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Cognizant Technology Solutions Corp.

(CTSH)

UBS Global TMT Conference

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CORPORATE PARTICIPANTS

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

OTHER PARTICIPANTS

Rayna Kumar
Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Rayna Kumar
Analyst, UBS Securities LLC

Good morning, everyone. I'm Rayna Kumar. And I lead US payment processors and IT Services Equity Research at UBS. I am lucky today to be joined by Cognizant CEO, Brian Humphries. Brian, thanks for joining us.

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

Happy to be here.

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QUESTION AND ANSWER SECTION

Rayna Kumar
Analyst, UBS Securities LLC

Q

So let's now look through your press release this morning. So you've just announced that you will be acquiring [indiscernible] (00:00:24). So tell us about the strategic reasoning behind that acquisition?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yeah. So just maybe from a capital allocation framework, first, to put it in context, we generate approximately $2 billion of free cash flow per year. We've committed to return about $1 billion of that to shareholders in the form of dividends and share repurchases. We've actually done deeper in share repurchases in recent years. We'll also spend about $1 billion of that on mergers and acquisitions.

So we tend to do that in areas where we have a strong affinity towards higher growth categories, namely the so-called digital arena. Also scaling our business internationally, which is part of our strategy and in key verticals and consulting areas. This is one of those key verticals in energy and utilities. There are secular trends towards smart grids and really, this acquisition is in that category. It's an SAP acquisition that's aligned to some of the larger utility companies in North America.

Rayna Kumar
Analyst, UBS Securities LLC

Q

Got it. You have partnerships with some of the largest hyperscalers, many of which have been enhanced by you during your tenure at Cognizant. How do you think your partnership specifically with Amazon Web Services and Microsoft Azure are differentiated with your competitors?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Look three years ago, we didn't have business groups behind Microsoft or AWS or Google. We established them in 2019 and 2020 and I would say the strongest one in particular is Microsoft. We set up two acquisitions behind the Microsoft Business Group in, I want to say 2020. New Signature and 10th Magnitude were two acquisitions that really strengthened our position there. Behind the Azure franchise, I'm looking at dynamics these days. I see a lot of momentum in Microsoft in dynamics. And that's where we're strongest. I see AWS as second strongest and GCP is of interest really around key workloads, data intensive workloads.

If you think about autonomous vehicles, electrification of vehicles and whatnot, they're going to throw off a ton of data. So with Thomas, we're exploring partnerships in areas like that. And variably, you see certain industries like retail where perhaps AWS for obvious reasons is not as strong as others and people want an alternative to Microsoft.

Differentiation is more challenging in that regard because let's face it, most services companies in the world recognize the power of the hyperscalers and therefore standing up practices behind it, but really becomes important in differentiation from my point of view for hyperscalers or industry-aligned solutions. So let me take one example, our TriZetto business, which has been a good turnaround story in the last few years for us, really

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positions us very strongly to be the service provider of choice for health cloud for each and every one of these firms.

So we're doing a ton of work with Microsoft as an example, linking TriZetto and then porting, [ph] franking (00:03:10) TriZetto [indiscernible] (00:03:10) Azure cloud and coming up with use cases around TriZetto that can be deployed around the world. We're also looking to bringing TriZetto perhaps into international markets. It's really been the US payer provider targets area for us with over 200 million people, we leverage at each year. We're looking at international opportunities that should enable us to scale that further.

Rayna Kumar
Analyst, UBS Securities LLC

Q

What's the timeline on that on scaling that over to international markets?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

It's been part of our strategy for the last year and we have some things in to work with them.

Rayna Kumar
Analyst, UBS Securities LLC

Q

You recently made some changes to your people strategy, including accelerating your merit cycle for most of your associates. How have you since been perceived by your employees? And have you seen an improvement in voluntary attrition in fourth quarter as a result?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

So, look, the industry, I think no – let's not disguise the fact with a robust digital environment. You end up in a services environment with demand-supply economics buying key skills that are imbalanced [ph] for the (00:04:13) industry's elevated attrition. We've been viewed as being an outlier in terms of the upper end of elevated attrition. Some of that's factually correct, and I can get into that. Some of it's smoke in mirrors, because we actually disclose every single thing in our attrition, whether it's a trainee or somebody from the BPO business versus others, they exclude those categories.

