

HCL TECHNOLOGIES
Q2 FY '05
EARNINGS CONFERENCE CALL
JANUARY 25, 2005

Moderator

Good evening ladies and gentlemen, I am Prathiba, the moderator for this conference. Welcome to HCL Technologies earnings call hosted by SSKI Securities. Mr. Surendra Goyal of SSKI Securities is your call leader today. For the duration of the presentation all participants' lines will be in the listen-only mode. After the presentation there would be a Q&A session for participants connected to the SingTel bridge followed by Q&A session for participants connected to India bridge. I would now like to hand over to Mr. Surendra Goyal of SSKI Securities. Thank you and over to Mr. Goyal.

Surendra Goyal

Thank you Prathiba. Good evening everyone. This is Surendra Goyal from SSKI Securities. I welcome you all to the HCL Technologies earnings call. We have with us Mr. S. L. Narayanan, Corporate Vice President – Finance, HCL Technologies. I would now like to hand over the call to Mr. S. L. Narayanan.

S. L. Narayanan

Thanks a lot. Let me welcome all participants to the conference call to discuss financial performance in the second quarter of this year. Perhaps for the first time Mr. Nadar is not hosting a call as he is on a vacation and I am hosting the call this time. I think I will begin with two of the most important developments in the recent history of HCL Tech. This quarters highlights were undoubtedly the buyout of the minority stakes in two of our major joint ventures, i.e., Deutsche Software and HCL Technologies Northern Ireland.

Many of you would know there have been several milestones in the past, HCL has always been on the forefront as regards to innovative use of its balance sheet to create value not only for our shareholders but also for our partners and customers. We have consistently demonstrated a unique ability to conceive, execute, and most significantly close transactions. I emphasize the aspect of closure since the navigation of a joint venture with well-defined sunset clauses calls for enormous skills in managing relationships, and require a corporate ethos that espouses trust and empathy. There is no doubt in my mind that value created for our partners, invariably our customers as well, is value indeed for our shareholders since nothing can be more enduring than a satisfied customer for a services business like ours.

We have already announced the successful closure of our purchase of the balance 49% stake in the JV with Deutsche Bank. With this Deutsche Bank has become our largest shareholder outside of the principal promoter group. Deutsche Bank has also been our largest client for some time now. Given the depth of this engagement and the traction

achieved with Deutsche Bank in recent months, we are absolutely confident that our relationship will scale newer heights in the coming years.

I cannot help but look back with nostalgia at taking up of 51% stake in DSL on September 26, 2001. There were several doubts about the price we paid and our ability to leverage the acquired entity to our advantage. Many people commented that there were challenges of turning a captive department and that too of a multinational bank into a full-fledged service provider.

As some of you might know, we at HCL were acutely aware of it since the very creation of HCL Technologies Limited was brought about by spinning off of the R&D division of the erstwhile HCL Hewlett Packard into an independent service provider. As a department, the culture of serving a customer with SLAs, controlling costs and overheads, adding additional documentation, and taking care of seasonal quantum variations and many other aspects of running a separate company were quite alien. Even in DSL we spent the first 12 months correcting those cultural differences with practically no addition to head count, and it took almost 17 months to get our CMM-SEI5 and other certifications. I must say Deutsche Bank approached Deutsche Software Limited with a lot of indulgence and trust. I take this opportunity on behalf of Mr. Nadar and HCL Technologies Limited entirely to thank Deutsche Bank and the team of CIOs for the stellar role they played in building this partnership so constructively and championing the cause of this JV vehicle within Deutsche Bank. Both the partners guided the nascent JV with customary caution, again so necessary while building an ambitious scale. Therefore, the period between the 13th and 36th month were epoch making. From a strength of 450 employees, we raced to 2700 employees and recorded almost 400% growth in revenue. In this entire period, the quality of delivery never fell short of what we call as the legendary German standards for excellence, not a heartbeat was missed.

We are proud of the entire DSL team for their outstanding and overwhelming performance. We at HCL have had the good fortune of being part of great partnerships, be it Hewlett Packard or British Telecom, or Toshiba, or Nokia, or Cisco Systems, but what we have at DB is very very special. All of us at HCL dedicate ourselves to do everything we can to grow this relationship with DB as a vendor and also satisfy them as the single largest non-promoter shareholder.

An equally satisfying moment in the last quarter was the culmination of the balance 10% stake into HCL Technologies. So the JV is now a wholly owned subsidiary, and as some of you will know this is the JV, which owns the facility in Belfast in Northern Ireland. Here again, the story basically revolved around converting a captive unit into a vibrant outfit, infusing it with the right kind of entrepreneurial energy, something that is typical of the HCL DNA structure.

