HCL TECHNOLOGIES
Q1 FY '05
EARNINGS CONFERENCE CALL
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Moderator: Good morning ladies and gentlemen. I am Monali, the moderator for this conference. Welcome to HCL Technologies earnings call hosted by SSKI Securities. Mr. Surendra Goyal of SSKI is your call leader today. For the duration of the presentation, all participants' lines will be in the listen-only mode. I will be standing by for the question and answer session. After the presentation, the question-answer session will be conducted for international participants connected to SingTel. After that, the question-answer session will be conducted for participants in India. I would like to hand over to Mr. Surendra Goyal of SSKI. Thank you and over to Mr. Goyal.

Surendra Goyal: Yeah, thank you Monali. Good morning everyone. This is Surendra Goel from SSKI Securities. I welcome you all to the HCL Technologies earnings call. We have with us Mr. Shiv Nadar, Chairman and CEO HCL Technologies, and Mr. S. L. Narayanan, Corporate Vice President Finance. I would now like to hand over the call to Mr. S. L. Narayanan. Over to you SL.

S. L. Narayanan: Actually Mr. Nadar would begin the call in keeping with the traditions.

Surendra Goyal: Okay.

Shiv Nadar: Thank you. Good morning everybody. This is Shiv Nadar from HCL Technologies at Noida. I take great pleasure in welcoming all participants at this conference call to discuss the first quarter results ending 30th September 2004. With me today is Mr. S. L. Narayanan, our Corporate Vice President Finance.

It is just about a month and a half we shared with you the results of our last quarter and fiscal year that ended on 30th June, 2004. In these intervening week we have had a spate of good news. I am sure many of you have noticed these as and when we put out these releases. These events are manifestation of our growing stature of our business. On the several recent developments that we reported, I consider the publication made by META Group in mid-September on the Indian IT vendors to be the most significant milestone and as quite solid positioning in the application solutions space. HCL Technologies has been ranked as the market leader in META Group's recently issued META Spectrum report for offshore outsourcing. The META Group is the leading provider of information technology research, advisory services, and strategic consultant. The happening of this event was not something that was an accident, but an outcome of a vision to rebalance our portfolio and a carefully orchestrated execution which spanned the last three years. In it lies some insight into the way we at HCL Technologies have approached our businesses. A mindset that seeks to underpin our organizational ambition on some very firm foundations and an attitude that keeps challenging the status quo.

Now coming back to financial matters, we have declared an interim dividend for the first quarter at the rate of Rs. 4 per share following a similar dividend for the previous quarter. We have doubled the first quarter pay out from earlier practiced of Rs. 2 per share. We had shared with you during the last quarter our endeavor is directed towards improving our return on equity while keeping comfortable liquidity to cater to opportunities that may arise in the future. We have had a record quarter in terms of addition to our growing cadre of talented men and women that constitute this company. Of course a dip in utilization has impacted our gross margins slightly, which is in line with our plans for this quarter. Despite this we have kept our operating margins fairly steady.

To summarize, we have had a satisfactory quarter as we continue to execute on larger game plans of building a strong and well-diversified portfolio of services. Our investments for the longer term are progressing well to facilitate enhanced deliveries and speedy capabilities that we foresee in the coming years. With this now I will hand you over to SL. Thank you.

S. L. Narayanan: Thank you Mr. Nadar, and a good morning to all of you on the conference call. Most of you would have spend some time looking at the release by now and I will not go over once again on the key financial metrics; however, I would highlight one or two very important aspects of these financial numbers. The highlight of the financial is undoubtedly the strong movement in our EBIDTA numbers. I will underscore some of the aspects relating to our expense controlling initiatives and the continuing improvement in our EBIDTA numbers, which all of you will agree is that directly correlated with the cash generation from operations. We have been able to steadily boost our top line and have supported such increased throughput almost on a constant base of overheads. Accordingly, the op-ex to sales ratio has been brought down significantly with consequential improvement in our EBIDTA numbers. In terms of margins, there have been almost a 600 basis point improvement over this period. I want to particularly emphasize the year-on-year growth in our quarterly run rate of EBIDTA, which has moved from around $21.3 million in September 2003 to almost $40 million for the most recent quarter ended 30th September 2004. This represents about 85% growth. Even assuming a very marginal improvement in the EBIDTA levels for the remaining three quarters of the current fiscal year, I want to point out that we are on track to post over a 50% growth in our operating profits. The total EBIDTA was $115 million for the previous year, up to 30th June 2004, and even that base of $115 million was a growth of about 47% from the previous year's achievement of $78.2 million. As a reflection of these trends, we have now stabilized the quarterly dividend at a higher rate of Rs. 4 per share, and we are further confident that we should be able to support our enhanced pay out of dividends and capex requirements out of internal cash accruals forecast for the current financial year. I would also take this opportunity to inform you that other income number will seemingly decline in the next few quarters due to some peculiar accounting treatment under US GAAP for debt securities where interest payments are received at the time of redemption. Some of you are familiar with the impact of this which happened between 2002 and 2003 when we restructured the portfolio to maximize the after tax yields. This is primarily due to certain actions effected to boost the after tax yields on our portfolio as a result of the new tax rules on dividends and capital gains on mutual fund assets, which have come into effect after Finance Act 2004. There is a clear 7% tax arbitrage in favor of holdings in excess of 366 days, and we were accordingly managed the portfolio to optimize cash flows from our treasury assets as well. With that I will conclude this update and may I request the moderator to invite participants for a Q&A session. Thank you.

