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Cognizant Technology Solutions Corp.

(CTSH)

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Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Okay. Yeah. Thank you. I think we're ready to get started. Thanks, everyone, for joining. My name is Tien-Tsin Huang. I cover the IT services and payments sector here at JPM. So we're here to host Cognizant. Ravi Kumar, CEO, is nice enough to join us for a fireside chat and I've gathered some good questions. Hopefully, we'll get through that. And we'll take questions from the portal, if I can just figure it out. I think I'm good now.

QUESTION AND ANSWER SECTION

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

But yeah, Ravi. Thank you for being here. Always grateful for your time. I think when we last spoke to you last year, you were just getting started and it was a great conversation to hear some of your plans, many of which have come to fruition, which is great, but maybe 16 months or so into the job, I thought we've had a lot of IT services, companies here at the conference. You've made a lot of changes that have worked well. Can you maybe summarize some of those things that have worked well? And what's still to come for Cognizant?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Sure. So thank you for the opportunity. I did come and see you last year. So 16 months on, so one of the things I did in my first year was not to front-load change and back-load performance. And normally, every new CEO in the first year does that. I layered change and performance together. So I kind of created performance to give me the license for change and I made change, create catalysm for performance. And I kind of created a flywheel on that, right? So going in, I realized tech services firms have a rhythm which Cognizant was very used to.

So to get back to that rhythm, you need people who have done this for many years within the company and outside. So we've got the CFO – we've got a new CFO onboard. We got a new CHRO onboard, which I got from internally. We got the CFO from Wipro, we got a head of the comms business. So the commercial teams, we

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made a lot of changes. I created more modular units, so we broke financial services into three, and we got one leader from outside and we got two leaders from inside.

We wanted to create new muscle. I mean, Cognizant is known for financial services and the healthcare ecosystem. We got a new leader for comms, and comms is one of my industries which did very well over the last one year. We've got somebody to run partnerships. So we made a lot of change on the commercial side. I also front-loaded commercial performance to back-end execution, so we made the changes from the commercial organization first so that the leaks are no longer there. I mean, there were leaks in the system in some ways.

So, we arrested those leaks and we created traction on the front-end before we made the changes on the back-end. On the back-end, we have made significant changes in India. India is where two-thirds of my workforce is. So we got a lot of execution bandwidth created out of India. In places where we had a strong muscle, we picked people from inside. In places where we did not have muscle, we actually picked from outside. So we made quite a bit of change.

I would say, a large part of that is done. There's still a little more to be done. I mean, change is always an evolving thing. And I think, for the rest of the year we'll make a few more changes. But we are in a good shape, very steady now. My attrition rates are at an all-time low. Last quarter, we ended with trailing 12 months, 13.1%, which is – I mean, I'm also carrying the load of the back-end.

If I take annualized quarterly attrition, it is significantly lower. And the way to look at attrition is relative to my peers, growth and attrition should be looked at relative to my peers, I think we're in a good spot. So, a lot of change; a little bit more to do. But this is, I think, been a great run for the first 16 months. If somebody told me this is what I'm going to get at the end of the year, I would probably take it.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Yeah. No. Well said. No. Hats off to you, especially on the attrition side and getting the delivery in a good place. I know that's not an easy lift and it seems like it's in a good place. So I think last year, you talked about your listening tour and what differentiates Cognizant for clients, for talent, for employees. Has that changed in your mind?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

In the 25-year history of Cognizant, maybe for 20 years or maybe 18 to 20 years, Cognizant was a winning – I mean, it was in the winners' circle. The few years before I came onboard, it wasn't. But the one thing which was very common, which made Cognizant, Cognizant, and which I actually want to draw from the heritage as much as I can, is client centricity, entrepreneurial spirit, extraordinary entrepreneur spirit.

I mean, it's a very entrepreneurial firm and it operated at the confluence of industry and technology. Cognizant was born in the late 1990s when the Y2K boom was over. So it kind of started its foray into tech services using application services, application outsourcing, which needed domain expertise and technology. So Cognizant always built that strength at the confluence.

I think I want to draw that strength. I think it's more relevant now than ever before because technology's in the core of every business. So the domain expertise really plays a role, intertwining it with technology, gives it a very unique positioning in the market. So good entrepreneurial spirit, client centricity, operating at the intersection of technology and industry domain, I think, are the three big important traits.

