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Kunal

Hi. Good afternoon everyone. I am Kunal Tayal the Indian IT Services Analyst for BofA Merrill Lynch. It's an absolute pleasure to have Vishal Sikka, the CEO and MD of Infosys with us here today. The format for today's discussion is largely Q&A. I'm going to start off with a few questions of my own and then open up to the audience. Vishal, thanks so much for coming here.

Vishal

Sure. Glad to be here.

Kunal

I guess over the past ten months or so, you've done a great job of laying down the strategic intent and direction that Infosys plans to take for the next three to five years. Now that the strategic direction is known and understood by the market, it would be great if you could share your thoughts on the operational rigor at Infosys. How do you think that Infosys compares versus competition on areas like proactive customer mining, forecasting demand, submitting quality RFPs? And for a large company like Infosys, how much time will it really take to turn around on the operation part of it?

Vishal

As you said, we have laid out our strategy which is to a large degree driven by innovation, both innovation in our existing business through renewal of our service lines with automation and then us doing completely new kinds of things, bringing more software and IP into the mix and so forth. But having said that, perhaps my biggest finding in the last ten months has been the fact that the company needs significantly better operational rigor. I think that over the last many years, the company grew significantly and largely linearly with the number of people and in many cases the operational processes did not keep up with that growth, in particular on sales and marketing on the front end. What Mr. Murthy had built originally was a company that was so differentiated because of this amazing ability that Infosys has to train people and the natural advantages of a Global Delivery Model and being based primarily in India, that massive degree of differentiation, basically you did not need a well running world class kind of a sales force. Things basically were just happening and money was easy to make.

That is no longer the case. Operational rigor is something that is very much necessary and we have been focusing heavily on that. People always ask me if I would lose focus on that and I always tell them that I wish I could lose focus on the operational rigor and do a little bit less of it and a little bit more on the innovative side, which is where my proclivity naturally is.

So we have been focusing on things like sales efficiency, sales effectiveness, mining accounts. If you look at the performance of Infosys over the last several years on the top accounts, we have significantly underperformed competition, whether it is the top 20 or top 50 or however you look at that. One of the things that we have done is organize in the office of the CEO, the responsibility for the top 15 accounts. We have five verticals that we have segmented our go-to-market in and we have taken the top three accounts in each of the five verticals to give a very dedicated focus to that from my side and from the office of the CEO to better connect the dots across the company and there is tremendous room to grow in those accounts.

Similarly, the RFP response process, we have streamlined that. All the proposals now go out through a single team that is led by a brilliant design thinker. She is from here from Stanford. All the proposals go through her and we have recently significantly improved our win percentages in the last couple three months. Just in the last 10-12 weeks or so, we have won 6 major deals of more than $50 million each. This is a result of these kinds of things.

And then, we have also brought our consulting team. Infosys was the first one to bring consulting to bear in the India IT services industry but we had a fragmented consulting effort. We had a consulting team here in the US and a consulting team in Europe which was out of our Lodestone acquisition. We have merged those two into one consulting organization but we have also merged that with the rest of the company in the sense that we have established consulting as the tip of the spear. The top 100 partners of consulting are incentivized to take top 200 accounts - top 100 accounts and another 100 where we want to grow and take responsibility to lead those accounts, so 2 each per senior services partner and co-lead that together with the sales leader for those accounts and help articulate the overall Infosys value proposition. We are giving them a special incentive to do that and to help the company grow beyond the growth of consulting itself.

So we have done many of these kinds of things - SGS the large deals team, has folded also into Ranga's team and we have done many of these sales-oriented things, operational things around forecasting, pipeline construction and things like that. So my sense is that as much as the innovation, both on the renew and also on the new is exciting, in the near-term this year the growth will be a direct responsibility of the operational excellence.

Kunal

Sure. That's encouraging to hear. Switching gears a bit, on the traditional business there's this view in the market that Infosys is playing a bit of catch up versus the competition and also when it comes to investing in areas like automation some of the players may have started on this journey sometime back. So how do you think about leapfrogging in these capabilities in this traditional business and especially if automation will be an integral part of it, how does Infosys leverage something like automation to a higher extent versus competition?

