"HCL Technologies Limited Q2 FY'21 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to HCL Technologies Q2 FY'21 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sanjay Mendiratta – Head, IR. Thank you and over to you, sir.

Sanjay Mendiratta: Thank you, Aman. Good morning, and good evening, everyone. A very warm welcome to a HCL Tech Q2 Fiscal '21 Earnings Call. Trust you all are safe and healthy.

We have with us, Mr. C. Vijayakumar, President and CEO of HCL Tech; Mr. Prateek Aggarwal, Chief Financial Officer; Mr. Apparao, Chief Human Resource Officer, along with the broader leadership team at the call to discuss the performance of the company during the quarter, followed by the Q&A.

In the course of this call, certain statements that will be made are forward-looking, which involves a number of risks, uncertainties, assumptions and other factors that could cause actual results to differ materially from those in such forward-looking statements. All forward-looking statements made herein are based on information presently available to the management, and the company does not undertake to update any forward-looking statements that may be made in the course of this call. In this regard, please do review the Safe Harbor statements in the formal 'Investor Release' document and all the factors that can cause the difference. Thank you. And over to you CVK.

C. Vijayakumar: Thank you, Sanjay. Good morning, good afternoon and good evening, everyone. I hope all of you and your families are safe and are in good health. I am very happy to report that we have had a fantastic quarter. We delivered 4.5% sequential constant currency revenue growth and delivered an EBIT margin of 21.6%. We saw broad-based growth across the portfolio.

It is also noteworthy that our EBIT margin in this quarter is at a 22-quarter high. Our stellar performance is a result of five key factors: First, the intensity of the technology spend in the market as companies calibrate their business models to the new normal is increasing. We witness many large deals in this quarter, including 15 transformational wins, which represent significant modernization and digital transformation initiatives for our clients.

Second aspect is our client relationships and the stickiness of the client relationships will continue to show confidence in us by giving us several new programs and expanded scope, many of them with very quick closure cycles.

Third aspect is the early lead and the leadership that we have in the Digital Foundation business.

As the world got into the pandemic, Digital Foundation, enabled by hybrid cloud, digital workplace, networks and cyber security became super critical prerequisites for any bold plans for enterprise transformation. And this has increased attention from all the key stakeholders in

client organization. So, the programs also get a lot of attention. We saw something rather come up in almost all the clients in the past quarter.

Fourth aspect is our continued focus on automation, right shoring and all the supply chain efficiencies and all the cost management initiatives.

And the fifth and most importantly, the hard work and dedication that our employees have invested despite all the odds.

Driven by these factors that I articulated, we posted a truly all-round performance this quarter. All our engines fired with positive sequential growth in every reporting category.

In terms of business segments, IT and Business Services grew 4.9% sequentially in constant currency. This was led by Digital Foundation in Mode-1, and digital and analytics and cloud native offerings in Mode-2, primarily driven by modernizing Digital Foundation and accelerating digital transformation.

Engineering and R&D services also saw great traction in the last quarter. This segment grew 3.6% quarter-on-quarter in constant currency, enabled by incremental product innovation requests as well as new engagements.

The third segment, Products and Platforms grew at 3.1%. This is a reflection of the stability and the positive traction that we are seeing in this business.

In Q2, HCL software did nearly 5,000 sales transactions and the number of unique clients signed in the last year increased to over 12,000.

If you slice this performance by Mode-1, 2, 3, we saw an impressive 4.3% sequential growth in constant currency in Mode-1, led by Digital Foundation and a 6.9% quarter-on-quarter in constant currency driven by Mode-2, largely Digital and Analytics business and our Cloud Native business.

We also saw very good growth of 2.1% QoQ in constant currency in Mode-3 despite it being a seasonally weak quarter for these segments.

Geographically, rest of the world led the performance in Q2 with the record breaking growth of 9% QoQ in constant currency. Americas and Europe also continued the strong growth momentum at 4.9% and 2.2% QoQ in constant currency, respectively.

In terms of verticals, our growth was led by Life Sciences and Healthcare Vertical at 8.6% quarter-on-quarter constant currency. Retail and CPG vertical also recovered very smartly and registered a robust growth of 8.4% sequentially. This reflects our strong participation in areas that are critical for this segment, including Ecommerce solutions.

Financial Services registered a broad-based growth across clients to deliver a 2.6% QoQ growth in constant currency terms.

Our top business headlines this quarter are a happy mix of recognitions and milestones setting as well for future success.

I am very happy to share with all of you that just yesterday, HCL Technologies has earned the prestigious designation in Forbes Fourth Annual List of the World's Best Employers 2020 Ranking Number 30th Rank overall globally, and making us the top ranked company among the multinationals headquartered in India.

HCL Technologies is the only Indian company to appear in the top-50 group of this ranking, and we are truly humbled by this recognition.

We also received recently the highest governance quality score of first decile from Institutional Shareholder Services. This score indicates higher quality and relatively lower governance risk. The score is derived after reviewing four key tenants of both structure shareholder rights compensation and audit and risk oversight.

