HCL TECHNOLOGIES Ltd

Q2 FY 06-07 Earnings Call

6.pm (IST), January 15, 2007

Moderator

Good evening ladies and gentlemen, I am Sunil, the moderator for this conference. Welcome to the HCL Technologies' conference call. For the duration of the presentation, all participants' lines will be in the listen-only mode. After the presentation, the question and answer session will be conducted for participants connected to SingTel. After that the question and answer session will be conducted for participants in India. I would like to hand over the proceedings to the HCL management. Thank you and over to the management.

Shiv Nadar

Thank you for joining us and good evening all of you. We are six of us here. This is Shiv Nadar, Chairman and CEO. There is Vineet Nayar, President. Ranjit, Head of BPO. Anil Chanana who is the Executive Vice President, Finance. We have Prahlad Bansal joining us today who is Corporate Vice President, Finance. Also Samrat Gupta from the Investor Relations. So six of us are here. I don't know how many of you are Tamils there. For those of you who are Tamils a very Happy Pongal. Let us begin by just walking you through very quickly some of the results highlights.

The quarter went more or less as what we had expected. The revenue for the quarter was $331.1 million, this is as per US GAAP and the numbers which is given is US dollar numbers. This is 41.4% year-on-year growth with 10.2% growth sequentially. The EBITDA just before the non-cash charges at $73.2 million up 38.7% year-on-year and 12.5% sequentially. Net income at $64.7 million is up 60.8% year-on-year and 18.7% sequentially. A very important part what we have is the new business contribution is 12% of revenue in this quarter. I think 18% of the new business that is the overall business, 12% came from customers who did not have revenue with us in the previous period.

During the quarter, the company announced a 1 is to 1 bonus which you know and as interm dividend we are giving for 16th consecutive quarterly at 200% and our net addition rate is at 1865. We have as per US GAAP but rupee translation which is convenience translation. Revenue stood at Rs. 1465 crores, up 39% year-on-year and 6.2% sequentially. The EBITDA before non-cash charges translated to Rs. 324 crores up 36.3% year-on-year and 8.4% sequentially. Net income at Rs. 286 crores up 58% year-on-year and 14.4% sequentially.

I want you to go back year and a half ago when I was talking to you on behalf of our company, a long-term trend what we expect. Our long term trend what we expected was between 30 to 40%, in this 3 to 5 year timeframe and also requested you quarter-to-quarter variations could be there, year-to-year variations could be there, but that is the range in which we will be. From this perspective, if you were to judge how did 2006 perform? That is what has been given in graphs on page 4, the revenue growth rate both quarter-on-quarter and year-on-year. If you have seen it has been keeping a very close stead trend of an upward gradient, and its been a very satisfying close of the calendar year. If you take the EBIT growth rate year-on-year as well as Q on Q it has grown steadily from a little north of 8% to a little north of 11.8% quarter-on-quarter. At year-on-year, the EBIT growth has been much steeper gradient. All that I can say is we are getting on a good growth trend. If I take the year-on-year net profit as profit after tax, growth rate that is an enviable curve and I am sure that all of you are very happy with the growth that has exhibited by the company. But the growth rate is an indicator, you know, at end of the day it is an output, but what was the strategy which led to building these out puts and what happened right with us, so that these results can be seen, after all it is good strategy implemented well is what the results in something, these are the results and I would request Vineet to take you through the strategies of growth that has been adopted and after that Ranjit will take you through highlights of the BPO business and Anil will wind it up with some comments on finance.