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As we went through this journey of the intersection of technology and domain, we also built a strong platform player. I mean, our healthcare business is probably the largest in the United States in our peer group, the entire healthcare ecosystem that is built on a thesis of platforms in the middle and creating a multiplier of services underneath it. I'm hoping that I could replicate that template in some of the key industries.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Okay. So, we'll dig in a little bit more on the business and whatnot. But I've been asking this question to all of your peers at the conference, Ravi. And you've seen a lot of different cycles. We've seen some cycles. This down cycle has been especially long. I feel like we've been fighting the demand question since the second half of 2022, and we're still seeing uneven results. Why do you think that is?

I think I've heard you comment on this unwind from this pandemic boom. Of course, there are some cyclical challenges, but are there also some structural or secular issues that you think is driving some of these uneven results across the peer group?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

So yeah, this has been unusually long. And I don't think there will be change in 2024. At the back end of 2024, there are elections in most parts of the world. So there'll be some kind of – I mean, I don't see the situation changing positively or negatively. Hopefully, in 2025, this changes. Now, unlike in the past, most times, you see either periods of change or periods of uncertainty. Very few times, you see periods of change and periods of uncertainty coming together.

The uncertainties because of the geopolitical situation, inflation rates, and everything else, and the changes because of the advent of AI technologies. By now, the AI revolution should have actually created a trigger on the CapEx cycles, which hasn't happened. So it's an unusual period of change and uncertainty that is kind of causing that, I would say, a standstill position. Equally, I would believe, coming out of the pandemic, there was significantly higher discretionary spend. Discretionary is a large part of tech services.

And almost every tech services company has the number one industry vertical as financial services, except for Cognizant, which is healthcare and financial services, both are of the same size. Healthcare is marginally bigger for us. And financial services has completely cut down the discretionary spend.

A large part of it will come back, some part of it will not come back. Over the pandemic, there was a structural shift of doing work remotely, and that has led to quite a bit of work actually going to captives. I mean, in 2023, back in India, on a base of 1.6 million employees, the captives added 200,000 employees. On a base of 3.5 million employees from tech services companies in India, they lost 150,000 employees roughly.

So there is some movement of the small amount of discretionary to captives. There will be an equilibrium at some point of time, so that will stop. I mean, the split of work between captives and IT services companies have to go through a little bit of a correction, and that has happened. So some of it will probably get recouped as well because the cost of technology deployment through a captive is higher than the cost of doing it from tech services companies just because of the pyramid, the scale, and the labor costs and everything else.

I do believe that the arbitrage on technology, I mean, the biggest use case for AI is applying technology on technology deployment cycles. That will kick off. That will give more productivity. As that gives more productivity,

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the trigger will come back to IT services. The other big shift, which I think I'm pretty sure this thesis is going to evolve, the cost of deployment of technology has to come down.

The last time when technology had to be invested into enterprises back in the early 1990s, when there was an information age and there was a proliferation of technologies and enterprises, the only way the pull happened then was because outsourcing was done through an offshoring wave. And that reduced the per capita cost of deploying technology. We're going to see one more wave happening.

In fact, there was a second wave, I would say, when the cloud came into picture. When the cloud came into picture, the ratio of plumbing to building changed. 70% of developer work was done by – was plumbing and 30% of the work was building and innovating. That ratio flipped on its head at that time. We're going to see one more shift, one more flip of that ratio again. And that productivity change will trigger the CapEx cycles on discretionary. I mean, it is necessary not because there is an advent of AI, that's the pull.

The push is the higher cost of capital. I mean, the higher cost of capital will – is almost forcing enterprises to slow down the important work. And some industries, technology is the biggest CapEx spender. In some industries, it's not. I mean, in manufacturing, you're actually competing with other priorities of manufacturers. So the cost of deployment of technology has to go down. And this time, it's not going to be on labor. It's actually going to be on a technology arbitrage and that will trigger a CapEx cycle back.

I mean, the clients were telling me, look, I have these five projects. The business case is not stacking up. If you give me a lower technology deployment cost, I think I can trigger those projects through. So we're starting to see that. So my thesis is you're going to see a tectonic shift in technology deployment costs. This is going to be a third wave, if I may. And that will then change the way – I mean, you could arguably say that that will actually add more technology to enterprises like it did. I mean, when offshoring happened, more technology got deployed. When the cloud happened, more technology got deployed. With the advent of AI, more technology will be deployed.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Now, that's a great framework of – that we should use and study. I'm assuming Cognizant won't be standing by waiting for that wave. And so what is – what are you doing to position the company to catalyze growth during this period?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yeah. So in a low velocity market like this, most of the large deals we do, we're doing some very good large deals. I mean, over the last one year, if you ask me one thing I'm very pleased about, I would actually say, a large deal momentum is one of the highest. We've got a proportionately higher share of large deals in comparison to others.