A few weeks back, we announced our intent to acquire DWS Limited, a leading Australian IT business and management consulting company. DWS provides a wide range of IT services, including digital transformation, application development, program and project management and consulting. We expect this acquisition to strongly enhance HCL's contribution to digital initiatives in ANZ region, while also strengthening our client portfolio across key industries.

This quarter, we also expanded our cyber security capability footprint through the opening of our First European Cyber Security Fusion Center in Gothenburg in Sweden. The center will help European organizations comply with the local regulations concerning data sovereignty.

Given the strong momentum in the cloud business, we are continuing to invest in our partnerships with hyperscalers to make our market differentiated propositions even stronger.

From a cloud business perspective, we launched a new IP to accelerate deployment of SAP environments on Google Cloud Platform.

We also became the only certified SAP competency partner for four hyperscalers -- Google Cloud, AWS, Azure and IBM.

HCL has become one of the early partners to qualify for Azure Migration Program Partner Status for Windows Virtual Desktop Engagements, a workplace solution by Microsoft.

HCL is also now a Microsoft Cloud Adoption Framework Enterprise Scale Certified Partner. CAF is a proven Azure framework designed to create and implement business and Technology strategies to succeed in cloud, which will help in accelerating the client's cloud adoption journey.

We also expanded our collaboration with AWS by joining the ISV workload migration program. This helps us to migrate ISVs workload to AWS via a repeatable migration process and accelerate their clients their journey to cloud.

On IBM Cloud, we had set up our partnership two years ago on hybrid cloud, recently expanded this partnership to include IBM public cloud with focus on certain regulated industries.

Now, moving to some color on our bookings and pipeline, our booking TCV in Q2 is similar to the same quarter last year, and is 35% higher than the last quarter. We signed 15 net new transformational deals, led by industry verticals including Life Sciences and Healthcare, Energy, and Media and Telecom. All the 15 deals are mentioned in our Investor Release.

I also want to highlight that these deals are new deals and exclude renewals. We also had robust renewals during the last quarter.

From a pipeline perspective, we are witnessing good deal creation activity across all verticals and geographies. We are also witnessing a good momentum in the cost transformation and vendor consolidation deals and continuing interest in Digital Foundation and the transformation opportunities.

Overall, our Q2 pipeline grew by 20% QoQ and currently it stands at an all-time high. Looking ahead, we have revised our revenue and margin guidance upwards; our constant currency revenue guidance for Q3 and Q4 is expected to be in the range of 1.5% to 2.5% on an average basis. This will enable us to deliver a positive growth for the full year compared to what we had reported at the end of Q1. EBIT guidance stands revised upwards to 20% to 21%.

Overall, we remain confident of our performance in the remaining fiscal of this year. We have a robust pipeline and are very positive about the market opportunity, especially from our vantage point of a diverse service mix, segmental leadership, strong client relationships, strong network of partner ecosystem and a robust operating model to manage our costs effectively.

We are also committed to making all the right investments in the market to capture the market opportunities that are emerging.

We are very committed to investing in our employee growth, both through learning and opportunities, as well as salary increments which will start reflecting from October onwards. The variable compensation for the full year is expected to be similar to that of last year.

With that overall high level commentary, I will pass it on to Prateek to provide more financial color on our performance. Over to you Prateek.

Prateek Aggarwal: Thank you, CVK. So, obviously a very, very healthy report for the quarter. Let me start off with something which is not so number-intensive while I will get into the numbers later on as you expect me to. So, I just wanted to start off with governance as a topic and why it is material now is because I think in line with the best governance standards, HCL set a new standard this quarter

by coming out at being the only one to come out and communicate publicly through our mid-quarter update that our revenues and EBIT were expected to be materially better than the range that we had guided back in mid-July. I think that is one of the hallmarks of this quarter I just wanted to start off with that. And potentially, those are the kind of actions that ISS as the Independent, Shareholder Services body, has given HCL the highest governance rating of one, which means low governance.

Moving on to some of the numbers, like we said in the mid-quarter guidance, we would be higher than 3.5%. That was at the end of two months of actuals what we saw, and the third month also came out very positive. And we finally closed the quarter with 4.5% QoQ growth in constant currency terms. In year-on-year terms, that translates to a (-0.4%) in constant currency terms. In US dollar terms, we are now at 2,507 million, $2.5 billion which is the $10 billion run rate which we had achieved earlier, but then due to the pandemic went a little lower, and we are happy to regain that $10 billion run rate again. In US dollar terms, that translates to a 6.4% growth on a sequential basis quarter-on-quarter and on a year-on-year basis, that is a 0.8% growth. EBITDA came in very strong 26.6% for the quarter. This EBITDA of 26.6% is 103 bps improvement on a quarter-on-quarter basis and 322 bps on a year-on-year basis. And Q2 EBIT was at 21.6%, that too up 108 bps on a quarter-on-quarter basis and on a year-on-year basis it is 165 bps.