Vineet Nayar

Good evening everybody and a very Happy New Year to all of you on the call. Eighteen months ago we had shared with you that we believe that there was a commoditization of industry happening. We believe that there was pressure on margins because of commoditization and also because of competition increase and as people become available less in the market. We saw an opportunity of doing some to bring about the business transformation so that we can respond to these and grow at industry rates or faster than industry rates. With that objective we had announced three large initiatives; one was to do with employee first and customer second. Second was to do with value centricity rather than volume centricity, our belief that if you focus on value the volume will automatically flow. The third was the fact that we wanted to create uncontested market spaces, so rather than focus on things which everybody else does, focus on things which we uniquely can offer to the customer, which will be the growth driver, revenue driver, and margin driver. I believe that this quarter is an early indicator that the strategy which HCL had outlined seems to be working and therefore the last four quarters should be seen as early indicators of this strategy which is been rolled out. So there are I would say 8 or 9 early indicators. Before I go there I would like to share once again with you that I do hope all of you have noticed the new investor release which we have shared with you. We went for higher level of information sharing with you last quarter and based on the feedback which we have received, we have added some more to it and hopefully this will give you a good ability to analyze HCL's data and build them into your models as you evaluate HCL as the potential investment.

The eight indicators as I would indicate them is #1, the sequential quarter-on-quarter growth on IT services, i.e. 6, 9, 11, and 10% quarter-on-quarter growth, so it reflects the consistency of growth and reflects that there is ______growth in IT services. A 41% revenue growth and a 46% EBIT growth of IT services again reflects the fact that the growth numbers are pretty good. The announcements of large deals, which is Skandia and joint agreement with Celestica go-to-market and concept-to-manufacture, not only reinforces our focus on big deals that the deals are coming but also the fact that the innovation in collaboration through which we want to reach out to new market spaces is working, so that is the third early indicator. The fourth early indicator is that we did face concerns and questions from all of you on slow down in US and we did focus on growing other geographies and therefore you see our dependence in US, (A) coming down, (B) amongst the lowest in the IT top 5. Our Europe quarter-on-quarter growth is 13%.

On services sector, which is very interesting that you know a lot of time in the last 5 years we did not grow at industry paces because of technology melt down, but what is very encouraging to see that the engineering spend is back and therefore the quarter-on-quarter growth in engineering is very, very healthy. Our custom application quarter-on-quarter growth is also very healthy based on our micro verticalization strategy and also our _____ strategy.

Infrastructure continues to grow quarter-on-quarter and year-on-year at a fast pace, which again reflects our beliefs that if you are first of to block in any services, and we were first of the block in infrastructure, you can actually dominate the market space and this is what we are doing.

Financial services, life sciences, and media and publishing are the three big growth drivers in this quarter and you would see aero also coming-in, in the coming quarters is a big area for focus for HCL. So that is what you saw as early indicators of our micro verticalization strategy, multi service strategy, and focusing on geographies like Europe and Australia.

The fifth early indicator is which is very interesting is top 20 customers growing 12% quarter-on-quarter. Now the reason this is very interesting for you to know and that is consistent with top 5 and top 10 and top 20 all of them have radically grown, and the reasons this is very interesting is because it will happen because of two reasons, it is happening #1, because we have a multi service offering, and the number of top 20 customers who takes multiple services from HCL is increasing. If you see out of 230 odd customers of HCL there are 45 customers who take multiple services from HCL, so that drives revenue in existing customers and that drives margins also in existing customers, so that is interesting to know.

The sixth early indicator is that we have welcomed one more customer in the $50 million club, so our ability to be able to grow existing customers, make these relationships larger and larger. We welcome four more customers in the $10 million club, these are all on LTM basis, and that again indicates our ability to be able to grow these customers. The total number of client additions you have already seen. So that is the sixth indicator.

