravi and the delivery team closely. We have nearly 21 tracks across which we are looking at cost optimization. I am just taking you illustratively around 6 of them. We are looking at the goal for this year between $ 100 and 150 mn of optimization as the year goes on.

The second part of improving shareholder returns is how are we going to look at cash because at the end the old adage goes 'cash is king'. There are two things that I want to really call out, which is taxation and capex. As we said in Q2 after the new tax regime was announced, for the India rates we are currently around 23% and the new tax regime is closer to 25%. We have a transition plan over a period of time where we can migrate to the new tax regime, number one. Number two is our capex. As you know the new SEZ policy is also getting sunset on March 31, 2020, that will also reduce our capex intensity in terms of building infrastructure for SEZ and number two is also as we look at becoming more asset light, we will look at rent and buy decisions in that light.

Also we have a lot of infrastructure capacities over the year which we have built, which we are looking to sweat more and more as we go ahead with plans. Of course, we have some capex which is in flight which we will get through over this year and next year but broadly we are looking at making sure that our overall cash drivers continue to be pressing the pedal on all of them.

Our M&A philosophy is basically hinged on three broad buckets. Number one is complementary Digital skills. Our entire strategy is predicated on digital transformation for clients and therefore if you see our M&A strategy, the first plank is are we looking at acquisitions in our Digital Pentagon? On the right side you can see our biggest acquisitions across the last few years have been Fluido, we have Stater, we have Ben from WongDoody right here and Brilliant Basics across the Digital Pentagon. Second, we will look at consolidating market share opportunities, which may be opportunistic and that is something we will also look at in our strategy. Finally if we see synergistic client specific assets. A classic example of that is HIPUS in Japan, which you read about earlier in the year. We have a robust post integration model of how do we integrate these companies, running with us and that is working pretty well. How do we have reverse synergy, bothways synergy is not just flowing in from the target company to Infosys but even from Infosys back there so that is something which is very ingrained. Finally, we have kept some money in our capital allocation policy for tuck-in M&A as required. We also have a strong balance sheet in terms of cash today.

Enhancing shareholder payouts, this is something over the years as we had seen our progressive policy in terms of increasing dividend distribution. As you see from FY14, where we were giving up to 30% of net profits, we have upped that this year in July to upto 85% of free cash flows over five years. We have already given our interim dividend, which is about 14% higher YoY. This is something which we continuously hear from shareholders that if we do not need cash, give it back. That is exactly what this reflects. Any excess, ideal cash in the company was also returned in the last few years. We finished Rs. 8,260 Crores buyback as well this year. So that is a progressive improvement as you see and is a more predictable cash payout.

Coming to Total Shareholder Returns (TSR), this is the pinnacle is what we do with our industry peers. This is over the last two years since the strategy was launched and this is against the leading peers of an industry. Upto September, we were number one. Events after that, we are still number two over the last two years in delivering Total Shareholder Returns to our investors. That is something which we have ingrained in our philosophy of management compensation. We think we are one of the first companies in India to use global best practices of aligning management compensation with shareholder value creation in terms of the new RSU 2019 plan, which we think is a benchmark in terms of how we look at this.

This is pretty much what I had from my perspective. Later in the afternoon we will look at Q&A.

Thank you.