Vishal

I would agree with the statement that we have lagged behind on many operational fronts. I will not agree on the automation point. I think first of all automation in our industry is not widely understood. People take regular productivity improvements that clients demand in their contracts as examples of automation and this is not automation. Automation is where we can actually displace the work that is being done by people by using a system or we can dramatically lower the number of people working on a project by using a system. That is something that is a fundamentally different kind of a proposition. We were doing some work on this when I started and now we have done a significant amount of work in this area in the last nine or ten months. In particular, we have built the Infosys Automation Platform, which is a set of tools to automate the work that is done by people in infrastructure management, maintenance, verification, many of these repetitive areas. We have also invested in our own platform and capabilities with on information processing, on AI and things like that. We bought Panaya for enterprise package system, landscape optimization and upgrade management and so forth. We are doing a significant amount of work in automation. As you said, the idea is to leapfrog what was possible. My sense is that the response to disruption from automation into the increased efficiency pressure, the cost pressure in the industry, many companies in the industry have reacted to that by basically becoming more and more efficient in the traditional model. I think that is the wrong direction to go. I think it is a much better idea to embrace automation, to embrace innovation and use that to leapfrog beyond this traditional model.

Kunal

And you think Infosys is right up there?

Vishal

Yes. Absolutely.

Kunal

So, that’s in the traditional business. As one now looks out at the opportunity in digital, obviously you have a very enviable team. So therefore technology capability for digital services is less of a concern. How do you think about bringing home the industry or domain expertise that might be an integral part of the digital deals going ahead? Would you think that you would hire more consultants? Would you rather prefer to partner with a management consulting firm?

Vishal

I don’t know the answer to that yet. My sense is that the answer is not a straightforward one. You see because the deep domain expertise in the industries, all major industries are being disrupted in a very fundamental way by digital technology and a lot of the stuff is new. So people don’t in fact know already, for example the expertise on how manufacturing will be disrupted by digital technology is not widely known yet, what the role of the 3-D printing or the role of additive manufacturing or these kinds of things, what it will play. Similarly in the oil and gas world the role of data in optimizing oil and gas, as it becomes more fragmented and smaller scale with fracking and things like this, as well as renewable energy and personal generation of energy.

So accumulating previous generation domain expertise is probably not a good idea. On the other hand, next generation domain expertise does not yet exist. Perhaps the right answer here is to get a combination of some domain experts who are able to transcend the role of technology or who come from multi-disciplinary point of view, augmenting that with young talent and augmenting that with new techniques like design thinking where we can rapidly acquire the know-how of a domain and bring that to bear. Yes, we need to strengthen our ability to have deep, important conversations with clients in their language but probably the answer here is not hiring somebody else’s previous generation domain consultants.

Kunal

Makes sense

Vishal

I had a very interesting experience. Education is at the heart of Infosys and we recently introduced a new training platform in our corporate university. We found astonishing results from there. We brought in all the leading ideas from education, real-time response or the work that Patrick Suprez has done here at Stanford on more quizzes and questions that look at problems from multiple points of view, immediate availability of a teacher and ability to talk to other students and so on. We had astonishing results from this. We taught the same class the same material using the traditional technique and using this ILP work we call the Infosys Learning Platform. The pass rate of the class that we split into these two areas, was dramatically different. In the traditional class on database fundamentals, 34.5% of the students who took the exam passed and in the ILP class 62% of the kids who took that exam passed. This was astonishing. This was the same distribution of students from exactly the same background. In fact, we found that in the class, the kids in the traditional class were asking the kids in the ILP class to teach them because they knew that they are learning it better. So it makes you rethink what is it that acquiring domain expertise is really all about?

Kunal

So probably a lot of the talent has the effort to be nurtured in-house for continual(?) technology.

Vishal

Yes, this is my point, exactly.

Kunal

Going back to an earlier point you mentioned about the sales effectiveness being an area where you want to improve Infosys, could you just elaborate on that? And specifically two questions come to mind. One is do you think that Infosys today is being adequately represented by senior client partners at the largest accounts? And second, is the incentivization today correct and competitive versus peers, in terms of trying to bring home those large mega deals?

Vishal

I think that on the second question, the incentivization on the sales side is quite good. It has to be tweaked a little bit to better align it with company goals and priorities and so forth. So I'm not so concerned about that and we'll make the incremental changes as we go. We are working on introducing a RSU plan and things like that. We are also in the process of hiring a new head of HR. So all that will take care of the incentivization part which is actually quite important, as you said. On the other one, are we well represented in our biggest clients? Not today. As I mentioned earlier, the consultants were not there to carry out the dialogue on behalf of the company. They were pitching consulting. So with this change that we have made, we are already seeing the results of that. So we will fix that. The answer is not today but we have already put the institution in place over the last couple of months that is starting to show results.