To give you a quick margin walk, just to cover the highlights. The net improvement is 108 bps. But we did have a negative impact coming from the Forex, particularly from the rupee appreciating, that gave us about 24 bps hit and we also invested this quarter in SG&A investments, mainly in the P&P business and that took away about 32 bps as well. We saved some 7 bps in the Depreciation and Amortization (D&A). So, on a gross basis, the productivity, or the operational efficiency that we delivered during the quarter was about 157 bps. This 157 basis points came from multiple factors, largely driven by the excellent revenue growth of 4.5% in constant currency. We had not taken any drastic steps last quarter, which was the right call since large portion of the revenue came back this quarter, and that resulted in higher utilization and therefore better margins. Our Mode-2 business has been growing well and margin increase in that business is also helping drive the overall company margins. If you see last year same quarter, Mode-2 margins were about 14% and, in this quarter, it is 18.5%. And this business has crossed the half a billion-revenue mark in this quarter. Therefore, a run rate of $2 billion plus.

Some volumes coming back also helped margins and some COVID recoup specially our ERS business which had some supply chain challenges last quarter also helped. So, all in all a great quarter from EBIT or EBITDA perspective.

In terms of profit after tax, net income was at $424 million. This increased by 9.7% sequentially and 12.7% on a year-on-year basis and translated to about 16.9% of revenue. Last quarter it was 16.4% which included a one-time benefit from a certain land disposal that we had done. So, in that respect, it is more than 50 bps improvement on a normalized basis.

The next highlight is on the cash flows. And this is something which is a clear standout kind of a number, not only for this quarter but on a longer term if you take a look at the Last l2-months.

So, for the quarter we delivered OCF of $643 million which was 152% of net income, and a free cash flow of $578 million, which was 136% of net income for the quarter.

In terms of last 12-months, the operating cash flow was close to $2.7 billion, $2,692 million to be precise, which was 161% of the net income in the last 12-months. Similarly, free cash flow for the last 12-months was $2,444 million, close to $2.5 billion and that also was 146% of the net income for the last 12-months.

This is the sort of concept that I had started sharing almost a year back that our cash flows are expected to be much higher compared to the net income, because as per accounting rules, the net income has several components which are non-cash in nature. So, that is what we had tried to capture in the cash EPS. And this is what you can see delivered in the last 12-months, $2.7 billion of OCF, which is also helped by the excellent work that we have been able to deliver on the DSOs, days sales outstanding and which currently stands at 79-days, including the unbilled which has dropped by 7-full days compared to the 86 that we were running at in the last three quarters. So, seven days improvement in DSO has completely changed the shape of the cash line ratio, and on a YoY basis, which is 11-days improvement in DSO. And so, all of this cash flow has generated, we ended last quarter at $1.33 billion of net cash. And you will remember that this was after paying off $812 million, the second tranche to IBM for the seven products that we had acquired from them. And you know that $1.33 billion has now increased by $500 million in one quarter to a level of $1.83 billion now, which is up 250% on a year-on-year basis by the way. And gross cash stands now at $2.25 billion. We used $200 million out of the solid cash that we generated to pay off some of the short-term loans that we were holding. So, the increase on a quarter-on-quarter basis in gross cash is about $300 million while using up $200 million out of the $500 million that we had generated.

Moving on then to the (EPS) Earnings Per Share numbers, reported earnings per share for the last 12-months is now at Rs.45.2 which is up 22% on a year-on-year basis. And the cash EPS is now at Rs.60.30 which is up by 36% on LTM basis.

Now, happy with the cash generation as well as the net income that we are generating, the board has chosen based on some of the feedback we got from some of you and a lot of investors also on a direct basis, the board has gone ahead and doubled the dividend per share on a per quarter basis. So, so far, we were giving Rs.2 per share per quarter. And you will remember last year, same time, we had come out with a bonus issue, 1:1 bonus, double the number of shares, and we had continued with the Rs.2 per share on double the number of shares. And now this year, we are doubling the dividend on those doubled number of shares. So, it is in that sense a quadrupling in a short period of four or five quarters, whichever way you count it. So, going forward, also, we intend to maintain the Rs.4 per share per quarter. And that is a good news that I have to share with all the investors who hopefully will like what we have done.

The revenue guidance, CVK has already spoken about, on top of the 4.5% that we have already delivered, which at the lower end of the earlier guided ranges kind of 3 times, the 1.5% that we had mentioned, we are keeping for the balance half of the year a similar kind of growth despite

having delivered much higher this quarter, which basically the 2% to 3% extra that we delivered this quarter we are carrying forward the same rate of 1.5% to 2.5%. In year-on-year terms FY'21 over FY'20, it basically means a growth of 0% to 0.7% versus (-2.3%) to (-0.8%) that we had given last time. So, that's an increase of 2.3% at the lower end and 1.5% on the higher end. Annual margin outlook has also increased; earlier, we were at 19.5% to 20.5%, and we have increased that by about 50 basis points for the full year and now stands at 20% to 21%. The ETR continues to be at 24%. And that brings me to the close of all the numbers. Thank you very much for your attention and over to you moderator for Q&A.

Moderator: Sure, sir. Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Ankur Rudra from JPMorgan. Please go ahead.

Ankur Rudra: I just had one main question. You have done very well on all accounts. The demand environment seems to be moving up quite significantly. And as Prateek, you mentioned, the cash conversion has been the highlight of the quarter. Any change to the overall way of thinking about capital allocation going forward, the dividend may form a part of that, that we can expect?