Apart from these two defining transactions, we also take this opportunity to share with you the several corporate entities that were created as part of the growth initiatives and the rebalancing exercise in the last three years are in the process of getting absorbed through a merger plan with HCL Tech. Some of the smaller ventures such as Shipara in

Bangalore will also dissolve into HCL Tech as the result of this rationalization exercise, and that would leave only HCL Jones and Aalayance as JV entities.

Let me come to the financial performance for the quarter. Our revenues have grown by 8.5% in US dollar terms. You have to bear in mind that the rupee numbers which have been put out in the release have been calculated on the basis of the closing exchange rate for the quarter.

Our consolidated EBITDA margins continue to remain stable. As is borne out by the year on year ratios, we are on track to grow our EBITDA or operating profit by 50% in the current year. This is something that we had indicated in the last conference call. I think nothing has changed in the environment and given the pipeline and the confidence that we have, we feel confident that the same number should be maintained. Our emphasis on EBITDA as a measure of profitability is especially important in a scenario where we are acquiring the minority stakes of our JV partners. Beginning next quarter the minority interest deductions on account of Deutsche Software Limited will stop and that alone will add substantial sum of net income because it will be a 100% consolidation.

The metrics in our software business may seem muted but they are entirely in line with the seasonality factor peculiar to our December quarter. Booking of man hours invariably get impacted due to the holiday season in the US, be it Thanksgiving or Christmas or New Year's Eve. And also we have significant reductions in the T&M business in India Centers that go through long shutdowns during the Pooja and Diwali holidays.

There has been a marginal dip in our utilization ratios. I think as this quarter proceeds, we should be able to take it back to 75+ utilization levels.

On the BPO front, we are quite pleased to report that our BPO business has now crossed the 100 million revenue run rate. You would have noticed that our revenues have grown by more than 22% in the current quarter over the previous quarter ended September 2004. I think this is quite predictable since the base is now reasonably large. As Mr. Nadar had indicated over the last two quarters, this growth comes on the back of no addition to the number of clients - our existing clients are ramping up at reasonably good rate. So most of these gains have come from existing clients through better account mining. Here again, our partnership with BT is an important part of the success story and the conclusion of the BT transaction provides an entirely new platform for growth going forward.

Our infrastructure services practice as we have indicated to you in the last quarter, the business is in a transition phase, where the new focus is towards providing services to global clients on a remote basis. The global services portion of this business continues to grow driven by the addition of some very impressive clients. We are confident that this business will transform into a sizable component of our overall revenues and act as an important differentiator in the market place. As already informed through releases, several industry analysts have rated this practice of HCL amongst the best of breed and the outsourcing of infrastructure services is a mega trend, which is about to unfold, and

we have prepared the business to be ready to take advantage of those opportunities as they come along.

Our reported net income numbers are down sequentially but that is only because of the drop in reported other income. I had indicated to you in our previous call that we have moved most of our mutual fund investments from dividend to growth plans. Some of you might recall a similar strategy we adopted after the Finance Act 2002 to optimize on the after tax yields on our treasury assets. On that occasion the tax arbitrage between capital gains and dividend distribution tax was almost 25%.

Currently, the differential is about 8%. By doing what we have done, we would earn Rs.8 more for every Rs.100 earned as interested income, which you will agree is the substantial advantage that should not be lost.

As we have emphasized time and again our focus would be on improving after tax cash flows, and other income is best seen over a continuum of at least six quarters. The unrecognized income for the quarter under US GAAP accounts derived from the growth in NAV is around Rs.11.5 crores. So that is the number which can be kept in mind when you are looking at the reported net income. As I already advised in the last conference call almost 91% of our assets are now in liquid funds, so there is practically no price risk in any of our investments, and the treasury committee has approved investments only in AAA assets.

I also take this opportunity to draw your attention to the forward contracts outstanding as of December 31, 2004. We have taken an extremely cautious view on the US dollar, as we believe that the dollar should be in a phase of weakness in the foreseeable future. Given the fact that over 60% of our revenues are dollar denominated, we have taken covers of almost 283 million dollars in anticipated net flows of US dollars for the period from 1st January to December 2005. And with offshore operations accounting for almost 80% of our effort it is imperative that we get a fix on the certainty of rupee denominated cost. So the strategy of protecting our margins presupposes fix on the anticipated rupee value of forecasted inflows and that helps us to align rupee cost to such planned revenues.

Also, I would like to inform the analysts that we follow the method of hedged cash flow accounting whereby the gains or losses out of these forward contracts beyond the quarter and date are not recognized in the current quarter's accounts. As of December 31, 2004, the marked to market position of the dollar forwards show a gain of about 6.8 million dollars, which is not reflected or recognized in the accounts for the December quarter. Our current weighted average dollar forwards is about 45.11 to the dollar. This number if it were to depreciate suddenly, the gains will reduce, but whatever those effects they will be recognized in the quarter in which the contracts mature on receipt of collections.