Kunal

I guess at this point, let's just go out into the audience if there are any questions.

Vishal

It's too late in the day.

Kunal

I guess. That's fine.

Participant

[Inaudible]

Vishal

The SAP experience, right? Well, I was at SAP for 12 years. It was one-fourth of my life. It was quite an amazing experience. Also, going through the whole renewal of a large organization, I was the CTO starting 2007 and in 2009 when Hasso asked me to lead the intellectual renewal, at the time I had no idea what that would mean. Then the subsequent experience of building HANA and being responsible later on for all the products, it became increasingly clear that renewing large organizations is as much about innovation and building products and services as it is about renewing processes and renewing cultures and the latter two are much more intricate and difficult and under-appreciated kinds of things.

So you bring your experiences to bear in the things that you do. But also it is also equally important to know that you have to build products and services that inspire us and that will galvanize a team and in some sense are bigger than us. But it is not only enough to build them but to demonstrate an exemplary way in which you build them. So when we were building HANA when I was at SAP, it wasn't enough to just build HANA but it was necessary to demonstrate that it was built in a new kind of a way, in an incredibly open way, incredibly global way and incredibly rapid way. So you have to build something new and exciting that inspires people but you have to also do it in a way in the underlying process of it, the skeleton of it, is one that is a new one that you aspire to get to.

So it is not yet clear what that will be in our case, some ideas are forming. But the whats as well as the hows and the whys, are all important.

In terms of any particular technological things, I think that the work on open source that we are doing is incredibly exciting. We have built an open source based platform. We call it the Infosys Information Platform based on Hadoop derived technologies. Our team has done some extraordinary work in this area. We have also contributed back to open source several things like the tableau driver for smart _____ Infosys and things like that. I think that the kinds of analytics that are now possible, the cost performance that is now possible on Hadoop, Spark, Storm world with the open source technologies on modern cloud hardware, is just extraordinary. It is very, very difficult for commercial platforms to compete with this kind of cost performance because the software basically is free.

Participant

[Inaudible]

Vishal

When do energy then telcos come back to the -- what kind of growth again?

Participant

Good level growth again?

Vishal

Good level growth again. I have no idea. I think you ought to separate the two. I think energy companies will probably see a rebound. I'm a software and services guy, so opinions are cheap and easy. Having said that, my sense is that before the end of this year, energy will have stabilized. It's a much more time independent thing. I think telcos, there are some fundamental disruptions happening, so it is not exactly clear. I'm sure these are very resilient, very large companies and so they will bounce back. But there is a little bit more intricacy as far as I can tell from what is happening in the telco world.

Participant

Two questions. Can you just talk about underlying demand environment, how you're going through a lot of operational _____ underlying demand environment might be. And then secondly, if you could talk to us about where you see margin drivers coming from over time. Thank you.

Vishal

At the very basic level if you look across industries, the demand environment is not bad. It is good in certain industries, challenged in certain industries like energy and telco that he mentioned, some parts of manufacturing, some parts of retail. Others like financial services is growing quite well, insurance. There is a significant demand in healthcare, in other parts of manufacturing and parts of retail and so forth.

So that is at the surface. If you look below the surface, even though there is a significant disruption happening, both from a cost-pressure perspective as well as the automation that is making its way into the industry, there is still significant room for just the traditional services to continue to thrive. It is just a more competitive environment with more price pressure, so operational excellence is necessary, as we talked about earlier.

Having said that, I deeply believe that a company that is innovative, a company that is able to demonstrate innovation and differentiation in all the work that it does, whether it is towards renewing customers' legacy landscapes and improving them, transforming those and so forth, or helping them build next-generation kinds of solutions, there is no shortage of the need for that. If you look at the aspiration that I have laid out, of $20 billion in revenue by CY 2020, just at a very high level, I mean the entire world around us is being transformed by software and there is a tremendous need for great software, great applications in every industry. There is plenty of demand out there to get to that kind of growth. So it is weighted more on the execution side to get our act straight, to get the transformation done and go after that opportunity, than something underlying inherent in the opportunity itself.