Prateek Aggarwal: Ankur, the big changes already in the announcement we already made. The rest of it is something that typically the board will see from a quarter-to-quarter perspective, largely in the last quarter I would say. But, which was part of the ask, we have set out a more definitive guidance almost in terms of what we intend to do in the future. So, we stay there for now and see how it develops from there.

Ankur Rudra: And maybe just one question, CVK, your thoughts on, you have seen this pandemic period changing the nature of demand quite a bit. How is your addressable market for your type of services expanding given your roots in foundational infrastructure services?

C. Vijayakumar: Ankur, I believe the addressable market does increase in a meaningful manner in two dimensions; one, there were sectors which were less open to adopting global delivery models and outsourcing, for example, the healthcare from a service provider perspective. Given the current cost pressures, that is one segment which has opened up, and we already saw two good wins in the last quarter. The second element is certain geographies which had started opening up more to global delivery model and offshoring, I think that trend is going to become a little bit more pronounced as we move forward. The third element will be on the Digital Foundation itself. The opportunities to partner with the hyperscalers, and because of the strength of partnership, I think we are also able to reach a lot more clients than we would have ever reached before. There is a lot of marketing investments made by hyperscalers, and there is a certain amount of pipeline that we are seeing that is getting built through that relationship as well. These are just a few points, there could be others, but these are the few highlights.

Moderator: Thank you. The next question is from the line of Pankaj Kapoor from CLSA. Please go ahead.

Pankaj Kapoor: CVK, I have two questions to you. So, given the accelerated adoption for cloud, do you also see a concurrent impact on your legacy business, which may be practically pulling down the growth? That is my first question.

C. Vijayakumar: Not much of an impact. I did talk about this even last quarter. Of course, some of the legacy data center business, migration to cloud would accelerate. But cloud migration brings itself a holistic set of opportunities which actually extends far beyond the data center, the whole digital foundation, network, security, all of this has to be enhanced. And the migration itself is a continuous program, because there is a huge amount of legacy estate. And it also opens up opportunities for us to play in the application modernization space in the clients where we were delivering some of the foundational services. So, overall, I see it as a tailwind. In the net, all these things put together, it is still a positive impact to the overall business.

Pankaj Kapoor: CVK, second question was on HCL Software. You have now completed a year there. So, what has been the learning in terms of your ability to say provide add on services to the product portfolio that we acquired? And related to that, do you see a need to do any incremental investment in sales like you did in this quarter?

C. Vijayakumar: Yes, of course, first year, there has definitely been a lot of learnings. I will have Darren share that. However, from a cross-sell perspective, or upselling perspective, the first year the focus was to ensure we are able to transition a large percentage of customers to be directly working with us. And that has gone extraordinarily well. We have seen very strong migration and very similar to what we had expected. Darren, could you share a few learnings from the broader software perspective?

Darren Oberst: Sure. CVK, I think you summarized it pretty well. I think as we were going through in the first year, like any transition, I think, first you want to make sure that you take care of the basics. And there was an enormous amount of focus on. Before we start thinking about all the upsell, cross-sell, all of those opportunities, let us be sure that we make this a smooth successful transition for those customers of these products. And that is showing them a clear commitment to their success, that will be a good partner to work with. And then just as importantly, that we are really on a pretty accelerated modernization innovation journey with these products. So, they are betting on the right technologies, it is going to be future proofed for the long-term. So, that I would say has probably been the number one real learning with 12,000-plus customers. We have had to go customer-by-customer. I think what we have really been relentlessly focused on is, working that list, customer-by-customer, deal-by-deal. And that first things first, the best strategies to execute really well through that. I think second then, and I think really coming to your question, we have begun to look opportunistically, for opportunities where we can drive synergy across different parts of the HCL portfolio. But I think, the principle that CVK set from the very beginning, and we have communicated in this forum and other investor forums is we have to respect the customer. And, first thing we have to do is make sure we are addressing what the customer is looking for. There are many customers that are looking for services, only solutions, there are many customers that are looking for software-only solutions. And so I think where we have been looking for those synergies is in that sweet spot of customers where bringing software and

services together can bring incremental value. And again, a great example of that was, we had a customer on our commerce software, actually upgrade from an older version of the software to a newer version. And they have successfully gone live. There was a great example, where they were a long-time customer of this software, they were looking for a single vendor to provide the overall solution to them. It wound up generating a large scale services opportunity, and a transformational opportunity in terms of really helping to upgrade them for the future. I think that is just one concrete proof point. But, I think those are the kinds of examples that we are looking to replicate.

Pankaj Kapoor: Prateek, how much of the margin gains that you would have made in the current quarter you think is structural and which you can defend? And how much of this can actually go off once the cost like travel, etc., normalizes?

C. Vijayakumar: Yes, Pankaj. So, some of the costs and travel is absolutely the right example, because we have gained almost a couple of percentage points there. Now, when things get back to normal, whenever that is, one would expect that cost to sort of increase at some point in time. But one also expects that it would not go back to the level at which it used to be. So, there are other discretionary costs like that. At the same time, this COVID pandemic has introduced new costs as well, so costs of testing, cost of maintaining your offices in a certain way, and so on so forth. So, all said and done, I think most of this has been driven by real productivity, which should be structural. At the same time, there were salary increments that we had held back for about a quarter. Our normal cycle used to start in July, this year it is now starting in October. And, you know, that will also be an impact in the second half, which is already budgeted and kind of factored into the guidance. So, it's something which is known. There are a few other new things which are cropping up, which are very new and it's a little too early right now to sort of put a number to that. So, we will have to keep working on those things as well, as we go through the second half.