So ours is very comprehensive. But actually, our employee engagement scores this year went up in eight categories, innovate and ramped multi-year highs. And I've been pretty clear last quarter, while attrition fell 3 points sequentially, we expect a much more meaningful reduction in attrition in the fourth quarter, much more meaningful than the third quarter reduction from Q2.

So I'm really starting to see the green shoots of the work we've done. We've put a retention war room in place 18 months ago. We've done a whole bunch of things from overhauling the compensation strategy of the company to overhauling learning and development, overhauling the promotion process. And that's starting to kick in. I dare say a slowing or uncertain macroeconomic background will also temper attrition across the entire industry. But I suspect that our attrition reduction sequentially will be higher than most in the industry this quarter, which is obviously good for us in terms of our ability to fulfill and obviously get back on a faster revenue curve.

Rayna Kumar
Analyst, UBS Securities LLC

Q

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You recently announced major management changes, including Ravi Kumar as President of Cognizant in North Americas and Prasad Sankaran as SVP in your Enterprise Technology global practice. Can you talk about their roles within Cognizant and where do you see the most opportunity for them?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yeah. Both are – I'm really pleased to have been able to recruit them. The first time I met Ravi, and started a dialogue with him, was over 15 months ago. So, this was a long gestation period to try to wine and dine and talk about the possibilities of us working together and what it could do for us here on Cognizant. So he's been the President of INFY for six years. They run a very good playbook and I think he brings a very strong growth agenda to Cognizant, which will really help us in North America, which is about $15 billion of our revenue. So, getting more growth in what is three quarters of our business ultimately helps overall company growth.

And Prasad Sankaran, actually, I started talking to him in spring of 2020, so this is almost three years in the works. I think about it in that regard, it just takes a long time to get people of this caliber into your company to find the right role that fits. He's running effectively, what we call software platform engineering so think of that as ADM, digital engineering or QE&A our testing business, our digital experience business. And he'll play a very strong role actually back to the hyperscalers orchestrating those relationships for us. He was in Accenture for 25 years before going to Bain for few years and actually he stood up the business group strategy in Accenture back in the day.

So both of those bring very strong skills to Cognizant. They've been in the works, if you will, for between 15 and almost three years, 15 and 36 months. But we're pleased to have them join. Prasad joined November 1 and Ravi starts January 16.

Rayna Kumar
Analyst, UBS Securities LLC

Q

In your third quarter earnings call, you appeared cautious on your outlook, particularly for your financial services business. Can you highlight the areas of financial services that are more prone towards discretionary versus non-discretionary spending?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

It's not just financial services, if – can I just [ph] jump (00:07:42) back just for one second, just the strategy of the company, what are we trying to do because the third piece of the strategy fits into your question. First piece of the strategy is pretty obvious. Globalize the company, $15 billion of revenues in North America, $5 billion overseas. We want to get at that market opportunity overseas and that requires us to change out some country leaders overseas, refresh them. I won't apologize for saying my head of Japan should speak Japanese and should probably understand the Japanese culture.

So, we've made those changes. We've got good momentum in Japan at the moment. We're also complementing our international business with more M&A, more branding, and actually a delivery network where we complement India with near shore and onshore international delivery capabilities, that's part one. Part two of the strategy is around scaling into digital, higher growth categories. It's ultimately about repositioning the company towards higher growth categories. When I joined a few years ago, we were about 30% digital, 70% exposed to lower growth categories. We're way by the industry. We've been pushing that envelope as quickly as we could, [indiscernible] (00:08:41) the balance sheet, we spent about $1 billion a year on that. We're now 51% digital that will help our growth rate.

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It actually also helps employee retention and attraction because employees want to have contemporary skills. It also improves our relationship with clients because we're not just doing build, run or maintenance, we're actually doing some of our most innovative and strategic projects. The third part of the strategy links back to where you're going with these things, which is – I inherently of the belief that being a provider of resources is not a sustainable advantage and it's not purely a strategic grab, as it was 25 years ago, Y2K or leading into that post Y2K era.