Moderator: Thank you very much Sir. At this moment I would like to hand over the proceedings to moderator at SingTel to conduct the Q&A for international participants. Thank you and over to Ayesha.

SingTel Moderator: Thank you Monali. We will now begin the Q&A session for participants connected to the SingTel bridge. Please press 01 to ask the question. At this moment, there are no further questions from participants at SingTel. I would like to handover the proceedings back to Monali. Thank you.

Moderator: Thank you Ayesha. We will now begin the Q&A interactive session for India participants. Participants who wish to ask questions, please press *1 on your touchtone-enabled telephone keypad. On pressing *1, participants will get a chance to present their questions on a first-in-line basis. We have our first question from Mr. Pramod Gupta of HSBC.

Pramod Gupta: Hello sir. Couple of things I wanted to understand. One was, has there been any progress on the DSL bought out and what is the kind of dilution we may see on that account?

S. L. Narayanan: You see there is a certain methodology by which the buy out will happen, which has been agreed as early as September 2001 in terms of a shareholders agreement. So we will go through a close of the books of accounts for the 12 month period ended 30th September 2004, and based on the numbers for the joint venture entity and the numbers for the consolidated HCL Technologies Limited, we would decide on the share exchange. So the exact numbers are not known as yet, but it is reasonable to presume that there will be a 6% – 7% dilution in terms of additional stock issuance, but at the EPS level, and this is very important, it is neither accretive nor dilutive, because we are using the same PE ratio of HCL Technologies.

Pramod Gupta: Looking at the clients, basically lot of the growth this quarter was driven by top 5 and top 10 clients, and we have seen some decline also in the $5-million account. Have there been any ramp downs?

S. L. Narayanan: Actually if you look at the share of revenues coming from the top 5 and top 10, there has been a very strong traction coming from our existing accounts. If you looked at the number a quarter earlier, there was a small decline because the rest of the universe had grown at a faster pace. So this is something which is dynamic and it is very difficult to ascertain any clear inferences from these numbers. Suffice is to say that you know over a longer terms if you see, our million-dollar account and $5-million account is pretty much on track, I mean today we have close to about 100+ clients and over a 24 month period this number has tripled. I think we would like to see this over a slightly longer term and not look at quarter-to-quarter variation.

Pramod Gupta: Thank you and all the best.

S. L. Narayanan: Thanks.

Moderator: Thank you very much sir. Next in line we have Mr. Trideep Bhattacharya from UBS.

Trideep Bhattacharya: Good morning to the management. I wanted to understand the infrastructure management business in a little more depth. We saw a decline happening in the top line as well as in the margins. What should we expect going forward, it is purely explained by seasonality, or is there something more to it?