Most of these large deals are built on cost optimization, vendor consolidation, productivity and efficiency-led. And I think we've powered some of those construct of the deals using productivity, leveraged by automation and AI technologies. And it helped us to win. And over the last 12 months, we've also done an analysis of a bid versus did ratios of our large deals. And we are in a pretty good spot.

Now, why has that happened? Very early on in March or April of last year, I made an announcement to invest onto infrastructure-related to automation and AI. Now, I don't think system integrators have a role to play in the innovation cycles of AI. Everybody will say this, but I don't think they have a role to play. They have a role to

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participate, they have a role to follow, and they have a role to invest on last-mile infrastructure. What is the last-mile infrastructure?

The last-mile infrastructure is, can I invest on platforms which can govern, orchestrate and manage AI initiatives? Can I build infrastructure to improve the accuracy of the models? Can I build infrastructure to invest on responsible AI? Because no longer safety is important, trust and equity is important because the output is coming out of a black box. Can I actually invest on infrastructure which will optimize cost, because the cost of compute is so high? Can I actually invest on productivity studies which will create the business case for more use case and [indiscernible] (17:15)? I mean, productivity is the biggest lever on AI and the business cases are not stacking up.

I mean, how many enterprises are buying end-to-end, wall-to-wall copilot? Nobody is buying. And everybody is buying small cohorts of copilot. The reason is, you need justification and a business case to do it. So what that means is, what does, say, for example, a teller of a bank do today? What is the exposure score for all the tasks the teller of the bank has? What is the future task the bank does – the bank teller does? And what does AI play a role? So, invest on productivity studies which are related to human capital.

So, those are the areas I'm investing and I'm realistic about what we can do. I mean, the billions of dollars being invested on the innovation cycles, I don't think we have a big role to play there. We have a role to play to take the raw power of AI to enterprise grade AI, and to make it and embrace. Even in spite of that, enterprises are not embracing it. I have 500 prototypes running on AI, very few are production-grade. So that journey, that cycle is going to take us longer. So we have a lot of work to do, heavy-lift to do in the last-mile and that's where I'm investing on.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

And I like that construct as well. So back to the large deals that you've won, you said it's vendor consolidation, it's a lot of cost optimization type of work. Is there something new to be learned on the margin profile of such deal in pricing? And of course, getting closer to the client is always a win as they get ready to go after the last mile you described. But just tell us a little bit more about the...

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

So if you've noticed in the last two quarters, we made sure that most of those large deals we are winning, we are actually announcing it to the market as well. So one of the recent ones we did was Telstra, which was an extraordinary win in Asia-Pacific. In most of these deals, when you're doing a cost takeout and a vendor consolidation, the first and foremost is you need to be a stable player.

I mean, if you're not a stable player, you will get consolidated out, leave alone, you're winning business. So we were on the losing side before. We are now on the winning side because we are a stable player. We have the right to win. I mean, I asked all my teams, if you have the right to win, then we'll go and fight it out. If you don't have the right to win, there's no chance.

We think we have invested heavily on this productivity infrastructure, which is allowing us to do this at a highly optimized, very efficient cost model. So once you have a stable leadership and a stable team and you're doing your piece well, you have the right to – you have the license and the right to ask for more things. So those consolidation opportunities, we are now on the winning side because the productivity benefits we are willing to share with our clients is compelling enough for them to provide it.

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There are some swimlanes where we otherwise had a strong position like healthcare. I mean healthcare, name the payer of the United States, we are probably having the number one, number two and number three wallet share. So we have the license there to go back and say we can actually do more cost productivity and vendor consolidation. The reason why we were not doing it before, we were not playing large deals. Second, we were not stable enough. If you're not stable enough, you can't go and ask for others' business. Your business is up for stake.

So I think we are in a good spot to win. This is also the CEO's agenda. I anchored all the large deals in the company. And this is right from my office. We have unified the firm. And once you unify the firm, it's very hard to beat Cognizant. Wherever we are not – we have not put the might of the company behind, we have lost. Wherever we put the might of the company behind, I think this is an extraordinary franchise. So the chance of losing is lower. So we've kind of made that happen most times and that has worked for us.

I mean, the places where we are not participating. For example, my exposure in some of the industries like energy utilities is not so high. My exposure outside the United States is not so high. I mean, we only do 25% of our business outside the United States. In fact, if you look at my peer group, a large number of them do between 35% to 40% outside the US, and the markets which are growing for most of them is actually international markets outside the US. So I have gaps which I have to fix either through organically or inorganically.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Can it be done organically, Ravi?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

I mean parts of it can be done organically, parts of it cannot. I mean – in one of the investor conversations I was talking about, our business is in four vectors, that is tech services, BPO, infrastructure services, and ER&D. Tech services, we are very deep, very big. There are pockets where we are understated like SAP, which we have to probably do an M&A. In BPO, we are very good on digital operations and vertical BPO, we are lighter on horizontal BPO.