So if you provide resources, you can inherently become more culturally passive. You're waiting for somebody to ask for .NET or Java or others. So, what we've been really trying to do is accelerate our shift from being a provider of time and material type work to sell solutions and deliver client outcomes. Now, easier said than done, and that's therefore the hardest part of the strategy.

In order to do so, you need to have a client interface that shows up with a point of view by industry and sub industry. Take an example, financial services and banking, retail banking versus capital markets or payments, different dialogues, different pain points, property and casualty versus life insurance, et cetera, et cetera. So you have to have a strong conviction and a point of view of the pain points of the C-suite in those industries and sub-industries. Then you have to have a client interface that shows up more proactively with a point of view. And thereafter, you have to have solutioning and project and program management capabilities to actually price solution and deliver successfully against those commitments. And so that pivots in that third part of the strategy is very important to us.

We're not trying to become McKinsey or trying to become a strategy consultancy firm. Our prowess is actually technology. But what we want to do is complement our technology capabilities with more of an advisory capabilities wrapped around that. That, that ultimately starts shifting your revenue mix away from time and material towards managed services/fixed bid/fixed price, which can enable us thereafter therefore to industrialize delivery. So the good news about this is if I have committed an outcome to the clients, I can manage my pyramid, I can manage my shoring, and I can better manage my margins because I leverage automation I sell larger deals.

If I'm simply providing bodies, resources and it's even worse if you provide resources that are interview-based resources, you can find yourself selling a lot more smaller deals and a lot of deals you can't automate because you're selling an individual sometimes based on an interview or teams of individuals. And so that's the pivot we're trying to make. And the best maybe illustration of the risk of not making that as if you're in time and material, you're subject to things you've known about for years, things like furloughs, because people want to make savings.

And in a period of macro demand uncertainty, you end up in a time of material business. Just like a consulting business, you're more exposed to the vagaries of budgets. We want to continue to evolve away from that. But as a company, we're still approximately 50% time and material. In banking more explicitly, our banking business, our FSI business is 57% time and materials, so therefore more exposed to that. And obviously, as we talked to the earnings call, there are pockets like mortgages that are weaker than they've been previously.

Rayna Kumar
Analyst, UBS Securities LLC

Q

What do you think is the right mix between timing, material cost plus effects for Cognizant?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

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Look, I don't really want to get into that because we have internal dimensions we're working through as well. But we will have less time and material over time.

Rayna Kumar
Analyst, UBS Securities LLC

Q

Got it. You spoke about elongated sales cycles on your last earnings call, are you experiencing any improvements in the sales cycle into the fourth quarter?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Earnings was just four, five weeks ago. So I don't think things change in the macro demand environment that rapidly. What we talked about at that moment in time was in North America, certainly a slowing of sales cycles, some degree of uncertainty. I'm a little bit worried. I was at an event yesterday in DC Business Roundtable, there were 200 CEOs. They were all talking about things like return to office, the macro environment. Sometimes [indiscernible] (00:12:55) we talk ourselves into a recession because if everybody's talking about interest rates and frankly, energy prices and a whole bunch of other things.

Before you know that CFOs are tightening their belts, anticipating scenario A versus B versus C for the forthcoming fiscal year and we can quickly talk ourselves into a recession. But it's certainly been a slower environment, as I talked about in the earnings call than I had anticipated three months earlier. Three months earlier, I had been somewhat cautious. I think certainly in the third quarter, we saw more of that, I'd say dynamic that people are second guessing spend, things that don't have a quicker ROI, things that could potentially be pushed out or postponed, have been pushed that.

Internationally, Continental Europe has been weaker for us. The UK has been a very strong success story for us for a few years now. It's our second largest country and really has been growing mid-teens to 20%. So that's a playbook we're trying to replicate, frankly, in the rest of Europe. And in North America by industry, it's really been banking a little bit in healthcare and consumer goods and technology has been a little slower, as I said, on our earnings call, than we had hoped. It's still a double-digit growth business for us, but you're seeing every week technology companies are laying off employees and I think CFOs there are second guessing spend as well.