Shiv Nadar: If you see the HCL Technologies core businesses, we have taken certain core competencies and skill sets that exist in this company, and we have converted them into businesses. The previous two examples which I would like to give you; one, we were creating products ourselves, we converted them into products engineering services that now contributes 40% of our revenues. It is almost, you know, if you take on a continuous basis, it is almost close to 300 million in size. Similarly that earlier on we used to implement SAP, PeopleSoft and CRM solutions within India, which formed the backbone of these services in HCL InfoSystem. We have taken the same concept, redeployed them for a global business, which is what took place during last year. Actually the decision was taken 2 years ago, but it was implemented during last year. So again we transited into domestic business into global business in a very profitable manner. Now in line with this, you will have to look at the infrastructure business. Infrastructure business was beamed towards India, it is roughly 11 years old, starting from the initial domestic focus from where it was built, and it was systems integration revenue at largely, which progressively was reducing it's profitability. From that we decided to invent a business of remote network monitoring, which is what was necessary to be done and we were monitoring them for several of our Indian customers. We implemented this across new products and new technologies and generated this as a pretty new business anywhere in the world, but what resulted out of this is the global business of remote network monitoring, which almost all the institutions have taken very active note of. And that business is growing. Now how do we grow the people that are needed for this business? We had to divert our domestic people into this business, because this is not something which is repeatable so easily, it takes a few years of monitoring, and I just want you to know, this is a business in which you cant miss a heartbeat, not that we can miss in anything else that we do, but here it is really really serious stuff. And if something goes wrong in this will show up immediately, and the competitor with whom we compete in this typically are the people like Hewlett Packard, EDS, IBM kind of organizations. So we are building it very carefully. People are getting diverted from systems integration business. So thereof you will see the inversion of top line more visibly than in other businesses. And I would like to add one more thing, systems integration business is always you know had high revenues in the first six months of the calendar year and lower revenues in the second six months of the calendar year, and if you see all the support revenue which we get renewed every year, the first six months invariably carried a larger renewal and second six months a lower renewal. Again follow up of that in accruals, again one has higher patterns for the first six months and a lower pattern in the next six months, though we in reality carry the same kind of expenditure pattern. So if I were to summarize this again for you, inventing a business out of local expertise into global remote network monitoring, transferring of people from local expertise into global business, and thus extracting the synergy. It is a three region, but what you need to know that what I need to know is on a going-forward basis you know fourth quarter to fourth quarter basis, how will it is likely to effect the EBIDTA, because EBIDTA is your effective driver. As SL pointed out, we grew by something close to 50%, I am not going to go to exact percentages, we grew to about 50% last year in EBIDTA. We are already well on our way to grow to another 50% during the course of the current 12 months of the fiscal year; will the infrastructure business keep in line with the similar growth? The answer is absolutely yes. What I would like you to really see as the demonstration of the confidence of the order backlog, the released order backlogs, which you want to see then. Right next to our corporate headquarters in Noida where HCL began, you know at the year of draught in 1976, you will find a big empty space next to it, because we had purchased this and scrapped it down to earth and rebuilding a 1000 people facility expected to be ready in less than 12 months, and that will house 1000 people, and that is the kind of backlog this part of the business is carrying. I just want you to know, it is a leadership space, and when the leadership space takes place, you know, we pay for that transition in the initial period, because there are absolutely common infrastructure services businesses anywhere in the world, you take anywhere in any infrastructure you don't see it in India, which is Indian companies have not gone into remote infrastructural services contracts that we have gone into. And in that transition cost you can see EDS, you can see CapGemini, you can see IBM that part of business, you can see Perot Systems in that part of business, transition cost have picked up by the outsourcer. That is what is causing mild changes, but I want to assure you infrastructure systems is a start and it is already in a place where we do the same similar 50% growth of EBIDTA level. I suppose that kind of answers your questions and satisfies your expectations.

Trideep Bhattacharya: Sure it does. And just wanted to understand as a followup to this that in the overall transition period from the I mean utilizing the local skill sets globally, where are we and how many or rather how many quarters or how much time in your opinion it is further remaining where we will see optimal kind of a mix?

Shiv Nadar: We are absolute pioneer here, and if the management team of infrastructure services is able to give a 50% growth year on year, if they take a bit too much it is only good for the company, good for the shareholders. We would not ask them to slow down. That is why 1000 people facility when it came up, when we were in the management meeting there, I was personally very very supportive of that initiative.

Trideep Bhattacharya: Sure, I see. The second question is on the salary hikes, now, like you know, do you foresee any dilution in the margins or do you foresee any change in the amount of salary hike that you need to give to your employees and should we expect any impact on margins in the coming quarters?

Shiv Nadar: We answered this question in the last call also, I will repeat that. Our people are added through the month and added through the year, and the major enhancement does exist, you are right, when our fiscal year ends, which is June. Because a lot of global op-ex compensation is linked to performance of the year, and those increases take place in July, and such increases I just want you to know, and the second is that because of the college system in India, the large number of people join in June-May, in this kind of timeframe, their increment, so a very large portion of the increments also falls due in June, not June, first of July, our year ends on 30 June, so it is due on 1st July. They have all been completed and factored in the first quarter's cost, all of them have been provided for. So there is no new increase that is ahead.

Trideep Bhattacharya: Right, and my third one is, like you know, this quarter the tax rates actually jumped up, should we expect, what kind of tax rates should we expect for the full year?

Shiv Nadar: The tax rates jumped up, I would request SL to answer this question.