Our cash generation remains buoyant. We have declared another dividend of Rs.4 per share for the quarter, which will get paid out sometime in first week of February. I also would like to point out that during the December quarter, we have paid 2 dividends of Rs.4 per share entailing a total pay out of more than \$60 million including the dividend

distribution tax, because the first dividend that we paid in the OND quarter was the interim for September 30, 2004, and the final dividend, which was declared for June 30, 2004, was paid sometime in December. We still have about \$456 million in cash and marketable securities, which as I mentioned is currently invested entirely in liquid funds. Our hiring remains strong and I think we are well positioned for the next few quarters.

With this I conclude and I throw open the session for Q&A. Thank you.

Moderator

Thank you very much sir. At this movement, I would like to hand over the floor to Ayesha at SingTel to conduct the Q&A for participants connected there. After this, we will have a Q&A session for India participants. Thank you and over to Ayesha.

SingTel Moderator

Thank you Prathiba. We will now begin the Q&A session for participants connected to the SingTel bridge. Please press 01 to ask the question. Ladies and gentleman, please press 01 to ask the question. Mr. Gupta, you may post the question.

Prathik Gupta

Can you guys hear me?

S. L. Narayanan

Yeah.

Prathik Gupta

Hi this is Prathik from Citi Group. Congratulation on the quarter. I just actually had a couple of questions to begin with. I am just seeing something on the voice about HCL being a little more aggressive in terms of its acquisition strategy, don't you think we should elaborate a bit more in terms of, are you just looking at more of these smaller acquisitions or do you think you will be looking at something more substantial to bring HCL Tech up to the next...?

S. L. Narayanan

Prathik to be very honest with you, I told some of the reporters that there is nothing on the anvil because there was a question that was put to me that, given the size of your cash balance are you looking at any kind of acquisition opportunities? I just said that, you know, we are always looking for opportunities but there is nothing on the horizon now. So, I do not know if it has been miscommunicated and misreported.

Prathik Gupta

Okay.

Prathik Gupta

All right. So I guess what that means, also implies that as far as your dividend policy is concerned that are going to sort of remain more or less consistent, right?

S. L. Narayanan

Absolutely, because you know, in fact some of the first suggestions on the quarterly dividend came from your region, in fact some of the fund managers in Hong Kong and Singapore suggested that it could be of one way of sending out the right kind of messages to an entirely new set of investors. And from a governance point of view they said that it is a good thing to have because the principle promoter holds almost 76%, so a liberal dividend distribution policy would be a good thing. So we began sometime in March 2003, and in June 2004 we increased that rate of interim dividend from Rs.2 to Rs.4 a quarter, and unfortunately we cannot say that this is what we will pay every quarter because this is something which is limited by section 205 of the Indian Companies Act. So we are just using the quarterly announcements to set in some kind of practice of regular distribution of cash flows.

Prathik Gupta

Right, okay, thank you. Just another question was regarding the performance and the outlook for some of the verticals and horizontals, in particular, if you just elaborate a bit more on the BPO business? We have heard in some of the other firms the attrition rates have gone up quite dramatically...

S. L. Narayanan

The attrition is a big problem in the BPO business, but I think, you know, we now have decided that the best way to look at attrition in the BPO business is to look at attrition for people who spend more than 6 months or more than 9 months or more than 12 months, because the crucial period is the first month to three months when you know whether a guy is going to stay or go away, because it is a very different kind of lifestyle because people come in late at night and they work through the night and they go home by the crack of dawn. So it is a very difficult thing to see who will make the grade and who will find it very difficult to stay. So if you look at our attrition on a monthly basis and we annualize it, our numbers are somewhere around 69% or something. But if you look at our attrition for people who are more than one year, it is still at about 8 or 9% and we have just now perfected that business operating model to survive with this kind of an attrition, and it no longer gives us the kind of headaches that it used to, and we believe that an attrition of 8-9% that we have per month is quite manageable.

Prathik Gupta

Okay. Sorry, did I hear you right, did you say 8-9% per month for people who are more than one year?

S. L. Narayanan

No, no, it is 8-9% for people who have spent more than one year. If you take it annualized, it is actually around 9.6% for people who have spent more than 12 months in the company.

Prathik Gupta

Okay.

S. L. Narayanan

If you look at people who have just been hired, that universe runs at an annualized run rate of almost about 69% attrition.

Prathik Gupta

Okay.

S. L. Narayanan

So that is something which is going to be inevitable because people who are not able to orient themselves to working in night shifts, the attrition happens immediately in 3-6 months, and then you know, over time we are also now trying to see how to actually identify the people who stay, and you know, over time our attrition should come down.

Prathik Gupta

Okay. Just two more quick questions, if you could just elaborate on the outlook for your aerospace and semiconductor segments in particular, and also if you could just elaborate overall on the pricing trends in the software services business?