On the margin front, right now we are around 25% to 26%. We have sort of been holding steady at that. Some quarters are worse than others because of underlying dynamics there. But generally our margin is 25% to 26%. My sense is that over time we can aspire to get this up to 30%. That's what I have laid out for 2020 vision. The basis for that is not cost controls and things like that as much as it is the new mix that we want to get to which is to introduce software and IP into our services and that will produce much more scalability in the business, reduce the number of people per project, the number of people per engagement and do more and more of that work with automation, that then creates a different profitability mix.

So my sense is if you look at the introduction of the new kinds of differentiated innovative services which will be higher margin, as well as bringing innovation into the existing services that we can aspire to get to a higher margin than we are at today. One other thing, I get asked this a lot is, if you look at other competitors and their margin profiles are significantly lower than ours, we have in fact looked at extensively - are we leaving anything, are we letting go of growth opportunities by focused on margins like this. And the answer to that is no. I mean the work on the platform that I described, or the next generation applications, of course everybody could use more money and more investment. But it is not that if we just threw more money at it, then the business would grow faster. This is not the case. It is the complexity in adoption, the complexity in the diffusion of the innovation is what dominates the rate of growth of revenue and margins, not so much the amount of investment that we are making. And that isn't at least in the strategy that I have laid out.

So of course we can make the investments that are necessary in sales and marketing and in bringing some of the innovations to life. But it is not like if you threw ridiculously higher money at it then somehow the roadmap would accelerate dramatically.

Kunal

I have some questions of my own But anyone in the audience, if there are any follow-ups, feel free to jump in until the end of the session.

One question on industry dynamics: Obviously drawing on your SAP experience, what in your view happens to IT services companies like Infosys as SaaS and cloud, more specifically public cloud, take center stage over the next few years? And I basically am keeping in mind two common investor fears. Number one, that the addressable market for IT services shrinks dramatically and number two is that there is potentially more competition or threat from specialty services companies which were sort of born specialists in the digital area.

Vishal

I think that anybody who is born specialist in any area gets disrupted by anybody else who is bond further specialist in a different area. This is this continuous dance that has been going on since Moore's law started for the last 50 years. So it's just a part of life and I think if we can demonstrate that if we can keep up with that, good things will continue to happen and at a certain point scale becomes our advantage. One of the things that we are doing to dispel that myth is we are starting to work heavily with startup companies. We're investing by ourselves in startup companies. Here in the Valley we are establishing an incubator. We have a $ 500 mn fund to work with startups in a massive way. So I think that the ability to be relevant to the next generation innovator and to participate with them to bring value to new kinds of enterprises, I am not concerned about that at all.

In terms of software-as-a-service and public cloud affecting the IT services world, first let us separate those two, software-as-a-service and public cloud because typically software-as-a-service companies don't usually run on the public cloud. They run on their own data centers and so forth. If you look at software-as-a-service, this is obviously a very effective model of delivering great experience and convenience to enterprises as you can see from the success of companies like Salesforce.com and Workday and so forth. The ones that are still there, still independent, they will continue to deliver this. My sense is that the need that the world has of software-as-a-service offerings and the need that the world has of applications that are delivered in the cloud, is far higher than what a group of these companies is today providing.

So that produces a tremendous opportunity for companies like us in two ways. One is to integrate into the software-as-a-services companies, to implement things, to integrate existing landscapes into these, doing analytics, things like that. And also in creating new kinds of applications or in extending existing applications or in adding new features and capabilities on top of them and so forth. So the need that is created by the software-as-a-service economy is far bigger than the fact that a particular software-as-a-service could cannibalize an existing custom application development effort or something like that.

The public cloud I see purely as a huge opportunity for us, both from a higher level of the stack perspective in building next-generation applications on the public cloud, but also at the lower levels in migrating legacy enterprise workloads into the public cloud. We are working very closely within Amazon, with Microsoft and others on bringing legacy mainframe enterprise applications and moving those to reference architectures and templates that sit on the public cloud.

I don't agree with this idea that SaaS and public cloud disrupt the IT services model. In fact for the right kind of an IT services model these are huge opportunities, huge opportunities.

Kunal

That's a useful perspective. From a geographical perspective, Infosys is so much about US and UK as end markets today. What do you think about increasing presence in markets like France, Germany and Japan and whether Infosys would be willing to sort of acquire its way into those markets?

Vishal

We would be willing to acquire its way into those markets if there are companies that make sense for the future not simply because they were doing interesting things yesterday, they would have to be aligned with our direction of the future. Otherwise, we feel confident in our own scale. I mean we started our European journey in France, not in England. So we have been there for a long time. In fact, Rajesh who heads our European business is based on Paris. We have a great business in Germany. It's app. 300 million euro today. We have 1,200 people working in Germany. Of course UK is a large business for us. We think that Germany could easily be a billion euro market within the next few years because of the great opportunity to transform manufacturing with digital.