S. L. Narayanan: Trideep, actually last quarter if you recall, you know, we had created a deferred tax within our BPO business, because the earlier three quarters we were not sure if it was to be created at all, and then once we had the opinions in place and we were sure that we could hold it, we created that in the BPO books. So that reduced the overall effective tax rate and which was disclosed accordingly in our, you know, numbers that we put out for that quarter. So I think anywhere between 8% to 9% effective tax rate is something that would be happening this year.

Shiv Nadar Can I add something more SL?

S. L. Narayanan: Yeah.

Shiv Nadar: You know, because of the new Financial Bill 2004, we need to have a different treasury policy to maximize on our return, because now the dividend plans in which the company was largely there, is taxed at a higher rate compared to a capital gains rate. There is a net difference of almost 700 basis points on the plan that we follow. So, our company did go and convert the bulk of where it was into a growth plan which will yield capital gains than dividends. So, there was a very high incidence of tax on the treasury income during the last quarter, these are the two reasons.

Trideep Bhattacharya: Right, and my last question is, like you know if you could please comment on, how do you see as we near the end of this calendar year, how do you see the next year throwing itself out in terms of pricing and volume?

Shiv Nadar: You know, the growth rates that we have seen during this period, let me just step back, we are very highly oriented towards EBITDA and the sustainability of it and the growth rate, just three things that we do there, EBITDA, sustainability, and growth rate. On that, we have been doing so during the last five quarters, and you are thinking what it will be in the next five quarters ahead, when you are talking about the next calendar year, correct?

Trideep Bhattacharya: Right.

Shiv Nadar: We would sustain a similar growth rate, which is around 50%.

Trideep Bhattacharya: Okay, thanks a lot and best of luck for the future.

S. L. narayanan: Thanks Trideep.

Moderator: Thank you very much sir. Next we have Mr. Anantha Narayan from JM Morgan Stanley.

Anantha Narayan: Yeah hi! Good morning.

Shiv Nadar: Good morning.

Anantha Narayan: Hi! This is Anantha. I had one question on the EBITDA margin front, you know, your software services and BPO services are fairly similar margins at this point of time, so what do you think would be the course of these margins, say may be two years down the line, do you foresee this similar margin trend to continue or do you think there could be a difference?

Shiv Nadar: Anantha, actually there could be a difference, I am choosing my words very carefully, there could be a difference, because in the software services so far there is very little in the space that can be linked to results. It is always linked to either completion of a milestone or the quantum of work which has gone in, you know, it is not related to what quantum you have achieved. Very simply, if I were to give a very simple example, supposing tele-selling is there, and if you are paid by the quantum sold, or if tele-collection is there and if it can be paid by quantum collected or quantum of bad deficit that are collected, or number of mortgages to be done and you are paid by the number of mortgages. Now wherever you do the work of this nature, there you are getting paid by the results not by the number of hours. Wherever it is coming closer to results, what HCL is very good is injecting technology into improving productivity. Then you are tearing away from cost and you are coming into productivity, and what tools that you deploy and what knowledge instruments that we deploy, that is a possibility in the BPO business, which I don’t believe is possible, not that HCL is in any of them today, I don’t know whether any Indian company is any of these today. Most of them are still towards task completion, either task completion or time input completion, I think these are the two things. Since there is not a scope in software services, I am not covering technology services here, I am only talking about application enterprise software services. But in BPO since the scope exists, we are exploring them. There is a possibility that business models worldwide are available, the business is being done in the forms worldwide, and if we go to those places there is a very clear possibility of margins in the business going past the margins in traditional software business. SL do you want to say anything?

S. L. Narayanan: No, I think you have covered it fully sir.

Anantha Narayan: Okay, thanks.

S. L. Narayanan: The only dimension is you know there could be a play between volume and margins, as the size goes up it is also reasonable to presume that there may be a slight let down in terms of margins, but we will be making hell of a lot more money in terms of increased throughputs, but as Mr. Nadar said that, you know, our endeavor would be to focus more on the value added segments where the bank for the buck is more.

Anantha Narayan: Thanks SL, and just finally couple of small follow up items, SL can you update us on the latest forward cover position, and also is there any outstanding grants still left by Northern Island?

S. L. Narayanan: Yeah, in terms of the forward covers, you know, we had kept positions open post first of January, what we have done is we have selectively started covering as and when we were getting good rates, and we would slowly start increasing the proportion of covers if we feel that we would be better off protecting against the possible appreciation of the rupee. We have not moved full flow into covering our receivables, and that I think has been fortuitous decision, but we are keeping our options open.

Shiv Nadar: He had one more follow up question? What was the other question Anantha?

Anantha Narayan: Are there any outstanding grants still left?