Now in the same vein, I would say the portfolio we built these days, it's very different. We've got a $10 billion digital business and a $10 billion non-digital business. And so whether a – this takes the more exciting part of uncertainty to a certain extent. If a client simply wants to massively try to do vendor consolidation and reduce cost, we have a very strong portfolio laying that arena or if they are committed to customer journeys and digital experience, rolling out packaged applications, et cetera, we have very strong capabilities there that we never had before.

We didn't have a Workday practice three years ago. I'm just on my second Workday acquisition six weeks ago. We were partner number – I want to say 14 for Salesforce three years ago. Today we're in the top three or five that we've really tried to make ourselves much stronger in the digital arena. And hopefully, the fruit of that repositioning of the company will actually start showing up with better growth over time.

Rayna Kumar
Analyst, UBS Securities LLC

Q

If anyone have any questions for Brian, feel free to put it into UBS' TMT conference app and I will read it off the iPad. Moving on, so quarter-to-date, have you seen any improvement in optimizing your onshore model in North

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America? Has your ability to secure work visas for your head count improved? And what do you believe is the right mix here between onshore, offshore and nearshore?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

So sometimes, the right mix depends on what you're selling. And there was a predisposition, I guess, a few years ago that digital meant much more nearshore and onshore. And yet COVID has proven that that's not necessarily correct because if you can work remotely in your home 25 miles away, well, then you can work 500 miles away. You can probably work 5,000 miles away as well. So we, like the rest of the industry, have shifted each of the last two years, about 1.5 to 2 points of our delivered revenue has shifted more towards actually India and away from onshore locations.

In the last few years, the classic like e-services model is, however, maximize margin rate offshore. You somewhat subsidize that with onshore capabilities and, of course, there therein lies the rub. If you reduce your head count onshore too much, you actually lose higher revenue and margin dollar per head counts. So while margin rate might be lower, on core margin dollar and revenue dollar per head is actually higher onshore. And that's a little – one of the things that hit us more recently and it wasn't because we were intentionally trying to reduce onshore head count. It's just we're in a world where I joined the company, we were well in excess of 50% visa dependent in North America.

That was Trump administration policies which were coming into play. And I would say as well, client pressure to say, you've got to show up more representative of society in North America. So we went through a meaningful visa reduction in North America. That, by the way, was one of the factors that hurt our attrition in India because hitherto you joined Cognizant in India, you get a one way ticket to North America and hopefully a green card thereafter.

The good news is most of that pain is now behind us. Over the last two years, we've meaningfully reduced our visa dependency well below 50%. And now we're in a better position with our employees in India. So, actually, now we can get more people back to North America because we've done the heavy cuts, if you will, and we're now more normalized. We've frankly gone a little bit too far, not because we wanted to go that far, simply because every company in the world is struggling with the US immigration policy, whether it's [indiscernible] (00:17:43) or hotel companies or frankly IT services companies. It's a great dialogue in Capitol Hill at this moment in time, as people are co-mingling, if you will, the Mexico border situation with white collar H-1B visa situations.

And so we, like many others, have had less H-1B visas approved than at any time in our history. And even those that have been approved to try to get them onshore is harder because the visa processing time in US consulates throughout India is at all-time lows post COVID, they still have not recovered. So those that are onshore are faced with lots of job offers because people are short of labor and those that you get offshore to try to get approved to come onshore, it takes longer to get them onshore. But the more fundamental change in onshore head count strategy actually won't be visa head count that will be around the edges, important for us and important for morale and attrition.

The more fundamental thing is actually attrition. And as I said on the earnings call, we've seen that four or five months of resignations on a daily basis [indiscernible] (00:18:43), and that's a very strong leading indicator of future attrition. So hence my confidence when I say you'll see substantially lower voluntary attrition in Cognizant in the fourth quarter versus the third quarter because, frankly, we know what's coming because we've seen a resignations data.

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Rayna Kumar
Analyst, UBS Securities LLC

Q

Given the changes in immigration that we've seen over the last few years. What do you think is now the value proposition that you offer to your employees in India?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Look, I mean, there still is the same value proposition as most other companies, which is you have an opportunity to work for a large company that serves multiple industries. You can work in some of the most interesting companies in the world. You can have an international relocation opportunity and you get to working in companies that have a heart.