S. L. Narayanan

The aerospace and avionics business is very well positioned because you know we have got some fairly solid accounts, and many of whom have large contracts for the next several years, and we do believe that that business will continue to grow. On pricing, there are some new contracts which are coming at marginally higher rates than the weighted average, but otherwise the pricing situation remains stable only. I would not say that pricing is starting to go up.

Prathik Gupta

Okay. And on the semiconductor side, is there any kind of slowdown because of what we are seeing...?

S. L. Narayanan

No. I think there are no major worries on that side because most of the work that we are now doing is on a completely outsource basis, we are working on a virtual R&D room kind-of structure. So, I do not think there is going to be, it may not grow rapidly in the next two quarters, but we do not anticipate any slowdowns there.

Prathik Gupta

Okay, thank you very much.

S. L. Narayanan

Thank you.

Moderator

Ladies and gentlemen, please press 01 to ask a question. Mr. Ajay Sharma is on the line. One moment please. Go ahead Mr. Sharma from Citi Bank. Thank you.

S. L. Narayanan

Hi Ajay

Ajay Sharma

Hi congrats on great quarter. Just on software services, you talked about seasonality, so should we expect better growth in this quarter?

S. L. Narayanan

I would really wish I could give you a precise guidance Ajay, I would rather not give you a number.

Ajay Sharma

No number, but qualitatively should things look better than what we saw in the previous quarter?

S. L. Narayanan

Then you are asking me to set a threshold.

Ajay Sharma

Okay. Secondly on stock option, are you guys still giving stock option and..?

S. L. Narayanan

Yes, in fact we have reintroduced it in a limited way to some people and we are looking at reintroducing it.

Ajay Sharma

But have you sort of tried to quantify the impact of any kind of expense once the new accounting guidelines come in place?

S. L. Narayanan

In fact, the next financial year, that is 01/07/05 onwards, you know, we will have to expense this as a line item on the P&L. By next quarter, we will tell you exactly what that impact is going to be.

Ajay Sharma

Thank you.

Moderator

Next question is from Mr. Mick Dillon. Over to you sir.

Mick Dillon

Apologies if you have already answered this question, but can you please just discuss the pricing environment in all the three parts of your business, that is software, BPO, and infrastructure services, and can you talk about whether prices are going up on average or just with new clients as part of that please?

S. L. Narayanan

Hi Mick, nice to talk to you. We have seen some kind of pricing improvements lately in the BPO business. If you were to look at this overall continuum, I mean, about two years back our pricing was far less than what it is today. Some of the newer engagements where we had a lot of pilot engagements, we were devoting people for knowledge transfers but we were not billing. Over time, as we have settled down the learning curve, the effective wheels of you know man hours deployed has gone up, and one reason why

our metrics in the BPO business has improved is because of better pricing and better utilization that have come along on the back of growth in top line without adding significantly to op-ex and other overheads. In the infrastructure business also, I do believe that our pricing would change for the better because some of the newer contracts that we took in the services side, in the remote infrastructure management business, some of the knowledge transfer costs and the relocation costs were underwritten by HCL in the initial few months. So, these two businesses I do believe that pricing would improve. On the software side, I think it will still be on a stable environment. I do not see any reason why our pricing should go up although I could be pleasantly surprised if the demand-supply equilibrium is upset in the favor of vendors with the new price discovery sometime towards end of 2005.

Mick Dillon

Okay, thank you for that.

Moderator

Participants, please press 01 to ask a question. At this moment, there are no further questions from participants at SingTel. I would like to hand over the proceedings back to Prathiba. Thank you.

Moderator

Thank you very much Ayesha. We will now begin the Q&A interactive session for participants connected to the India bridge. 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. Participants are requested to use handsets while asking a question. To ask a question, please press *1 now.

Our first question comes from Mr. Ashish Agarwal of IL&FS InvestSmart.

Ashish Agarwal

Your SG&A has increased this quarter as a percentage of revenue, any reason for that or...?

S. L. Narayanan

No, I would say that percentage basis it is not a significant increase.

Ashish Agarwal

Around 50 basis points increase..

S. L. Narayanan

Nothing special about this, I think, you know, we look at the overall EBITDA margins, those are fairly stable.

Ashish Agarwal

Okay, thanks.

Moderator

Thank you very much. Next in line, we have Mr. Mahesh Vaze from Brick Securities.

Mahesh Vaze

Hi

S. L. Narayanan

Hi Mahesh

Mahesh Vaze

If one looks at the revenues, ex-top 20 revenues, then last couple of quarters they have been sequentially declining. Actually in the first quarter they declined by about 9.1% and this quarter they declined by 3.7%. Just wanted to understand what is happening here because the million-dollar clients are certainly going up?

S. L. Narayanan

No, I think you know it is, the top 10 clients are growing at a faster rate, so that is the reason why, you know, it looks like they are decelerating, because you know, if you actually look at the absolute numbers, the numbers would look very different.

Mahesh Vaze

No SL, I am talking about absolute numbers. See, for fourth quarter 04, the absolute number was \$76.7 million, which came down to \$69.7 in first quarter, and \$67.1 in second quarter.