Shiv Nadar: Yeah, what we have covered so far as grant is only one-fourth, what we have taken into consideration is only a fourth of what the grant that has been given, and with passage of time, by the end of next year, the balance three-fourth also will be considered as approved to us.

Anantha Narayan: Okay. Sorry SL, just on this forward cover, you had given a figure of $80 million at the end of last quarter, can we have a corresponding figure for this quarter?

S. L. Narayanan: At the moment, you know, we don't have the numbers. Anantha, I will give you the exact numbers, we have taken some additional bookings in the last few weeks.

Shiv Nadar: It should be in the region of 45 million or so.

S. L. Narayanan: It will be between 45 and 50,

Anantha Narayan: Okay, thanks a lot.

Moderator: Thank you very much sir. Next in line, we have Ms. Priya Rohira from Refco Sify.

Priya Rohira: Yeah, good morning sir. My first question relates to the utilization trend which we are seeing in offshore, you know, this quarter it is gone down by 200 basis points, is it largely to do with higher number of recruits in the current quarter?

S. L. Narayanan: Yes.

Priya Rohira: And could you highlight on the break up of new recruits in terms of percentage of fresher and percentage of laterals?

S. L. Narayanan: This quarter almost 80% is constituted by freshers.

Priya Rohira: Okay. And what is the hiring plan by the company for the next two to three quarters to go ahead?

S. L. Narayanan: It should hover around these levels.

Shiv Nadar: And it cant be even, you will find that A-M-J quarter typically will be higher because it is something to do with students passing out of college and campus recruitment.

Priya Rohira: Okay.

Priya Rohira: Okay, and if you could give us the capex for the next three quarters?

S. L. Narayanan: It is expected to be somewhere around 150 to 160 crores.

Priya Rohira: Okay, thanks a lot sir and wish you all the best.

Shiv Nadar: Thank you.

Moderator: Thank you very much madam. Next Mr. Mahesh Vaze from Brick Securities.

Mahesh: Yeah hi! SL you mentioned the change in the tax laws because of which you have changed the way you invest your money, does that mean that the other income would be much lower than the 59 crores that you reported for this quarter going forward.

S. L. Narayanan: Yes.

Mahesh: So what are the kind of ballparks we are looking at, will there be any booking at all now?

S. L. Narayanan: No, see, the thing on the US GAAP, so, where there is an income that has accrued on a debt instrument, but which is not received in cash, we don't route it through P&L, and it is only booked in the P&L at the point of redemption. This if you recall was something that happened during 2002 to 2003, when you know the dividends were taxed at the maximum marginal rate, earlier dividends were at 10% and capital gains were also at 10%, so when it went up to 36%, we moved everything into the longer term securities. So something similar will happen. But in terms of the actual earnings from the portfolio nothing changes. It is only that the recognition in the P&L account gets deferred, but by doing this we get a clear 7 percentage point benefit, because the distribution tax is currently been up to 20% and the long term capital gain is still around 13%.

Mahesh: Could you give some sense of what the numbers would look like on other income side.

S. L. Narayanan: Okay, I will give you. I carry it in my head all the time. A simple way of working this out is, there is about 2000 odd crores in the company, the way we work we will always have about 2000 crores in the company. So 2000 crores you take between 4 to 4.5% that is your fees, 80 to 90 crores, see like taxation though you provide for it on a quarterly basis, it is an annual event. Similar to that, you must look upon it as an annual fees, 80 to 90 crores. And if you want to simplify if feels accounting understanding, take the EBITDA and put that treasury income on one side and take the tax plus any minority deletion from the other side, your cash flows in the last three years you will find, it will always balance out, and EBITDA is what you will be carrying for distribution to shareholders or carrying it to your balance sheet plus capex. That is why we focus so much on EBITDA.

Mahesh: The second thing I wanted to understand, there was a period when you were acquiring quite aggressively, and there has been a lull since, what is the strategy, because the industry as a whole seems to be following your footsteps and seems to be undertaking quite a few acquisitions, so what is HCL Technology stance as of now?

S. L. Narayanan: I want to know which part of the industry is acquiring?

Mahesh: Patni did acquire recently, and you are aware of some other names also.