Moderator: Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: Congratulation on a great execution and performance. And wish good health to everyone. My first question is that, you mentioned these are at an all-time high. Is it more to do with the increase in size of our business, which is a natural thing, or you think it reflects a substantial uptick in demand? And also related question is that if it is substantial uptick, then why we are doing hikes in two parts, for some employees from 1st October and for others from 1st of January. I understand that we are still better off because we are still holding back only a quarter three in there.

And my second related question is, why the guidance is muted for Q3 and Q4, which doesn't look like a upcycle kind of guidance or new opportunity kind of guidance. Wanted to just understand how much of it is seasonality, how much of it is fear of second wave of the pandemic? Or you think conservatism is a most part of it? So, if you can help there.

C. Vijayakumar: Yes, sure. Let me start with the pipeline. Obviously, one always expects the pipeline to continuously increase. But I would say that the increases have little more than whatever regular growth in revenues are. So, to that extent, it's a little bit incremental from a total pipeline perspective. The second is on the salary increases, there is no real delayed increase, because as per our normal operating plan, employees up to E3 level get their increments in July, which is now going to happen in October, and the E4 and above get their increments on 1st October, which is now moved to 1st of January. So, we have made it uniform, a three months shift in the appraisal cycles.

Coming to the guidance for Q3 and Q4. Q3 has certain seasonality which I am sure all of you are aware on the services business relating to furloughs and some of this. And the product business actually has a positive seasonality in Q3. However, what we have seen is, some of the business also got preponed and got signed in the previous quarter, especially some of the commerce type of transactions. And we think the seasonality in the product business will somewhat moderate compared to what it was in the previous few years, because our sales policies got nothing to motivate anyone to kind of close everything in December, very different from what it was in the previous operating model. So, these are the two factors which makes us go to 1.5% to 2.5%. I think you have to see this on an increased base of a 4.5% growth. And the higher pipeline will take some time to convert them into deals and then deals will take some time to convert to revenues, I think it's a good six to nine months kind of a window from pipeline to deal to revenue. So, we have kept all this in mind. Of course, there is definitely some caution, because several countries are going into a second lockdown, that's also being considered into our projections.

Moderator: Thank you. The next question is from the line of Prashant Kothari from Pictet. Please go ahead.

Prashant Kothari: My question is around this new tech cycle that many of industry participants are talking about, that after COVID maybe the growth rate for the industry will kind of have a step change. I just wanted some kind of top-down thought on that, do you really see that happening from the customer side? Or is it that the customer revenues will kind of constraint that exactly from happening?

C. Vijayakumar: If you look from a macro perspective, the overall tech spend is increasing in a low single-digit. That's what all the industry reports and research reports are talking about. Now, obviously, the spend on new technologies is increasing at maybe close to 17% to 20% year-on-year. And the demand for some of the traditional services is flat or in some areas marginally shrinking. So, keeping in line with the trend, we believe the spend on new technologies will accelerate, that's what we're seeing. Now, where is that money going to come from? I do think compared to what the increase in tech spend forecasted prior to the pandemic, to what is being forecasted now, I think there is going to be a small increase. Because this is a very big priority area for almost all the clients. So, to that extent, we will see a little more funding coming into the tech spend.

In terms of the tech cycle, I think some of the key themes which are very strongly playing out, I mean, of course, cloud migration is something which is very, very visible. But it's not just cloud

migration, it's really strengthening the whole digital foundation. There are numerous network opportunities, there is significant amount of work happening in increasing the employee experience, consumer experience, which is driving a good interaction on the digital workplace offering. And in every vertical segment, there are a few programs which are really being accelerated, whether it is a customer experience and all the retail facing clients or supply chain transformation or optimization and manufacturing and logistics industries, ecommerce platforms are significantly being scaled up in Retail and CPG. So, there are a specific two or three ideas which are getting increased attention and investments, which is driving our DNA revenues and pipeline. I hope I was able to give you a view of the tech cycle changes.

Prashant Kothari: Yes, that's good. And just one on the margin side. I think Prateek mentioned that there are some new factors which are also cropping up, which are difficult to quantify just now, but you can adjust name these new factors which could have some implications on margins?

C. Vijayakumar: Prateek, you want to take it?

Prateek Aggarwal: Yes. So, what I was kind of referring to in per say was things like the H1-B changes that are happening. And, of course, it's something which just cropped up about a week back, so we haven't had time to do too much of planning around it. But that is something that is going to be some kind of issue going forward. Obviously, it has a three year renewal cycle that it will play out, but some of it is already applicable and we will have to plan on how do we address that, either by moving work to some of our centers in the U.S., or to Canada, Mexico, etc., or back to India and things like that. So, we are relatively better off compared to some of our peers, because we have a high localization index, and more than two-thirds of our people are local with the same size of PRs, permanent residents, or citizens. So, to that extent, we are insulated. That one-third people who are visa dependent, we will have to see and manage that.