In our case, we do a ton of work around Cognizant Foundation, volunteerism, et cetera. But I daresay if you go to Accenture, Capgemini, INFY or otherwise, we all have similar ambitions with our employees. We're going to throw a lot of money at your learning and development.

Last year, we invested 23 million hours in learning and development. We had a 130,000 people take digital training last year in Cognizant. You get to move internationally. You get to work on companies across all industries. I mean that's a similar value proposition and what we've been trying to do as well as make sure that we do that with as I said career path progression with a compensation structure that's more advantageous these days than previously. And I think getting people back to the office by the way is going to be important, an important element of that, because it helps cultural affinity and engagement levels and this notion of camaraderie, whether it's transportation or cafeteria, where it's like people ultimately do better when they're in a convivial environment.

Rayna Kumar
Analyst, UBS Securities LLC

Q

We have a few questions from the audience, so let's take some of these. How long will this turnaround take with respect to organic revenue growth, which is below your peers?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

You've got to start almost with the starting point and by the way I should say as well, last year we grew revenue, our highest growth rate since 2015. And most people don't recognize that we grew revenue about 11% last year, about 2 points of that was inorganic [indiscernible] (00:20:58). In order for us to get where we need to be, I would say in terms of top quartile revenue growth a few things.

First of all, attrition, getting attrition back where it needs to be is so fundamental to achieving unit growth potential. The second thing for us is changing the portfolio and as I said, getting from a starting point of 30% digital to now 50% digital. We're still behind the industry, but we're catching up. Many of our peers were 50% plus digital three years ago. We're exposing ourselves to the higher growth categories, and that's going to help a relative performance. And I think people like Ravi coming shouldn't be underestimated and Prasad because they really bring a clients' tangent and followership and that's really going to help I think our top line momentum.

And then last but not least when I think about – some of our peers have had 2, 3 points, it's viewed as organic growth rate. It's really structured deals. Sometimes they deploy capital to get those structured deals. So in a strange way, people talk about M&A as inorganic, but structured deals is organic. That's one of the inconsistencies. But we had stepped away from some larger deals in the last few years. We were very, I would

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say, disciplined in terms of how we approached them. Why? Very simply because I inherited a lot of structured deals that were not very healthy.

And when you peel the covers back and do a postmortem on it, they were poorly [indiscernible] (00:22:16). The Ts and Cs weren't very good and we could have lost a lot of money. And I went as far as exiting one of those structured deals in the bank key space in the Nordics at the end of 2020, because frankly, it could have cost us hundreds of millions of dollars as far as I was concerned and would have massively impacted our brand in Europe, which is one of our growth regions.

But as I said to the board at the start of this year, we've made a lot of progress now with the deal governance. We have established what I would call pretty standard deal governance, around legal and solutioning and delivery people signing off and HR signing off their element of the solution. We have done a lot of work around pricing. We have also done a lot of work around what we call a solution architect environment and what good looks like for single practice deals versus multi practice deals.

And project and program management, of course, is pretty essential and we've been doing a ton of work to try to industrialize, if you will, what is the gold standard there and make sure we get more people trained to those levels. So I entered this year having made progress in those elements, feeling, okay, we can be a little bit more open this year in 2022 and beyond around doing larger deals. And so that will be the other thing of the relative growth rate.

It's attrition, it's client-facing leaders like Ravi joining the company, reducing attrition, getting people like Ravi [indiscernible] (00:23:43) in the company, and also changing the portfolio with the higher growth categories like digital, which was well underway. And last but not least, you'll see us do more opportunistically these larger deals aligned to key geographies or industries where we can get an anchor-tenant client or supplement what we already have. But I'll still be, I would say, judicious when it comes to those things.

Rayna Kumar
Analyst, UBS Securities LLC

Q

Will you move more aggressively towards software development like EPAM, which offers higher value-added services, digital engineering.

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

We actually have a multi-billion dollar digital engineering business already. And if I take the ADM business, which is also multi-billion, we have a very clear pathway towards a $4 billion-plus modern [ph] application (00:24:27) business within Cognizant and that is very much part of the strategy.