S. L. Narayanan: Because you know we followed a process, okay. For candidacy for acquisition, we did not go through arithmetical addition**.** We picked up pieces where substantial work has to be done and value has to be created. In anything that we do, we have to say that the management team, which is the almost 3 decades in this business, must be capable of bearing up vis-à-vis visualizing the changes that can be done and create value. So we did three carve outs. The three carve outs that we did were, one was Deutsche Bank, one was British Telecom, and third was Jones Apparel Group, all very large recognizable, multi-billion businesses where we went and carved out business, and created value on all three, and it is very difficult to create value on a carved out, because carve out has a mentality of a department, does not have mentality of a vendor. They don't have, you know, between department and department, they don't sign SLAs. So, our acquisition which was on one side created like that, on the other side whether it is government business or brand new initiatives in BPO, we have made all of them work. There is none which has not crossed into EBITDA positive and then growing into what the normal business should be. Now, we wanted to make it work**,** and normally if this, this I am sharing with you as an entrepreneur, if this had been a private company, we may have done two or three more, but here we had been more cautious, more steady, we said we must make things work, before make this work, convert them into profitability, and in the EBITDA going forward in the next five quarters, let us say, the visibility should be there that they have come all to organic levels, and all created substantial value, and created niches in the particular businesses. Having done that, now what we are addressing is a totally different breed, where not again arithmetic addition of units which are already running well, now that is not what we are going to do. We are going to take units which are running well, but that transition could create substantial value. Now we would go to the next layer of acquisitions which we are studying. There is nothing ahead of us in these three months, I have always mentioned that, something is ahead, I will, and we will give you an definite advanced notice that something is around the corner. There is not anything around the corner, but we are putting together some very good strategic initiative to look at higher value added pieces. So in simplicity if I were to give you, next three months nothing is visible; in the subsequent six months, something can be in the offing.

Mahesh: Sir, one last thing, sir small thing, these grants from Northern Island Government, just wanted to understand what is that you have already got, what is the total amount, and how would it get booked?.

S. L. Narayanan: It is about £2 million. It is in the order of about couple of million dollars and it is for having created employment which we did last year, but we needed to, you know, government world over have changed, so we needed to cross those stages before it was formally offered to us and it takes the certain number of months before it is recognized as income. So far what is recognized, I think it is about fourth of what has been given, and over the next I think 15 months the rest will also get recognized. They are all strictly under US GAAP numbers, actually everything what we do is strictly under US GAAP.

Mahesh: SL, this comes under other income, is it?

S. L. Narayanan: No, actually, since this is towards creation of jobs and it is related to the continued employment level, this has been credited to direct cost, in fact, we have disclosed this in the results booklet. If you see there is a footnote under the BPO services that exactly gives you the amounts, the agency which is Invest Northern Ireland, and the amounts and how it has been treated.

Mahesh: Okay, thanks a lot.

S. L. Narayanan: Thank you.

Moderator: Thank you very much sir. Next is Mr. Manoj Singla from JP Morgan.

Manoj Singla: Hi! Congratulations on a decent quarter. My first question relates to the VC investments and last quarter we talked about they running at 2.2 times book value. So what is the status right now, and have we started booking any gains or losses from venture fund investments?

S. L. Narayanan: No, none at all, because we cannot book the income. The overall portfolio, we cannot recognize the income till it is realized in cash. In fact one of the star investments in Carlyle Asia's portfolio is a company called CTrip which is a Chinese equivalent of Travelocity or Expedia, in fact which has been featured in the recent economist article also as one of the biggest successes of venture fund investment. So we have a stake in the fortunes of C Trip through our investments in Carlyle Asia. At the moment, we have not booked some of these gains which have been written up in their books, because under US GAAP once you record a diminution, we cannot recognize income till it is liquidated.

Manoj Singla: Sure, and secondly sir, you talked little bit about both the BPO business and the infrastructure business, but if you look at the software services business, we have grown roughly 6% sequentially for the last couple of quarters now, and if you compare that with the peer group it is definitely much lower. I am just trying to understand would we expect some acceleration here going forward, what has been the reason that some of the peer group has shown much better growth rates, what's the outlook here?

Shiv Nadar: I got to put something on record here. It is just that we have grown to the size of the peer group very fast. For all practical purposes we are a 7-year-old company. The peer group, you know, it's like a marathon race in which they are on the 20th mile when we started at the start point in 1997. So the momentum, sheer momentum those organizations had built is enormously more than what we have. We would grow step to step in technology services not because we have been there for number of years because of our sheer experience in this space. In enterprise space, I honestly do not believe that we will grow at the same pace as what they do, and in the new area like BPO, definitely the profit areas we would be growing ahead of anybody else in the next eight quarters, if you were to take it. In fact, in infrastructure business we are the only one, so there is nobody to compare. Well, I understand that Wipro possibly is there but I don't know, I don't have the Wipro's numbers so I cannot comment.

Manoj Singla: I think there is one last question from my side on the pricing environment.