S. L. Narayanan

The composition of clients is also changed Mahesh, you know, it is very difficult for all people to record the same level of revenues. There may be some quarter in fact, I remember a couple of quarters back Jones sequential revenues had declined because there was an implementation where there was a large sale of license which came through in

one quarter, so the subsequent quarter, since you know, it was more of services component, there was a seeming decline. But I do believe that we should look at these things over a continuum of four quarters. I do not see there are any reasons to believe that you know our customers are decelerating.

Mahesh Vaze

Okay. One more thing SL, sorry to labor on this, this SG&A, it was asked earlier. See if one looks at the trend for six quarters before this quarter, the SG&A as proportion of revenues has been continuously coming down, and the whole logic was that there was quite some investment in the sales infrastructure in some of the newer businesses like BPO and technology infrastructure services, and that was getting, the leverage was playing out. So, is there a reason to believe that now a second way of investment is happening or something structurally is undergoing a change?

S. L. Narayanan

No, see the thing is, if we look at from say December 2003 to December 2004, the absolute numbers of SG&A have grown from about 23 million to about 26 million. I do not think this is anything out of the ordinary because we have also had, you know, the salary increases, we have added some additional locations, so it is more in the wash that you see this. And once you know revenues, I do not anticipate our SG&A as a proportion of revenues to be more than 14% next quarter.

Mahesh Vaze

And SL, going forward on the other income front, barring the forex fluctuation, what is the kind of number one should be looking at on the interest side?

S. L. Narayanan

I do not think we will have anything coming into the other income in substantial numbers because most of it, see we had kept a little bit of these assets on dividend plan because we had to pay out dividends and some capex-related commitments were there. Now, you know, barring the quarterly dividend and some advanced tax requirements, we do not have anything in terms of immediate cash requirement. So most of the assets are now gone into liquid funds growth plans. So between what is reported and what is going to be accrued, I think it will be about 1% of our assets under employment. Because I do not think on after tax basis will get more than 4 to 4.5% on the portfolio. So most of these gains will come through in the quarter beginning September 2005.

Mahesh Vaze

And one last data point, the minority interest that is there this quarter, what proportion of that is on account of DSL? Basically just wanted to see going forward what the numbers would be like?

S. L. Narayanan

It is almost about 5 million.

Mahesh Vaze

So about 2 crores to 2.5 crores is what it should be going forward?

S. L. Narayanan

About a million will be, because Jones and some other small impacts will be there.

Mahesh Vaze

Okay, thanks a lot and all the best.

Moderator

Thank you very much sir. Next question comes from Mr. Anantha Narayan from JM Morgan Stanley.

Anantha Narayan

Thanks SL. This is Anantha from Morgan Stanley.

S. L. Narayanan

Hi Anantha.

Anantha Narayan

Hi. Just a couple of small question, first is, if I look at the volume numbers that you provided this quarter and compare it to the volume numbers last quarter for the organic software business, there seems to be almost a 35-40% QoQ growth?

S. L. Narayanan

Yeah, see what we have done is; earlier, we were giving only for the organic software. Now we have integrated everything. Beginning this quarter, we are giving for the entire software services group.

Anantha Narayan

Okay. And secondly, can we have the bill rate number that you individually provide?

S. L. Narayanan

Our offshore rate is now around \$4,800 per man month.

Anantha Narayan

And onsite?

S. L. Narayanan

Onsite is around \$9,800.

Anantha Narayan

And these on a like-to-like basis, these would be flat QoQ?

S. L. Narayanan

Like-for-like, they will be flat, but because we have integrated Deutsche Software and some other entities which were outside, the core software business, we have had some increase in the effective offshore rate.

Anantha Narayan

Okay. And just final question SL, followup on the previous one regarding the minority interest for this quarter, you mentioned a \$5 million number, and again you know, I do not have the exact revenue number for DSL, but the impression was it was somewhere in the region of around \$80-100 million on an annual basis..?

S. L. Narayanan

Okay, I think just for the benefit of you people I can just now give you, it is currently around a run rate of about \$30 million per quarter.

Anantha Narayan

Okay, that is useful. Thanks a lot.

S. L. Narayanan

Thanks.

Moderator

Thank you very much sir. Next in line, we have Mr. Manoj Singla from JP Morgan.

Manoj Singla

Yeah, hi good evening SL, congrats on a decent quarter. A couple of questions from my side; firstly, on the onsite man months, the billed man months that you have provided this quarter, it is 2136, and this is on a consolidated basis obviously. The last quarter you gave us the number for only software services, but if I look at the number quarter-on-quarter, there is a 40% decline from 3500 odd to 2100. So I just want to understand what's happening here?

S. L. Narayanan

See some projects have actually moved offshore now.