So it's not as though we're starting from scratch. We have a $2 billion-plus digital engineering business. We've done a lot of acquisitions in the last few years. Even before I came, we acquired Softvision in 2018 and then in the last two years, we have acquired Tin Roof, Magenic and a host of other digital engineering firms. That bridge was in Eastern Europe as well. And our vision, ultimately, is to have a very strong on-ramp into digital engineering, [ph] leading (00:24:58) ADM business and ultimately take that business forward and Prasad Sankaran is in charge of that for us.

Rayna Kumar
Analyst, UBS Securities LLC

Q

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What is the salary inflation environment like today versus 12 months ago and how does that compare with pricing environment?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

It's tempering a little. There was irrational behavior in the market, I would argue, in the last 18 months, two years, it started changing in the last three months, three to six months. Irrational behavior of people that work for you and that leave and they get a 45% or 75% salary increase to go across the road. You think their build rate, there's no way in hell that their build rate is going to go up 45% or 75%.

So ultimately, it was going to lead to margin pressure in the industry. We've been, I think, from our perspective, quite pleased with how we've managed in a resource constraints environment. I wish we didn't have the same elevated attrition we did. I'm delighted to say we will see a meaningful reduction in voluntary attrition now in the fourth quarter.

But in a resource constrained environment, we try to optimize our yield. That's how I've been trained over the years. So demand-supply economics, If you don't have enough headcounts and you have more demands and you have more demand than your headcounts, then you put them on accounts that yield the highest margin. Last quarter, you would have seen perhaps for the second quarter in a row when the industry was going backwards in margins, we drove margin expansion sequentially and year over year. And actually for the year, we'll drive about 20 basis points margin expansion in line with our framework that we outlined about a year ago.

We've been able to do that because we've maximized yields in a resource constrained environment, but we've also done a lot on pricing. I think it's been one of the nice success stories for us this last year, and it's not something we've hitherto been [indiscernible] (00:26:40) known for, we've been known for client centricity and delivery excellence and an awkward conversation around – I think my labor costs have gone up 10% 15%. I'm going to have to pass those on to you as a client was somewhat foreign for a client-facing team, but we tried to industrialize the program behind that and that helped us recuperate.

So I would say, look, net-net, the upward pressure on salary is not as great as it was six months ago. We've been able to mitigate that better, I think, than most in the industry, as you've seen in our margins. Everybody has benefited from a depreciating rupee [indiscernible] (00:27:15) take those common things out. You just stand up and see, okay, whose margins didn't flux? And so I think that's something we're looking forward to continue to drive on a go-forward basis.

We have very good knowledge around [indiscernible] (00:27:30) and why and where they stand on a pay scale. We have five pay bands. And the median is, let's say, P50 in the markets and where our people vis-à-vis the median of P50. So, one of the reasons we actually have, I would say, significantly changed our comp philosophy in the last two years and we've baked it into the next two years financial plans is because we wanted to take our relative compensation closer to industry norm. We were a little bit lower than the industry. And some of that was – we could afford to do it because we had a, let's say, a richer green card program in the past. But as I said, regulatory policies in the US changed that and forced our hands a little bit. So next year, we moved our comp strategy up from Q4 to Q2 proactively, and that's one of the things that's helping employee engagement scores and reducing attrition.

Rayna Kumar
Analyst, UBS Securities LLC

Q

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Just follow up on your price point comments. When does the pricing changes typically go into effect and if you can help us quantify those increases?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Look, there's no one single rule. I mean, clients are smart. And many clients leverage companies like [indiscernible] (00:28:36) say, well, how do I [ph] deflect (00:28:37) these pricing increases. So, some of them have already come into effect in Q3 and in Q4. And next year, therefore, we'll get, let's say, 12 months annualized benefit versus three or six months benefit in 2022. Other clients have said, well, look, I'll do it, but it's not on my budget, I'll do it effective January 1. So, it is ultimately a mix of the benefit for that but it's meaningful for us. It's the most meaningful price increase agenda we have driven, I would say, in our history.

Rayna Kumar
Analyst, UBS Securities LLC

Q

Given the announcement of your acquisition of [ph] SAP Align (00:29:14) this morning, are you continuing to see an improvement in your deal pipeline?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

The acquisition this morning is a company called Utegration. It's a US company. And that's the third acquisition we've announced in the last six weeks, and so that starts getting it back on the framework. We had a slower start to the year because the – I would say there was irrational behavior in the M&A market last year, where we actually walked away from some deals because the buyer and seller disconnect in terms of valuations was greater than I was comfortable with. And at the end of the day, I'm the custodian of the company and I don't own the company and I'm a part of it but I'm here to represent you. So we're not going to do anything irrational from an M&A point of view.