S. L. Narayanan: Manoj, if I can just add, you know, the things like, the accreditation that we are getting from industry advisory services group like Gartner and META Group, well they point out to certain very important developments taking place in the way we are perceived, we were relatively new to the application space, three years ago, we brought together a clutch of key accounts through Deutsch Bank and Jones Apparel Group, and on top of it we have overlaid certain organic effort through hiring and building our competencies, getting the right kind of accreditation, in fact our business solutions centre when I joined HCL in May 2001, had just about 100 odd people, when you compare people as of today. These are sort of clues to the overall strategic thrust that the company has been following. And I do believe that increasingly we will see our name being mentioned alongside the veterans in space, and that's when the real growth number will start accelerating, and as Mr. Nadar said that this is fairly long run race, but we are doing our best to make sure that we fast forward our evolution, and I think suddenly, you know, it's a $700 million plus kind of franchise when there was hardly anything 7 years ago. I think that's the way to proceed the quality of the managerial talents that work and the kind of initiative that we have put in place and how the bearings fruit.

Manoj Singla: Just one last thing from my side. On the pricing environment have you seen any uptake here in terms of specially the existing clients and new clients?

S. L. Narayanan: This again is a function of the size of engagement Manoj, in fact every now and then we see the odd 18-man, 20-man engagements coming at rates which existed some years ago, nearing $30 plus per hour, but those are very very stray instances. The larger engagements, which we have of traditional customers, some minor improvement, but otherwise we would still say that on a weighted average basis it is stable through marginally positive. That's about it.

Shiv Nadar: I want to just share one trend with you, which can give you some comfort. You remember when not one call, two calls ago, I mentioned that we are tying to get into the revenue model which will be yielding growth beyond completion of jobs and in 2005 – 2006 onwards, that will start making some difference to the operating margin, I mentioned that, I do not know whether it is strongly registered or not, but during this period we have won probably most prestigious technology contracts in the whole world, this is for developing avionics for a brand new aircraft of one of the two largest aircraft companies in the world. I am not going to give you any prize for guessing who it is. Because there are only two, and this organization has awarded technology contracts though they are working currently in US. Actually when they came up and asked this question where were you, we said that we weren't there. But the key point is in pricing in that contract the yield fetches something like 20 years after the completion of the work based on the number of units that are produced, so it's the kind of equivalent of the royalty.

Manoj Singla: Thanks sir.

Moderator: Thank you very much sir. Next in line we have Mr. Amit from IL&FS.

Amit: Hi, thank you very much; I just wanted to understand, you mentioned in your opening remarks that the enhanced dividend pay out you believe is sustainable over in medium term and the target is on an ROE you know the number, I just wondering if you could just throw us some light on the kind of rings and ROE that you are considering, you know my question is coming from the fact that we continue to grow pretty smartly on the top line and on the net income level, but if you look at the accrual to the balance sheet size it is not going to be as aggressive as in net income accrual because most of that will be paid out. Wondering that do you assume that the current balance sheet size is optimum from our perspective or there could be something more to it?

S. L. Narayanan: See the way we look at it is we will not sacrifice something which would you know not give us the right kind of ammunition when the right opportunity comes, so we said that we will keep at least $450 million plus kind of a cash reserve and make sure that going forward over a 12 month's period we will start reaching return on shareholder funds ratio in excess of 20%. So basically what is going to happen is the opening denominator is going to remain constant and we will make sure that whatever is getting thrown out of the operations is balanced between dividend pay outs and capex requirements. So that way we would achieve a higher return on equity; and putting it differently, this is something which arises from a one time gain on the disinvestment of our investment in HPS, there was a lot of suggestions from shareholders that we should look at one time dividend to correct the size of our balance sheet, but then on very careful review we thought we would rather do something which does not impart a very short term speculative interest in the stock, so if it something which is spread over four quarters and with the improvement in our operations, our net income, hopefully, should sustain at a higher level and thereafter we should be able to sustain this anyway.

Amit: Okay, but SL, you know if one were to counter this by saying that why not a buy back program; then what is your view on that?

S. L. Narayanan: The thing is, I think buy back is not something which is good for a company the way it is held today, I think Mr. Nadar is smiling at me, we would rather, you know, keep something which is of an attractiveness for a lot of shareholders, because in the longer run it pays to have a highly liquid stock, and at the moment buy back doesn't appear too attractive, and again it will have a one time effect.
Shiv Nadar: Buy back programs in India have not been successful, and secondly that when we are going for this DSL buy out, there were some statuary issues, but even post that the recommendations which have come, it is something which we studied and then decided not to consider it and consider quarterly dividend policy as the superior alternative.