The seventh indicator which I think here is I want to spend a little time to explain this to my friends on the call. The way the IT industry is evaluating the business is on repeat business percentages. Now HCL for good reasons decided that unless we acquire substantial new customers who become growth drivers we will not be able to grow at the pace at which we want to grow, and therefore we increased our sales and marketing, we actually doubled the number of sales force on the ground, we focused on new services, we focused on value, we focused hugely on marketing, all these focus has resulted into new business of 12% as Shiv pointed out in the last 12 months. Now, I would like you to think about the following. If you take the top 5 companies in India, Indian IT listed companies, and total their revenues, you will come up with an market share for HCL, you know that is the HCL market share on a total basis. However, if you were to focus only new business and everybody is sharing with you new business and you were able to total all the new business which is outside the repeat client business versus new business for all these 5 companies and look at the market share you will come to an interesting conclusion that there are some IT companies whose focus on new business is increasing, they are increasing their market share in new deals, and that is what HCL measures as its own performance; what is our market share in new business which comes up for grabs in the market space? That is an early indicator that most of our strategies are working in existing customers, because it is difficult to wean away an existing customer from a high quality existing vendor which I believe all IT services companies in India, are high quality vendors.

The eighth early indicator as I would say is that if you see IDC report and we have included part of that report in the release, but I do hope that each one of you will find time to read the detailed report, which has been sent to you. The IDC report talks about HCL being a disruptive force in the IT landscape and being most ready in being able to attack the new challenges which are emerging and being pioneer in an infrastructure management and being extremely good in combining the infrastructure management and applications. Now, if you really see the way the disruptive force really works is we launched a division called the Enterprise Transformation division, which is what the IDC report talks about, and it is a different strategy to a consulting division where we are focused on technology transformation on the table, so when we launched multiple services, we said we will launch infrastructure services, application services, and try and launch BPO services, which right now we don't have a client where we have all three, but infrastructure and application services if we got in to a client and offer that multiple services, we will be able to transform the cost points because we offer both services and that is the reason we will not stay enterprise transformation services, which have been very very encouraging, not from a revenue point of view but there is a reason for us to win major deals. So that is the early indicator from IDC, Gartner, Forrester, some of those comments are linked are and Fortune recognizing HCL strategy to be unique, and appreciating what we are doing. I will close this with one statement that in the end you know it is your employees and your customers who tell you whether you are right or you are wrong. And when you look at the attrition data of HCL from core software and infrastructure point of view, one thing which does not reflect in this increase in attrition is the fact that the attrition in what I call you know - key staff which is other than project engineer, project leader and above, it is substantially lower than the total attrition, and I am happy with the attrition at which my top 1200 managers are there the balance 4000 to 5000 people are there.

It reflects in customers when we launched the global customer meet for the second time in India, it was very difficult for customers to convert for a global customer meet in India, it needs a lot of commitment. I was happy to note that 250 of them made that commitment of 1 week to work with us on the subject of transformation where we were sharing with them how HCL has transformed, how you should look at business models, how we can transform IT, and 250 of them converged in Agra, which again demonstrates that that customers are really believing in what we are saying and wanting to participate in the journey of transformation. So with that I conclude my comments and hand over to Ranjit to share his views on what happened in BPO.

Ranjit Narasimhan

Thanks Vineet. The BPO Division completes an almost successful quarter. The revenue from our Indian operations grew 81% compared to the same quarter of the previous year, much higher than the growth rates of the industry. Our Northern Ireland operations have almost reached the full capacity and that is stable. There was a significant growth in manpower there has been a net head count addition of 1069 people during this quarter. Our operations also continued to get growing international recognition during this quarter HCL was awarded the first investor of the year award by the UK Trade and Investment Board. Our Northern Ireland operations won the Irish Contact Center award for the best new service.

We also continue to move up the value chain. We see lot of traction in non-voice business. During this quarter we added two new clients in insurance sector; one in US and one in UK, apart from a specialized market to such companies in US. Thanks. With this I will hand over to Anil.

Anil Chanana

Thank you Ranjit. I will walk you through how the revenue growth has taken place. During October to December quarters we have recorded a 7.2% increase in the revenues, 3/4th of this business is core software where 7.1% of this increase was contributed by effort based revenue growing. The increase in realizations per man month gave 1.3% and non effort base like expense reimbursements contributed 0.8%, so the core software at 9.2% increase in revenues quarter-on-quarter basis.