I mean, the ones which are most commoditized like customer service, F&A, I think we have a unique opportunity because those are the ones which are getting cannibalized and disrupted the most. On infrastructure services, we have built significant traction now. We didn't have historic muscle. For the last one and a half years, the most wins we're having is in that space. On ER&D, it's actually a new kid of the block.

It's countercyclical, it is less outsourced, less offshored. And these are industries which will take off. We have built a muscle in automotive. We bought a company called Mobica in January of last year, just as I was getting in. And then we bought one more company the year before, but we have very little presence in the other industries.

So if I take that vector, I mean, there are spaces where we can. I mean, for a $20 billion company, you ought to be wall-to-wall in enterprises for you to do well. So we need to be in all those four vectors. Industries, we are underpenetrated in many of them, which we – I think we have a good shot at it. Our healthcare business, I want to double down. I mean, my TriZetto platform is the largest platform in the United States for healthcare. 65% of the US insured population goes through that platform.

So I have very little member base leverage, headroom, but I have leverage on the breadth by adding more things on the breadth of the platform to buy. So M&A is an important lever. We didn't do much the first year. I mean, I

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said this, I wanted to layer performance and change together and I wanted to get the license to do big bets late in the year. So late in the year, we went and did a big – I mean, a reasonably big M&A, which is TriZetto.

And we are now the number one ServiceNow partner in North America. But I waited all the way until the end of the year because I wanted to layer the performance and change with the big bets. In the second year, I would like to do big bets. I'm exploring, but M&A is always uncertain things, so you should start organically and then look for M&A.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Okay. No, that's helpful to go across. Let's hit a few more topics and then we can open up. Just India delivery, you led with that, that's been turned around in a good place. And it feels like it's gaining traction as we talk to privates, CIOs, et cetera. Do you agree with that? You talked about gaps from a – in that level, but what about on the delivery side? Is it a double down on India? Could you expand?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

No, no. We are doubling down. I mean, we – I front-loaded commercial changes. I back-loaded execution changes. We've hired quite a few people in India now. And we've built extraordinary muscle. In fact, I also did something called the NextGen program, which was about taking out cost. So we also moved a lot of our corporate functions in the process as well, moving it to India. We expanded from Tier 1 cities to Tier 2 cities. I mean, the Tier 2 cities story in India is fascinating.

I have 20,000 people in a small city called Coimbatore in Tamil Nadu. We are the largest employer there. I mean, the attrition rate is almost zero. So, I'm expanding into Tier 2 cities. So I gave away real estate in Tier 1 cities to move to Tier 2 cities. We opened a center in Bhubaneswar, we then opened a center in Indore. We have a few more coming on the way. So I want to mix it with Tier 1s and Tier 2s, so that we build our own market.

So, India is going to be at the center of who we are as a company. We are the second largest employer in India. So we want to keep that momentum. We've got a mojo back in India. So, we'll continue to keep that, be focused. Interestingly, Cognizant also invested on distributed capability. We have 8,000 people in Eastern Europe, in Romania, Poland, and other countries from two acquisitions we did before called Softvision and Devbridge.

And we have surprisingly 10,000 people in Canada catering to local Canadian clients, one-third of them; two-third of them catering to American clients. And then we have capacity in Mexico. So we have extraordinarily strong offshore in India, but we have a distributor network which means whenever digital engineering comes back, that is more amenable for a more distributed labor market, we will be well-equipped to seize those opportunities.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Okay. And the ability to train, hire within India, I'm assuming that's still a competitive advantage and...

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

That's always – Cognizant always had that rhythm. It kind of got into a pause for three or four years. And I have reinvested back. We have 70,000 people who have more than 10 years' experience in Cognizant. So, that's the

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muscle of the company. That's the middle of the firm. So moving forward 10 years from now or 15 years from now, we want that same ratio of old-timers in the company.

We have the highest number of returners in the last one year, people who left Cognizant, who always thought Cognizant was their home, but they left before, and they actually came back now after I've come onboard. And actually, I've opened a green channel for them.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Good. Good. So I know, last year you put through some unusual – a couple of merit cycle increases and it seems like it's working. Do you feel like we're on a normal cycle now in terms of inflation, especially across the Tier 1, Tier 2?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yeah. So, the industries which are measured by how much innovation capital to build and how much magic to build through the innovation capital like software companies are, our industry, both investors and employees, measure us on predictability, reliability, and trust. I mean, I shouldn't say this, but we are like the restaurant business. You have to serve a good meal every day, you have to keep your employees happy so that they'll serve a good meal every day.