Amit: Alright fine, thanks a lot and all the best.

S. L. Narayanan: Thank you. May I request the moderator to announce that we will take just two more questions.

Moderator: Okay, sure sir. We take our next question from Mr. Bhuvanesh of SC SSB.

Hello Mr. Bhuvanesh?

We will take the next question from Mr. Pankaj Kapoor of ABN AMRO.

Pankaj Kapoor: Hi! Congratulations on a decent quarter. Just a couple of questions on the clientele; if you look at our contributions from the top 20 clients, they have grown at a fairly good pace is about close to 20% quarter on quarter, but the business from the rest of the clients actually has shown a minor dip of about 8% or so. Can you just explain something on this?

S. L. Narayanan: It is again you know, I think I mentioned this towards the start of the call, this is something which we have absolutely have no control on because various relationships are in various stages of evolution. If you looked at the last quarter, it actually was marginally lower, and this quarter the traction level from our top 20 clients have been at a faster clip, I mean our quarter-to-quarter aberrations is something that will always be there.

Shiv Nadar: Actually it is not an aberration, if I can mention this to you, if there is a larger client and they have a program to enhance it, they kind of do it on an annual basis, and on that basis the initial part of it will go on a large stream going offshore and understanding the work for in-house training or cutting that work into pieces and then moving it offshore; and let's say there are a 100 people going up to 140 people, the 40 people going on site will suddenly show a blip above, but after that it keeps coming down as it moves offshore, but we must understand that that's the value that we are really adding to our customer. Don't worry about, lest I want to assure all of you that there is no customer decline at all.

Amit: Okay, just another question is on the fact that we can see present in all the three spaces of outsourcing, application outsourcing, infrastructure outsourcing, as well as business outsourcing. How successful we have been in selling to our customers integrate set of offering for all these three outsourcing areas, has there been any specific cases in which we have gone with the integrated offering to a customer, I am not talking about the cross selling part but going to the customer with the integrated offer?

Shiv Nadar: I want to be very honest with you. It is something very difficult to be sold to, actually we have four offerings; one is technology services, which is bought by Chief Technology Officer of the company; second is application solutions and application services, is purchased by the Chief Information Officer of the company. In most of very large institutions, where in a completely separate team which addresses infrastructure and security of networks. That team for some reason in all large organizations report independently not necessarily to the CEO. Quite a few of organizations that we know of, I can't name them by name, but are largest client, and the second largest client, and the third largest client, you know who they are, and all of them have three different people looking after this, and they all have independent budgets. The fact that one talks to the other and refers, good references, when we do good work, that actually is yielding the results of the other businesses being sold. For example, AMD if you take it, the name which we can use, we entered into with infrastructure services, we did a good job as they were very happy with the outcome, and then it went on to BPO work, we did again a very good job, and it went on to application services as well. And whether it will turn into technology services also, I don't know because we served very well in the semiconductor space as well. So it is taking place, but decision makers are different, there is no single person in our client organization who takes these decisions, but within that, because of the quality of what we do, which is spreading and we are getting business from each of them.

Amit: Fine thank you.

Moderator: Thank you very much sir.

S. L. Narayanan: One last question.

Moderator: Sure sir. Our last question is from Mr. Ashish of IL&FS.

Ashish: The question is like earlier you used to give a breakup of the government practice business in P&L, but in this quarter I guess you have consolidated with the software business. Would you give us some idea about the government practice business?

Shiv Nadar: I will answer that question. See we kept giving the details just to indicate how we were evolving into initially, you know, greenfield practices to newer areas of business and from loss giving to slowly growing into profit giving, and once we have a very clear plan that in the next four quarters we are going to achieve the same percentage gross margin and net margins at the post software business then we pull it out and merge it with them. Second is, if the same teams are well aligned and if execution teams are well aligned, then it is not even possible for us to segregate. For example, if you take our banking practice, so well aligned with DSL, that it is not possible any longer to segregate. It has happened with the government business as well, but just to give an indicator, we began with a 8 million business, during the first year of booking, and in the last 6 months our booking has been $10 million. So, it is very well aligned into our current business.

S. L. Narayanan: Thank you very much to all of our callers, this is not to say that this is end of the Q&A, please feel free to call either me or Sujoy Ghosh, we will be happy to answer all quarries. Thanks and have a good day.

Shiv Nadar: Thank you very much for joining us from all of us from HCL Technologies. Goodbye.

Moderator: Ladies and gentlemen, thank you for using CyberBazaar's conferencing service. That concludes this conference call. Thank you for participation. You may now disconnect your lines. Thank you and have a nice day.