Manoj Singla

Okay, but this would mean that there is a 30-35% decline sequentially in onsite, so is that actually correct in terms of..?

S. L. Narayanan

See the thing is, you know, the other problem is on the offshore centric, now there are some people who are actually attached to the onsite location, but we count them as offshore centric. So much of the rationalization that has happened now, so we want to just now make sure that we get it right, so we made a one-time correction on this. I think from going forward this would represent the right kind of base to track.

Manoj Singla

Sure. Secondly SL, there was a question earlier regarding your top 10, top 20 clients, I think just broadly if we look at let's say your top 5 client concentration, that's continued to increase over the last let's say 5-6 quarters, which obviously indicates that your top 5 clients are doing very well, but I just want to understand given that you are diversifying the base of clients, should we expect going forward that your client concentration should come down? Other way I think of asking the question is, are there any other clients below your top 10 who you think can become top 5 or top 10 in the coming month or two years?

S. L. Narayanan

See that play is a constant feature. I wouldn't be able to say with very precise estimation who will go into top 10 from top 20, and who will go to top 5 from top 10, but you know, I've seen the emergence of two new names over the last..., in fact Deutsche Bank and British Telecom were just not there, and suddenly they have come by. So this is going to be a feature that's the part of this business. There are one or two very promising clients who have reached almost 2.5 million per quarter and therefore have come into the top 20 list now, who might move into the top 10 list in the next couple of quarters.

Manoj Singla

Okay sure. The other bit SL is on the infrastructure business side, how much of that business now is coming from the international portion, and can you just talk a little bit relative in terms of how much is the margin of international business compared to your average margin in infrastructure?

S. L. Narayanan

See roughly 30% is now coming from what we call the global clients in infrastructure for whom we do the remote services. I wouldn't want to disclose the margins between hardware and software services as yet in that business because I think we would first get the business going because there are a lot of strategic interest that might get compromised if we reveal many of these numbers now. Suffice to say that of the total number that we have put out, about 30% is from global services.

Manoj Singla

Okay, just one very last question from my side on the BPO, what is the kind of shift utilization and people utilization we are running right now, and do you think there is still some leverage on the margin side going forward?

S. L. Narayanan

Certainly. We are currently at about 66% utilization, and it is just on a single shift running. I do believe that very soon we will start a day shift.

Manoj Singla

Okay thanks.

Moderator

Thank you very much sir. Coming up next is a question from Ms. Mitali Ghosh of DSP Merrill Lynch.

Mitali Ghosh

Hi good evening and congratulations on a good quarter.

S. L. Narayanan

Thanks Mitali.

Mitali Ghosh

I had a question on business process outsourcing, if you could give us a sense of what is the transaction part of that business, and also if you could just take us through those attrition numbers again, I sort of, I don't think I got it very well when you mentioned it earlier?

S. L. Narayanan

Okay. See at the moment the voice business is 75% of our revenues and 25% is non-voice.

Mitali Ghosh

Okay.

S. L. Narayanan

Then on the attrition, my point is simply this. We do have big recruitment that happens in BPO business because business is growing and we need talented people to run this business, but very often what happens is we recruit somebody who really has the credentials and a capability to do a job, but within two or three months into the job he or she finds that it isn't worth it. They say that, you know, I don't want to work through the night, so they just drop off. So if we look at that universe, that happens by third or fourth month itself. If a person goes beyond say 9-10 months, then you know, he or she has settled down fairly well, and after that they just make a career out of it and the career prospects are pretty good for people who can adapt to this kind of lifestyle because within three or four years they become team leaders then they become project manager, what have you, and suddenly you know they all become very senior. So the way I see it is the real attrition that one should look at is for people who have completed 12 months in the system. That really is the attrition because what happens in the first few months is really people who are finding out if at all they can adapt to this kind of an environment. So if you look at the entire attrition statistics and you just classify this into two groups, one representing people who have churned out less than 12 months of joining and those who have churned out after 12 months after joining, there is a dramatic difference. The annualized run-rate for people less than 12 months is about 69%. The annualized attrition rate for people who have completed one year is just about 9.6%. So this being the reality of the business, we have resourced it and you know organized it in such a way that this attrition is built into the recruitment plan and the utilization plan, and most of the attrition under one year is involuntary.

Mitali Ghosh

Okay. And when do you think this non-voice part of the revenues can really go to or what sort of a mix are you are looking at, and you know, on a standalone basis would that typically be a higher margin business or is it only because of higher shift utilization?

S. L. Narayanan

Non-voice is higher margin business simply because the assets required for configuring a non-voice BPO opportunity is far less than for a voice opportunity, because, you know, it is very bandwidth like, and you know, typically a non-voice business also requires slightly more than just, you know, English language skills and ability to take a call. So we are now trying to grow that part of our business, and I do believe there is a significant opportunity in filling up those seats during the daytime hours because if there is a back office, order to cash, reconciliation, or supply chain, you know, documentation that can be done at the end of business hours in the US, it will then be early morning hours in India. So while the rest of the world sleeps, you know, you can actually get these things posted, reconciled and edited, and you know, mailed back to the customer location when they wake up around the time we are ready to go back home. So we are looking at it very seriously, and I think in the next few quarters, we should be able to break new ground here.