Things have, I think, become more rational. There are certain deals last year, by the way, we wanted to get done where we couldn't get close, we couldn't get into exclusivity, it's always invariably competitive. So I'm pleased that having not had acquisitions to announce for the first three quarters of this year, we've just announced three in quick succession. And I actually think the M&A pipeline for us is pretty healthy at this moment in time.

I feel confident we'll be very much under the realm of this normalized $1 billion of acquisitions, give or take, per year. And we'll do it [indiscernible] (00:30:32) what we've been doing the last few years, more tuck-in type acquisitions aligned by industry, aligned into the higher growth categories like digital, supplementing our international growth agenda with acquisitions to complement what senior leaders we put in those markets. And one thing it's important for me, that third part of the strategy to move up the value chain by selling solutions and delivering client outcomes, more of an advisory capability, so we call it internally consulting. And if you've been a client interface that has really been around a certain business model, but you want to complement that with more thought leadership by industry that's why we have our consulting business aligned by industries, so we can show up with that point of view I talked about earlier.

Rayna Kumar
Analyst, UBS Securities LLC

Q

As we exit 2022, what do you think will be the key themes and IP services in 2023? How do you think your clients will prioritize their spending?

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Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

With the client advisory boards, I want to say that two months ago and this was a topic we actually discussed with major clients. I would certainly say that clients like us and their CFOs are [indiscernible] (00:31:42) the macroeconomic backdrop. It is not necessarily a time to be dogmatic. It is somewhat uncertain. There's lots of pockets of opportunity. We see some larger deal opportunities that we hadn't seen in prior years as people look through workflows and processes and want to get automation.

So, I think the themes will be one, and I've talked about this for a while now, vendor consolidation is real. And I think that will only continue in a period of time where there are demands for cost efficiencies, automation and AI by definition. Historically, maybe we thought about technology as a stack, the application layer, the data layer, the infra layer. I think more and more clients think about customer journeys. And so, you start thinking about, well, sometimes because of [indiscernible] (00:32:32) iPhone where people want a consumer-grade experience, but, of course, [indiscernible] (00:32:36) wants an enterprise grade security. You want hyper personalization if you're trying to – if you're in the telco arena or a banking arena or insurance arena or otherwise. There's no such thing as a segment of male or female or youth or elderly.

Those days are gone. It's a segment of one. And in order to get a segment of one and a consumer-grade experience with enterprise-grade security, you need massive data sets that are engineered in a modern manner that [ph] are openly (00:33:04) sitting in the cloud with target metric. So I think that whole customer journey will actually become very, very real in the years ahead and how we modernize that customer journey. You'd still be surprised, by the way, how many of the larger companies in the world assuming their early innings of their cloud migration and their tech stack modernization. So, those trends will continue.

I'm actually pretty optimistic that come what may in the short-term and it is uncertain. Frankly, this is a great industry. This year, well, we wish we would have done better. We guided in our guidance last quarter's 7% organic growth rate for the year and 7% to 8% of EPS growth for the year. And we're giving back year-to-date, I think, $1.5 billion to shareholders via dividend, via share repurchases. And this is the year that's been somewhat uncertain in the recent quarters. I mean, this is a fantastic industry to be in. It's a high growth industry, it's a cottage industry. And I'm convinced that the digital transformation agenda of companies will fuel growth in years to come.

Rayna Kumar
Analyst, UBS Securities LLC

Q

Can you talk about some of the dynamics that will drive margin performance going forward. What levers remain for Cognizant to offset some of the investments made in the employee base? And how should we think about the benefits from margin from the depreciation of the Indian rupee versus the US dollar?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Well, Indian rupee depreciation is not a secret, it's happened over multiple decades and I'm not sure I'm in a better position than UBS to comment on what the future is as an example [indiscernible] (00:34:31). But that's somewhat of a level playing field. Some companies are more exposed to India than others. So versus the Indian pure-play companies, we may have less exposure there, but we're probably more like a Accenture in some regards that we're more of a US listed company and a more global leadership team, for want of a better word.