Moderator: Thank you. The next question is from the line of Ashwin Mehta from Ambit Capital. Please go ahead.

Ashwin Mehta: Congrats on this set of numbers. One question on the R&D side. So, in the backdrop of a 9% fall last quarter, how much of the pickup in R&D is the supply side? And secondly, in terms of outlook going forward, do you see an improvement in terms of growth there?

C. Vijayakumar: Yes. GH, would you want to take that question?

G.H. Rao: So, in this quarter, we have two types of growth. One is certainly driven by the demand in certain quarters, verticals like software, hi-tech, and also medical devices, we do see a demand driven growth. Some portion of the growth was also due to the reversal of some of the work our supply side issues we had during the previous quarter so that those problems were not there in this quarter. So, I would say, by and large it is demand driven. We continue to see growth in next few quarters as well.

Ashwin Mehta: Okay, thanks. And just a second question. So, if I look at the difference between your Mode 3 and Products & Platform revenues, that should ideally be the HCL part of products and not the acquired products. So, one thing I notice is that the revenue seems to be falling there. And secondly, the margins in that part are materially lower than your services margins. So, what explains that? While there is an improvement over the last few quarters on margin, but what explains such low margins on this difference?

C. Vijayakumar: Yes. Ashwin let me take that question. See, you are right, the difference between the P&P segment and the Mode 3 segment is really the organic IP that we have built and that's what we are reporting under that. This has two components. One is the DRYiCE and the second one is on the ERS business we have a focused group driving products. Now, while there is good products, we are also continuing to invest a little bit more and building product management teams and a little more marketing around that. So, that's why we have not really focused on improving margins there, we are really focusing on how do we drive more growth. That's really the focus on that segment. I hope that clarifies the difference.

Prateek Aggarwal: Ashwin, just to add on to that. If you do the math, the revenue in both the quarters is almost exactly the same at $57 million for the quarter, and margins for this quarter are 18.2%. So, it's not very materially different from the rest of our business, either services or a little lower than obviously the rest of the products.

Ashwin Mehta: Yes, I was actually more looking at it from a YoY perspective. So, that explains. Thanks a lot, and all the best.

Moderator: Thank you. The next question is from the line of Mukul Garg from Motilal Oswal Securities. Please go ahead.

Mukul Garg: Congrats on the great quarter. CVK, I just wanted to get your thoughts on one of your larger peers, which has just split the company into two. While I understand that you may not want to comment on individual competitors, you have clearly benefited in the past from similar actions done by other companies, especially in the intra-practice. So, it would be great to hear the thoughts on whether similar market share gain opportunities exist in the current environment or not. And then I have a follow-up question.

C. Vijayakumar: Yes. I think this particular development really increases the opportunity to deepen our partnership, especially on some of the hybrid cloud and some of the newer investments they are making. I think it's a good outcome from that perspective. On the services side, of course, there are some areas where we compete, and that was there and that will continue. I think overall, I would consider it to be a positive development, even from HCL perspective.

Mukul Garg: Got it. And the second question was a two-part question, basically on the cloud segment. We are seeing hyperscalers delivering massive growth. What is the kind of growth you are seeing in your cloud practice? And whether it's a rising tide, lift, or boat type of an environment? Or are you seeing clients gravitate towards best of breed service vendors?

And the second part was, do you see a scope to capture a larger share of opportunity on Google Cloud which you guys have to peek at highlighting? Versus what is there on either AWS or on an Azure?

C. Vijayakumar: Okay. Overall, cloud offers very good opportunities. We have partnerships with all cloud providers, there are certain areas where we partner, in certain verticals and certain solutions that we have built along with our partners. So, I would not like to comment on one specific partner versus another partner. And from a client perspective, the way we are coming across and the customers are looking at us like a trusted advisor on the overall tech architecture and what is the right place for the workloads. And many customers continue to adopt a multi-cloud approach, especially the large customers. Barring a few exceptions, almost all large clients are looking at a multi-cloud kind of an approach and the hybrid cloud approach. So, all of this makes the service providers like us very important in driving the client's cloud journey and partnering with them in this whole big migration cycle.

Moderator: Thank you. The next question is from the line of Shashi Bhushan from Axis Capital. Please go ahead.

Sashi Bhushan: Congrats on a good quarter, sir. Can we have more granular understanding of product portfolio growth outlook? Can these segments achieve company level growth rate in foreseeable future, say one or two years? And if not, any vision for that? And if yes, what we need to do more to achieve that?

C. Vijayakumar: Shashi, our overall commentary has been, these markets are in segments which many of them are in a very good growth segments like commerce and a couple of security products that we have. So, I think in certain products we are confident of a good growth trajectory, and some of the products would be more or less stable. That's how we see. It's too early for us to take a view whether this will grow at the company level growth rate or not. Obviously, that's always our desire to ensure that the product business also grows. But I would not comment on it now. We continue to work on product innovations and making them more and more relevant to customers and we continue to see a very positive reaction from our customers. So, all of this augurs well in the long-term, but it's too early to kind of provide a view on the long-term perspective on the growth.