Mitali Ghosh

Okay, I had just one more question on BPO and then one question on IT, the last question on BPO was that, are you also seeing a trend towards a lot of bundled deals in terms of something like transformational process outsourcing, you know, what is the kind of opportunity you are seeing there?

S. L. Narayanan

I must confess, I do not think I have the knowledge or the inputs to answer this question, but I can come back to you. What did you say, transformational transaction, what is that?

Mitali Ghosh

Transformational outsourcing, were basically you are transforming the process which you are taking over and then managing it. So, we had heard that there is a trend, you know, picking up towards integrated deals in that sense, IT and BPO deals.

S. L. Narayanan

I need to come...

Mitali Ghosh

I will take that off line. And my last question is on IT, you did touch upon it in the beginning, I think somebody asked you about the environment in the semiconductor area in terms of IT spend, if you could just elaborate a bit on the trends in that area because, you know, another peer of yours some days back mentioned about some weakness there in total IT spending as a result of cycle weakness.

S. L. Narayanan

Yeah, see, we also have come across some of these, you know, industry reports that predict that after the last 12-15 months of rebound in spending there may be some tapering off or plateauing happening, which is why I also said that we do not expect the numbers to grow because we have now transited the phase where our fortunes were dictated largely by the spends on some of our client organization by their end customers, because today we have more of routine engagements which are more in the nature of sticky contracts, so it is more of support and maintenance that is being done for some of these semiconductor clients. Because, you please remember, we do not work with the semiconductor foundries but we work with semiconductor equipment manufacturers. So a lot of things which are now under development have been outsourced. So we have these test-bed facilities which have been moved out of US into Chennai. So we do not anticipate any deceleration in the spends by foundries to impact on us.

Mitali Ghosh

I see. Just on the attrition on the IT services side, and this is my last question, do you have a number for that as well?

S. L. Narayanan

Yeah, we do have. Our numbers are currently running at about 13%

Mitali Ghosh

Annualized numbers. Thanks a lot.

Moderator

Thank you very much mam. Next question comes from Mr. Shekar Singh of ICICI Securities.

Shekar Singh

Hi sir. Just basically like, I was looking at the total employee addition in the software business over the last four quarters, now the total employee addition in the software business is almost like 44%, where as the dollar term revenue growth over the past four quarters is somewhere around 28%, so can you just explain?

S. L. Narayanan

I just want you to take your memory back to early 2003. In fact, we had lag between our recruiting and the growth that happened in our revenues. In fact the real traction in our revenue started happening from September 2003. I have emphasized time and again that

you know it will be very difficult to smooth out these growth numbers. In fact, we frankly did not think that, you know, some of the ramp-ups that we achieved in the last two quarters in BPO would happen by December. In fact, we thought it was more like a 30th June kind of milestone. So, the thing to see is, you know, how does it behave over last 4 or 5 quarters and what is the kind of recruiting that is happening. I would not like to see some very definitive and precise kind of analysis like you have done, because you know, it is more a reflection of what we see as possible in the coming quarters, and the hiring reflects that.

Shekar Singh

Okay. Secondly like, as far as your other income is concerned, this 160 million rupees of other income which we had this quarter, do you think this number can come down further, because as you mentioned it seems like this number will be coming down further in the coming quarters?

S. L. Narayanan

It will probably be lower than this by maybe 10 to 15%.

Shekar Singh

Okay. And lastly like, since your pay out this time of Rs.4 per share was almost like 100% of your profit after tax being paid out in the form of dividend for the quarter. So do you think this is sustainable?

S. L. Narayanan

See, the way to look at this is you know, we had the suggestions coming from several investors that you know we should have done a special dividend of the HCL Perot joint venture divestment. That disinvestment brought us close to about 105 million dollars in cash. So another way to look at this existing dividend policy is that, you know, we are just using four quarters to dividend out what we received as one-time extraordinary gain. So basically what we are now doing is, you know, given the fact that we have fairly comfortable cash reserve, we have indicated to the market that any kind of free cash flow, which is generated by the business will be dividended out, because you know, if you look back three years ago you know, our pay out ratios were somewhere around 5 or 6%, and there was a need for conserving cash in those years because you know we need to have the financial capability to do deals, and now that you know all these deals have been executed well, integrated well, our cash flows have gone up. We know are making sure that you know the return on equity does not get diluted through further bolstering of the net worth.

Shekar Singh

Okay. Thanks a lot sir.

S. L. Narayanan

Thanks.

Moderator

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

Trideep

Good evening gentleman and congratulations on the results.