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You know, if I think about things like that that are in common across the industry, I'll go back to where we are. One thing I said is we're trying to move away, not fully away, by the way, it will always be portion of our portfolio, but from time and material type work to enable us to sell more managed services and fixed-bid, fixed-price deals. That will fundamentally allow us to industrialize delivery.

You know, let me just spell this out in clear terms for everybody. If a client who has been trained to think of Cognizant to strip away for two decades has grown used to leveraging us as a provider of resources, and they interviewed 10 people in this room to say, hey, we love Rayna, we want Rayna. Let's make this really simple. So Rayna is based in India. You cost me $100. I bill you for $150. After 12 months, you want a 10% increase. Your cost go to $110. The bill rate typically will stay $150. After another 12 months, your cost base is $121. Your bill rate is still $150. My margin on you has gone from 50% to 29%.

That is not a – that model can work if you're growing exponentially and always offsetting that margin erosion. And I would say that was one of things that caught up in Cognizant as our relative growth rate slowed in 2016, 2017, 2018 and then into 2019, that exponential growth that had been driven in the company started – because we started losing that. We started being unable to cover the reality, which was a time and material heavy business. Shifting away from that really allows me to say what we can sell larger deals which I can automate. We can make the outcome what's important to the client, not the input. Therefore, I can actually rotate employees with you. I can have a very different pyramid and I can have more offshoring versus onshoring et cetera. So there's a whole bunch of things like that is very important, what I would call delivery industrialization.

We have other initiatives underway, procurement, real estate, as an example, that should drive margin opportunities for us. And then last but not least, recognize companies that scale to a certain extent. My areas of my business will not scale with revenue. Let's take an example, my corporate functions, legal finance, HR et cetera. I will get financial leverage on those portions of our business going forward as the company gets larger and larger. So those are key elements. Pricing is, of course, relevant. And as I said, we're proud of our pricing progress. You think about a labor cost increase model, you have to offset that labor cost each year with delivery in industrialization and placement. Otherwise, you're running to standstill. So that's how I think about the margins.

We talked about our multi-year lens back one year ago, granted the economic outlook was different at that moment in time. So there was two elements of the discussion, one was the top line story, a multiyear CAGR, and then one element was a margin expansion story. And I certainly feel, the 20 basis points to 40 basis points margin expansion story we laid out is something we should be able to accomplish if we execute our strategy. Things like digital for us, by the way, are fundamentally more profitable than the non-digital. So as that business has gone from 30% of our business to 51%, that gives us some tailwind on margin too.

Rayna Kumar
Analyst, UBS Securities LLC

Q

Very helpful details. So we're at the last few minutes of our session. So I guess, just finally, what are you most excited about as we enter 2023 for Cognizant?

Brian J. Humphries
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

I think I'll have the strongest leadership team. First of all, I have had since I inherited Cognizant 3.5 years ago, Ravi, Prasad, Rob Walker, who stepped into an international role. These are all very strong leaders, at least more stable now than it's been. And in terms of our strategy, the digital mix is bigger than it's been, which is going to give us some breathing room in terms of margin and revenue growth. All of those are good things. The brand is getting a little stronger with every passing year. But probably the bane of our existence in the last few years, I

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mean, it's been a challenging year. We had a cyber-attack 2.5 years ago. Then we had a work-from-home brush with COVID, humanitarian crisis in India, followed by – we had exited content moderation, we exited a larger contract with Samlink. So there were some exogenous events and some company specific events that I stand behind.

We did the right thing exiting that contract. We did the right thing exiting content moderation. I think our strategy now in some of those early moves that I felt were needed is more stable. And so I'm looking forward to a year where we have less change, frankly, less attrition and that will, in my mind, hopefully [indiscernible] (00:39:32) the macroeconomic backdrop that's the great uncertainty but I think [indiscernible] (00:39:36) is more and more in order than it's been.

Rayna Kumar

Analyst, UBS Securities LLC

Brian, thanks for joining us today.

Brian J. Humphries

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

Thank you.

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