Sashi Bhushan: Second question is on our current dividend payout means almost like 40% to 50% payout. So, is this a new normal for the company? And is my understanding correct or is there room for improvement in the same, maybe next financial year or so?

Prateek Aggarwal: Sashi, let me put it this way. I don't want to define a new normal. And we have just taken a step forward by doubling what we were doing so far. And give us some time to sort of settle down to this normal and then we will define the new normal.

Moderator: Thank you. The next question is from the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain: So, how do you plan to plan a change in the various walk of business post pandemic kind of a thought, in terms of growth aspiration, go-to-market strategy or partnership model, or the pricing model? So, what are our proactive initiatives on these? And then do you see our ticker should be faster in product business, given the non-linearity nature and right mix of offering that we have?

C. Vijayakumar: So, Rahul, was your question on the Product & Platform, or it was more broader?

Rahul Jain: So, the first aspect was more to deal with this digital acceleration thought process, how the growth acceleration of the business and go-to-market strategy and pricing model, these things changes from a general overall business perspective? And especially for the product business, given the non-linearity nature, do we see the ticker should be even faster than the services business?

C. Vijayakumar: Yes. So, let me answer the first one, and then maybe Darren can provide a little more perspective on the second. I mean, our overall strategy is very agile. As we see more opportunities, as we see more traction and pipeline, we will obviously enhance our investments to align with the demand that is there in the market. So, like what is happening now is very similar to what happened four years back in terms of a few technologies, where the adoption increased. Only thing now, the speed of this adoption is changing. I mean, the technologies themselves have not significantly changed, the speed of adoption of some of this is changing. So, depending on where we are seeing traction in terms of solutions, in terms of partners, in terms of verticals, we will continue to strengthen those aspects, as we keep planning on a quarter-to-quarter basis and annual basis. That's what I would say. And Darren, if you want to add any further colour from a P&P perspective.

Darren Oberst: Again, I think you have summarized it pretty well. We will see some different dynamics by product. We will see some non-linearity, in the sense that in some products, and I think you have mentioned them, products like commerce and security there were definitely positive demand drivers that we have seen in the COVID era. And so we did receive, I think you saw that this quarter, we are the beneficiary of some deals coming in earlier than we anticipated. So, I think, again, some products are going to see that. I would make maybe an overall comment that I think at a pricing level we are seeing pretty good stability, at least in the product business we are not seeing a lot of pricing pressure. In fact, probably at the margin we are seeing prices continue to have just a moderate increase in the market. I think in terms of the overall go-to-market strategy, certainly it's changed for everyone. We are a very transactional business and so that means every day we have to be in the market doing deals with customers. So, leveraging new technologies, new channels, digital marketing, finding new ways to reach customers, I think we have seen a lot of innovation over the last six months. And I think that will certainly continue good forward.

Moderator: Thank you. The next question is from the line of Sudheer Guntupalli from ICICI Securities. Please go ahead.

Sudheer Guntupalli: Congrats on a good quarter. Just a couple of points on the growth within the portfolio. One recurring theme we have noticed in this earnings season is that Europe has been a strong driver of the comeback, partly because of two reasons. One, some of the major economies within Europe have recovered quite well from COVID. Secondly, in the last quarter, most of the IT services companies have reported a very sharp drop in revenue, including HCL, from Europe. So, that segment, ideally, we would have expected to see a stronger comeback, it has not happened. And same thing within financial services as well. Most of the global banks have been spending, expense have remained quite resilient throughout June and September. However, if I look at kind of growth delivered in financial services in this quarter is also below the company growth. So, CVK, if you could explain these two points.

C. Vijayakumar: Yes. Sudheer, Europe, especially the July-August-September quarter, is normally a lean quadrant for Europe due to the vacations and all of that. Probably, it's the trend that's reflected in the numbers. Otherwise, I think the pipeline and the demand environment in Europe is very good. And Rahul, if you are on the call, why don't you take the financial services question?

Rahul Singh: So, financial services, I think we had a 2.6% growth this quarter. We must keep at the back of the mind that last quarter we had a slight decline. But the decline was not as sharp as we had seen for the peers. So, we grew at 2.6%, on top of a lower decline in the last quarter, and that's the reason why you are seeing the peer level numbers higher than what you are seeing for us. We continue to see good demand across the board, across our clients, across geographies actually, also. The demand continues to come from both service transformation, that's digital transformation, as well as digital foundation deals with this across our clients. More importantly, we are also seeing good deals coming in some of our vertical propositions like payments and open banking. Our pipeline continues to be good. So, I think the growth that you are seeing of 2.6%, you have to keep at the back of the mind that we had a less sharp decline last quarter versus some of the peers that were there. And therefore, the number of 2.6% is on top of that lower declined last quarter.

Sudheer Guntupalli: Sure, that's helpful. And CVK, the other question is on DWS acquisition. So, if I exclude the last 12 months, I think growth rates of this company before were quite strong. So, is it fair to assume that COVID has resulted in a hit on the last 12 months revenue? And second part was, if you can through some more qualitative color on the nature of services provided by this company, it would be very helpful. And lastly, on the valuation of it, I think you seem to have acquired this entity at quite an attractive valuation, let's say, if it is a fast growing entity in the digital services, can you give some color on how you are able to acquire it at such an attractive valuation?

