

HCL banks on Axon purchase

Indian outsourcing company hopes to use acquisition to expand SAP consulting

BY NIRAJ SHETH

NEW DELHI—In an industry reeling from the global economic slowdown, one Indian technology company is banking on a large—and possibly risky—acquisition to boost itself into the top echelon of outsourcers.

On Monday, HCL Technologies Ltd. is expected to officially conclude its \$811 million takeover of U.K.-based Axon Group PLC. in the largest overseas investment an Indian outsourcing company has ever made.

The takeover is a defining moment for HCL and its chief executive, Vineet Nayar, who is under pressure to make the deal work.

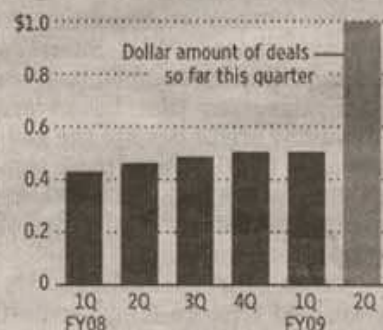
The timing of HCL's acquisition bid, announced in September, is inauspicious, some industry analysts suggest. As outsourcing customers in the U.S. and Europe cut budgets to survive a global slowdown, fewer tech outsourcing jobs are being sent to India, and the industry's once-skyrocketing expansion has come to a standstill.

Since the Axon deal was announced on Sept. 26, HCL's stock price has dropped 50% to close at 106.95 rupees (\$2.21) on the Bombay Stock Exchange Friday.

"Making this acquisition work out financially in the next one to two years will be a big challenge," says Pankaj Kapoor, an analyst with ABN Amro. Even in better circumstances, other acquisitions by Indian tech companies "have not always been as successful as the initial benefit they thought they would

HCL Technologies

Revenue in billions of dollars



Note: Fiscal years end June 30 of year shown
Source: the company

have brought in," he adds.

To offset such challenges, Mr. Nayar and HCL are pinning their hopes on Axon's consultancy expertise in SAP, a popular type of software that many large companies use to manage everything from supply chains to employee payrolls and accounts receivable.

The software is produced by German tech company SAP AG, but requires significant after-purchase work to implement and customize for each customer. A new, independent subsidiary called HCL Axon will be spun off after the takeover, HCL says. It will employ 4,500 consultants, mostly from Axon, who will advise companies on how to transition to SAP software.

The key to making the acquisition work will be holding on to Axon's consultants, who have deeper customer

relationships in a wider range of industries than most Indian tech companies usually operate. Because few Indian outsourcing companies currently offer SAP consulting, HCL believes the potential market for SAP-related outsourcing to India is still large. Every year, SAP AG sells more than \$10 billion in new software licenses to corporate customers, whom Mr. Nayar has targeted as potential clients for HCL's services.

The deal for Axon is the latest in a series of unorthodox moves by Mr. Nayar. Although HCL had been in talks to buy Axon for months, its larger Bangalore-based rival, Infosys Technologies Ltd., offered \$753 million in cash for Axon a month before HCL went public with its bid in September.

While the Infosys bid initially appeared to threaten the deal for HCL, the move played right into the company's hands, Mr. Nayar says. Infosys' all-cash bid gave the deal the credibility HCL needed to get funding from banks that had been hesitant to support HCL amid the then-growing global credit crisis. "But the moment that [the Infosys bid] happened, we went to the market and got five [financiers] to compete" to lend HCL money, Mr. Nayar says.

When it made its \$811 million offer for Axon, HCL said it would take out \$735.5 million in loans to fund its bid and pay the rest in cash. The takeover is expected to be completed midday Monday in the U.K.

An Axon representative in the U.K. couldn't be reached for comment over the weekend.

Acquiring Axon is expected to

change the face of HCL. Unlike larger outsourcing rivals such as Tata Consultancy Services Ltd. and Wipro Ltd., the Noida-based tech company doesn't have hordes of programmers writing customized software. That's why, Mr. Nayar says, the company looks for "blue oceans"—untapped markets where potential is high and the competition light.

Soon after the Axon deal is final, the company expects 30% of its revenue to come from SAP-related work. The impending deal has already brought in \$1 billion in new contracts for SAP consulting this quarter, compared with \$273 million in contracts HCL inked in the quarter ended Sept. 30, the company says.

HCL's interest in Axon goes back to early this year, when HCL hired a consulting firm that short-listed three SAP consultancies—Axon and two based in the U.S.—as its best acquisition targets. The company had been trying since 2005 to develop its own in-house experts in SAP, "but it can't be created," says Mr. Nayar. "It comes from experience."

At HCL, which he has headed since 2005, first as president and then CEO, Mr. Nayar has introduced a policy that makes managers accountable to employees. Performance evaluations for top managers are routinely posted on the company intranet, and employees can earn "miles" for quality work that they can redeem for rewards later. The management strategy, which the company calls "Employee First, Customer Second," is now the subject of a case study at Harvard Business School.