Kunal

This is organically?

Vishal

Yeah, organically. And wherever we find interesting opportunities to acquire which give us acceleration, give us unique capabilities, new kinds of technology, skills and innovation we will of course do that. But I think just buying something from yesterday that just to be relevant somewhere, by itself doesn't make sense to me. So we can grow in these new areas, in these new geographies quite significantly and we are really excited about that. I think China is a huge opportunity, just as Germany is. China we believe could be 20 times bigger than it is right now. China could also be a billion dollar market for us in the next few years.

Kunal

One question on the near term. How do you think Infosys has started the year on its guidance of 10% to 12% percent revenue growth for the year? And what are the areas within the business where you think an acceleration is just looking obvious at this point of time?

Vishal

I think we are confident about the 10% to 12% constant currency guidance that we have given. It is all based on as I said to a large degree getting the operational excellence to get this, to get ourselves organized to serve the opportunity and to a lesser degree by the innovation and the renewal that we will do on the existing ones. The innovation and the renewal will kick in more in the second half of the year and will therefore contribute more meaningfully there. In the early phase and throughout the year it is all about operational rigor and about operational excellence.

Typically in the recent years we have seen that the first half of the year is weighted higher and the second half is weighted lower. This year we are expecting that in the second half also there will be more contribution from innovation and things of this nature. So we feel confident about the 10% to 12% guidance that we have given.

Kunal

That's encouraging. One question on your CY 20 guidance. On the employee productivity you have this intention to take it from $ 52,000 roughly towards $ 80,000. Any broad contours of how do you get there? Obviously automation is going to be a key part of that. But do you think just automation is enough or...?

Vishal

No. So automation is a big part of that. If you look at Infosys up until 15-16 years ago, we were primarily an application development and maintenance company, ADM and product engineering. The newer services - BPO, infrastructure management, verification, these services started relatively recently. These are the services that are sort of off after 'the flat world' phenomenon. These are the services that are actually more prone to automation than application development and so on.

One of the things that we see is that the more automation that we can bring in the better off we'll be. As long as we are able to transform from a people only model to a people per software model with less number of people, more software and we monetize the software, we'll continue to see the increase in the revenue per employee. However to get that real benefit we do need to move the people towards the more innovation, creativity, imagination-oriented world where our people can help clients identify the next great challenges that they have, the big problems they need to solve and come up with ways to solve them.

I think that if people are working on more of these imaginative next generation kinds of problems, then the combination of that and the automation in the more mundane things really could give us that acceleration that we need to get into the higher ends of the revenue per employee.

Kunal

I guess we have time for just one last question. Capital structure - obviously you've raised the dividend payout ratio from 30% to 50% which is a very welcome change. But do you think 50% is sort of optimal and there isn't too much scope for further improvement? Just some quick calculation: In your 2020 target you've laid out roughly I think $1.5-$2 billion from acquisitions. Give or take, that's about let's say a treasury requirement of $4 to $6 billion and you could generate that from your incremental cash flow. So your existing cash is sort of still lying there.

Vishal

We do about $2 billion per year in operating cash and if you look at the 50% dividend, that's basically a billion per year going out into the dividend and after taxes you're looking at roughly $0.80 per share. That is a significant amount. Basically if you look at $80,000 per employee as the aspirational target and $20 billion in revenue, so that gives you 250,000 employees. Right now we are at app. 180,000. So we need room for 70,000 more for which we need infrastructure and so forth.

So if you look at all of these kinds of things and just the working capital that we need and so forth, there basically isn't much else remaining. On $1.5 billion revenue that I have talked about, so out of the $20 billion in 2020, the $1.5 billion that we want to generate out of acquisitions, we expect that these are smaller companies and innovative companies. So the kind of multiple that you typically consider on something like that would require somewhere in the neighborhood of 5x typically, so that would require a payout between $6.5 to $8 billion. You cannot do that just out of your free cash flow. You need to think about that ahead of time. So when you take all of those factors into account there basically isn't much remaining.

Kunal

For now 50 percent.

Vishal

Yes.

Kunal

Great. On that note, Vishal, thanks so much for coming here and sharing your perspective.

Vishal

Thank you very much.

Kunal

Thank you all so much.