S. L. Narayanan

Hi Trideep.

Trideep

Hi. My first question is, like you know, how do you rate your, lets say, the win rates on a going forward basis, in terms of larger contract getting into, like you know, getting short listed into larger engagements with the clients, as now you have a well diversified revenue mix and also probably along with that expertise in individual niche areas, I mean, how do you rate your success being short listed for the larger contracts right now as opposed to let us say two to three quarters back?

S. L. Narayanan

I would say that, you know, certainly we stand in a better footing now than two to three quarters back but if you where to ask me precisely whether we have made it to any large contracts, I would not be able to throw any light at the moment because you know we have not won any ground breaking kind of contracts in the last two quarters, but I would say that you know our business is in a fairly good footing now. We have the right kind of service mix, and we are confident that you know we will continue the same momentum.

Trideep

Okay. The other part of the same question is in terms of your software services overall business momentum, over the next four to six quarters, I mean, looking at a run rate not just getting into a qualitative guidance or anything, I mean, do you think that, lets keep the currency out in dollar terms, the business momentum is likely to be better, where it is, or like you could slower?

S. L. Narayanan

I would say it will at least be at the same momentum if not better.

Trideep

I see. The second part is regarding, I mean, on your unrealized gain that you have put out on the press release it gives a different number whereas the number that you said on the call is I think 115 or something, and whereas it is given is 135 or 140, what is the right number here, or am I looking at the same numbers?

S. L. Narayanan

Which one is this?

Trideep

The unrealized gains that you, I mean, because of your switch over to the different plan that you mentioned.

S. L. Narayanan

That is about 3.2 million dollars.

Trideep

3.2 million dollars. And the other thing is regarding this forex gain treatment that you talked about, can you run me through exactly what is...

S. L. Narayanan

Actually what has happened Trideep is you know we did not cover our receivables beyond 30th September, I mean, in March of 2004 when we had that eventful week when the ONGC remittances hit country's banks and it went to 43.50 or something, there was a temptation to sell everything forward, but we just held our nerve and you know we staggered the forward sales, and then once we got the feeling that you know there was so much of uncertainty on account of the change in government and other apprehensions, we did not keep any forwards post 30th September. Then once we started seeing some kind of re-rating and then you know the confidence coming back, we took the opportunity of those oil price hike days, selectively we started selling forwards, and now we are booked all the way up to December 2005, for almost about 290 million dollars of net dollar inflows that we anticipate.

Trideep

Right.

S. L. Narayanan

On that, we are now at a weighted average rate of about 45.11. The spot is today at about 43.50 - 43.60, we are now in the money to the extent of about 6.8 million dollars based on a mark to market position on 31st of December in respect of forwards post January 1, 2005. That number of 6.8 million dollars has not been considered in the accounts of 31st December 2004 because we follow what is called the hedged contracts accounting. So as and when the quarter ends, we will only relate these forward contracts through the remittances that come against them, and at any point in time we will keep re-valuing this as we go forward.

Trideep

I see. But does not mean that in the coming quarter you could see something of this getting booked..?

S. L. Narayanan

You see, if we are going to have lets say the same rates, say 43.60 or whatever on 31st of March, we will have forex gain which will come through. Our forwards are as I said weighted average of 45.11.

Trideep

Okay thanks a lot and best of luck.

S. L. Narayanan

Thanks Trideep.

Moderator

Thank very much sir.

S. L. Narayanan

I request that this should be the last question.

Moderator

Sure sir.

S. L. Narayanan

And of course let me just add that should there be any other queries, though it is Republic Day, National Holiday, Sujoy and I would be happy to take calls tomorrow.

Moderator

Our last question comes from Mr. Pankaj of ABN Amro

Pankaj

Yeah hi, congratulations on decent quarter

S. L. Narayanan

Hi Pankaj, thanks.

Pankaj

My question was on the effort distribution that you have given for the offshore centric business which apparently now includes nonorganic thing also, can you give us a comparable number for the last quarter?

S. L. Narayanan

I really wish we had done this on a quarter on quarter basis but you know since we have so many competing objectives that competed for time, we do not have the numbers for the preceding quarter, but we promise you at some stage we will be able to give you the back numbers. At the moment we do not have it.

Pankaj

Okay. And any sense of kind of wage increase or something, any plans are there for the coming quarters?

S. L. Narayanan

No, in fact, most of our wage increases have been factored in from 1st of July. So in fact in some cases we have also provided for retention bonuses. All of it has been absorbed in the accounts.

Pankaj

Okay. And can you give us some sense of capex plan for the remaining two quarters?

S. L. Narayanan

I suspect that we will be spending another 30 odd million dollars for the next six months.

Pankaj

Fine, thanks a lot.

S. L. Narayanan

Thank you. With that, we end this call. Thank you ladies and gentleman for all the help and understanding. We look forward to talking to all of you very soon. Good night.

Moderator.

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