C. Vijayakumar: Yes. Sure. First is, the nature of services are largely application services. And in the application services, a lot of consulting work, especially in the government segment, that's the biggest differentiator why we wanted to acquire this company. And because if you see in Australia, the government is a big spender and we are not there meaningfully in that segment. And to really participate in any meaningful manner, having a stronger client base and references and teams which have engaged with these clients, that will be very helpful. So, that's one of the drivers and

that would be the primary strategic rationale, apart from a little more benefit on localization and driving that localization in that geography. In terms of growth, of course, I think this company while it has grown well in the last few years, there are clients who are looking at global delivery model and some of those aspects. A couple of clients who are the non-government clients, they have slightly scaled down work or looked at some global delivery options. So, we thought that will be a good opportunity for us to be providing more holistic services for these clients. And the valuation is driven by the growth and the margins. Obviously, the service portfolio is very attractive, but growth and margins are what it is. And that's the reason whatever valuations we came up with. It's still a good premium over the prevailing stock price, if it's a publicly traded company.

Moderator: Thank you. The next question is on the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: Congratulation on a good execution. Now, just on the product side, after completing four quarters, any experience to share in terms of some of the low growth products like Lotus Notes and Domino after coming into brand of HCL software, what exactly are we doing in terms of regaining the wallet share?

C. Vijayakumar: Darren, would you want to cover that?

Darren Oberst: Sure. It's a great question. In a product like Domino, it's hard to give just one simple answer, because there are a lot of different dynamics. Since we first got involved with the product, we have had two major releases, so we released Domino Version 10, we released almost a year ago now Domino Version 11. What we have also done, start repositioning the product, modernizing the underlying architecture, and building adjacent product components. And so for many of you that are familiar with Domino, the first thing you think of is email. Well, when you really look at how large enterprises around the world are using Domino and driving value from it, a much higher percentage are actually in the workflow applications. It's the applications for supply chain, for HR processes, for other internal operations, that tends to be the most sticky use case and the highest value use case for Domino. And so we have also pivoted in terms of really focusing on those capabilities and that value proposition.

And so given that it's such a large product with such a large customer base across so many different markets, again, to give you a summary of some of the key learnings. Certainly, and it probably goes without saying, we have faced headwinds in some pockets of this product portfolio, especially as it relates to many email customers and the demand that we have seen around the move to Office 365. And so where we have really seen the opportunity, both for long-term stability, as well as growth opportunities around some of those areas that I mentioned, so we have rolled out earlier this year a new product component called Volt. Volt actually is a low code tool that runs on top of Domino. We have sold it to over 100 customers in the first six months. We have some other new announcements that will be coming out later this quarter. And so, again, if I am trying to give you a balanced view, there are definitely some geographies where we are on defense with the portfolio, there are other geographies, markets like Japan and

Germany, markets across Latin America, few other European countries where we see very stable performance and even some limited pockets of growth. So, I would say it's a work in progress. There are headwind areas and then there are other areas where I think we are seeing really good adoption of customers embracing the vision and sort of the new innovation that we are bringing to that product portfolio.

Sandeep Shah: Thank you. Just CVK, in terms of the digital acceleration, kind of understanding we are getting in the first phase, it would be more about cloud migration, which may continue for another couple of years, and thereafter it may be more about the application, modernization across the landscape. So, are you believing that in the second phase also HCL Tech will be able to compete and get its wallet share? Or you believe the growth rate should be higher in the first phase for us versus in the second phase, because we are slightly late entrant in terms of the application market?

C. Vijayakumar: I don't think this is a sequential equation. Because, of course, cloud migration is a first step. And then as a part of cloud migration, customers could look at application modernization. So, it could happen along with cloud migration. But irrespective of cloud migration, the opportunity in application modernization is very, very strong. And we continue to do very well in that space. If you see, our Mode-2 has grown 6.9%, almost 15% year-on-year. And I think even in a lot of large clients where we are not a existing provider, we are coming in as a challenger. And we are seeing good wins, even though some of this starts as a smaller engagement, but very good client recognition and good opportunity to scale the business. I would say that we are equally bullish on both opportunities as we move forward.

Sandeep Shah: Okay, thanks. And just last kind of a feedback, I think free cash flow now being at a new normal of $1.8 billion to $2 billion, I think committing a 50% payout should not be a difficult task for the Board, because still you will have an idle cash or close to around $500 to $1 billion to address the M&A opportunity, unless at a Board level you keep discussing a large size M&A as a whole.

C. Vijayakumar: I think we will come back.

Prateek Aggarwal: Feedback taken.

Moderator: Thank you. Ladies and gentlemen, that would be the last question for today. I now hand the conference over to Mr. C. Vijay Kumar, for closing comments. Thank you. And over to you, sir.

C. Vijayakumar: Yes. Overall, we believe we are in a very strong position in addressing the market opportunities that are evolving. We are very happy with our continued consistent execution, which has happened over the last four years and it continues even in this difficult environment. So, thank you for joining the call and have a good evening.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of HCL Technologies Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.