I would now walk you through the EBIT margin drivers. There was a expansion of 30 basis points in EBIT margin. It improved in all the three business segments. It improved by 30 basis points in core software and in infrastructure and by 20 basis points in BPO. There were two positives and there were couple of negatives. The positive are the higher utilization. If you look at onsite, there was a 3% increase, and offshore there was 1.5% increase. In BPO, there was a 5% increase leading to an impact of 120 basis points. The realization increase per man month lead to 140 basis points. The negatives were the exchange, the negative impact of exchange movement, which took away 150 basis points, and other factors like depreciation, one time SG&A as Vineet mentioned about the global customer meet having held in Agra contributed to negative of something like 90 basis points. So net-net we were 30 basis points positive.

I would now walk you through the other income. On the foreign exchange, we had a 7.8 million gain during this quarter. As of 31st of December 2006, we have 560 million of forward cover; this is opposite $300,000 of gain in July to September quarter. If I take you to the other income, which is a treasury income, the treasury income this quarter was 3 million, this is the income which has been booked in the books. If you look at the note at the bottom of the page, you will find that the unrealized gains have increased from 11.7 million to 15.3 million, a jump of 3.6 million. This 3.6 million together a 3 million gives us the other treasury income of 6.6 million. The drivers: two drivers. The receivables in terms of number of days of sales went down from 77 as of September end to 70 days at the end of 31st of December, this released something like 24 million of funds for the operation. Second thing which happened was we got higher return from the treasury investments. This quarter it was 6.72% opposite 6.53% in the July-September quarter.

I would now take you through the capital expenditure. We incurred 20 million capital expenditure during October-December quarter; this was on top of 27.5 million which was incurred during July-September quarter. So therefore we are on track to incur 100 million, which we said at the beginning of the year that we will be incurring during 2006-2007.

If you look at the debt side, debt as a percentage of earnings before the foreign exchange gains this quarter was 8%, that is more or less at the same percentage which were in July-September when it was 8.1%. With this I will conclude my comments.

Shiv Nadar

Thank you. Now we will leave the floor open for questions.

Moderator

Thank you very much sir. At this moment I would like to hand over the proceedings to Salvia to conduct the Q&A for participants connected to SingTel. After this we will have a question and answer session for participants at the India bridge. Thank you and over to Salvia.

SingTel moderator

Thank you Sunil. We will now begin the Q&A session for participants connected to the SingTel bridge. Please press 01 to ask a question. If you have a question, please press 01 now.

Sunil, at this moment there are no further questions from participants at SingTel. I would like to hand over the proceedings back to Sunil.

Moderator

Thank you very much Salvia. We will now begin the Q&A interactive session for India participants. Participants who wish to ask questions please press *1 on your 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 only handsets while asking a question. To ask a question please press *1 now.

The first question comes from the line of Mr. Sandeep Shah of Motilal Oswal.

Sandeep Shah

Yeah sir, the first question is in terms of the growth in Enterprise Application Services, in the Indian rupees it has degrown by 1.5% during the quarter while some of your peers have registered almost a double-digit growth in the Indian rupees, what is the reason for the same? Is it decline in some discretionary spending towards this?

Vineet Nayar

You are saying custom application has gone down in rupee terms?

Sandeep Shah

Yeah in the Indian rupee terms, Enterprise Application Services.

Vineet Nayar

Oh, sorry okay. The Enterprise Application Services if you go to the last quarter, you know April-May-June was about 42, I mean there was a 16% quarter-on-quarter growth from April-May-June to JAS quarter.

Let's take the next question, I will answer this question by the time the next question comes up.

Sandeep Shah

Yeah, sir on the billing rate, what is the HCL Tech's experience in terms of renegotiation with the existing customers in all the three segments of the business?

Vineet Nayar

Our experience so far has been that whatever contracts have come up for renegotiation, we have been able to renegotiate and that is the reason there is expansion in margins because of the increase in billing rates. Our experience says that contracts coming up for renegotiation we have been able to grow them by about 3 to 5%, that is contract coming up for renegotiation.