The day you don't serve a good meal, they forget that you serve them for the last five years. They just walk away. It's that business. You have to wake up every day and do this again and again and again, and not be bored about it. So, both for investors and for employees, predictability, consistency, not negative surprises. Hopefully, positive surprises is what they look for. And we want to become that platform again. And that's why I am consistently looking for, right from my first quarter, to make sure that I deliver to the numbers I'm committing.

And I'm also committing to the – I'm also delivering to the promises I'm committing to my employees. So we have converted that into a rhythm now, more predictable, reliable merit cycles. I mean, merit cycles are going to be tough for the future. All the merit cycles in the last 10 years in tech services companies have actually been funded by the rupee depreciation, to a large extent. That's not going to happen anymore. So, you will have to create the money, hopefully through AI-led, non-linear ways to fund it. But we have become a more consistent, predictable company for employees. And that's one of the reasons why our attrition rates have gone down.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Okay. I won't ask around on gross margin and operating margin and all that good stuff, but because I always ask on the earnings calls. But just the importance of margin expansion, Ravi. How important culturally, philosophically for you is it to expand margin?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

The NextGen program we did last year, the idea was to contribute some back to the margin and the idea was to use a significant portion of it to invest into markets, use that – use the growth to actually drive operating margin. In some ways, that is non-linearity between growth and SG&A. So it's important for me to keep the margin competitive enough and in the range. I mean, this industry has a huge range all the way from 10% to 25%. I want

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to be somewhere in the middle of the range, if you ask me. And that's why we did a margin expansion of 20 to 40 basis points last year. But the lot of the savings I got, I want to use it back into investing back into growth.

Now, most of the NextGen program was focused on the operating margin and the SG&A. There is room in gross margin as well. I mean, we bumped up our utilization by 1% over the last few quarters. I think we can – we have some room there. There is opportunity to create a better pyramid. There is leverage on AI-led automation, how much you save – how much you share with your clients, how much you keep back, and that arbitrage goes away over a period of time because everybody then starts to share.

And this is again an industry where anything which has come as a cost advantage has actually gone back to clients in a very efficient way. So I mean, you want to run a tight ship so that you're competitive in the market. That's how I see it. If I don't run a tight ship, I'm not going to be competitive in the market on pricing.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

It's fair. I know you're standing up, so we should pick one question. We have one minute left. Any quick questions here to close it out? So we've covered a lot of ground. You're very thoughtful, Ravi, around thinking about the framework of the industry and then the company. So thank you for that. Just any other – I know it's tiresome for us as sell-side analysts tracking the same metrics over and over again across all the groups and trying to compare them, fair or not. What other KPIs or signals or maybe other leading indicators that you would encourage us to take a closer look at either for Cognizant or for the sector?

Ravi Kumar Singisetti
Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

I would say, I mean, to revenue and growth and margins are all – not margins, but growth is always relative. If I'm in the winner's circle in a low market, the growth rate could be lower. If I'm in the circle with the high market, the growth rate could be higher. I think sell-side analysts also get overwhelmed with bookings numbers. Bookings, is by itself, not a great indicator, if you ask me. That as a practitioner, I can tell you, because – I mean, I could do renewals and keep my bookings up. But it may not lead to go. In fact, in this age where there is leverage on AI, you could do renewals ahead of time, and keep your bookings as well. In fact, when you do a renewal, you could actually bump up your booking but reduce your revenue. That's possible as well.

Bookings, in conjunction with book to bill, most sell-side analysts see both and try to gauge the health of a firm. I would say the other big metric nobody tells the market is ACV. I mean we have started to track it internally now, but ACV is an important metric as well, if you ask me. Because the duration of these deals depending on if you're doing platform deals, they're 10 years. If you're doing cost takeout deals, they're more than 5 years.

If you're doing transformational deals, they're 1 year, and actually, sometimes less than 1 year. So imagine if you have bookings which are all related to transformational deals, you will actually make more growth. Imagine you have bookings related to platform deals which are 10 years, you will make very little growth but huge booking. So I think you have to see all three metrics, if you ask me, to forecast the future.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Excellent. Ravi, thank you so much for your time.

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Ravi Kumar Singisetti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

Thank you. Thank you so much for the...

Tien-Tsin Huang

Analyst, JPMorgan Securities LLC

Hopefully, you'd be back here next year as well. Thank you.

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