Sandeep Shah

This is for all the customers who are coming for the renegotiation?

Vineet Nayar

We believe that we have seen higher success in engineering services, but we have been able to see this across all segments. In addition, what interestingly we are noticing that the customers are sensitive to ever increasing competition cost in India and are open for such rate revision, not all of, but a good number of them are open to such rate revision across all services.

Sandeep Shah

Okay, so sir these renegotiations are effective from this year itself?

Vineet Nayar

So wherever the contracts come up for renegotiation, you know there is a cycle for each of the contracts, we are able to successfully renegotiate an increase of 3 to 5% on within those contracts.

Shiv Nadar

The type of contract renewals they get renegotiated.

Sandeep Shah

Okay, so do you expect that the realized rate in the coming quarters will be higher than this quarter?

Vineet Nayar

We are not making that comment.

Sandeep Shah

Okay, sir in terms of the ESOP which has gone up because of the shares which have been issued below the market price, so where do you see these ESOP charges going forward in the coming quarters?

Vineet Nayar

So let me try and explain what this ESOP is all about. The way we look at the market in 2010 is that key managers will be the key to driving growth and if we are going to bring about the transformation in HCL, which is substantially going to change its value for its shareholders including employees, we do believe as we have always believed that the key managers should have a stake in it. Now one from a retention point of view, and #2 from a motivation point of view, and #3 from a gain sharing point of view, we launched this scheme where we gave stock options which would vest over a 5 year period to key employees. Right now we have covered 1250 key employees in this plan, which is grant at Rs. 4 below or hcltechmarket price. Now the objective has been largely met, predominantly because #1, we have complete goal alignment within our company. I believe the motivation within HCL is larger than some of the other colleagues of ours. The attrition in this 1250 managers is substantially lower, substantially lower, compared to the attrition on the non-1250 managers, and we also believe that the reason, the value centricity and the long-term thinking and planning within the company which is coming in is because people are looking at a 5 year career in HCL rather than jumping at the most attractive job offer they may be able to get, and we also believe that you would not see the gains right now but as you go into 2007, 2008, 2009, and 2010, where you know hopefully the stock options will become very valuable for the employees and hence they will help the employee think long-term on behalf of HCL. So this process and this philosophy will continue. I do not have a number for you as to what it would be next quarter or next year, but what we really do is we take this charge on a straight line basis and amortize it equally over the period of the vesting. The details of number of shares which have been given out and the details of the charge which have been taken in this quarter has already been shared with you.

Sandeep Shah

Okay and sir what about the attrition at the lower level, so do you expect because of the higher attrition at that level you might be required to do another salary hike in the coming quarters?

Vineet Nayar

We don't believe, we right now do not have plans to do any salary hike from now to 1st of July, you were right in terms of the attrition at lower levels is high. As I do not believe that compensation is the answer to that problem, I believe that the answer lies somewhere else. I do not believe, in the past we have seen you know whenever we have done compensation hikes, it is a revolving door, I mean in terms of you do a hike and somebody else does a hike, so you know there is no impact. I think we have to find better answers, better career paths, give people a 5 year perspective on why they should continue with HCL and that continues to be business challenge for business managers in IT and we want to address it in that form rather than just giving compensation increase and assuming that they will stay back.

Sandeep Shah

Okay and sir your comments in terms of the EBITDA has been going up quarter-on-quarter, last time you said that the SG&A investment will continue, so where do you see margins, just not on a specific number but do you believe this trend will continue?

Vineet Nayar

I am sorry, did you ask me the question on infra or you are talking about IT?

Sandeep Shah

Overall, and if you can give us some comments in terms of segment wise also?

Vineet Nayar

The overall comment on margins I think you know I will just comment on IT and then Ranjit could comment on BPO. Our overall comment is that our SG&A will continue to be at current level which is about 15.6 plus some one time events like a global customer meet, which took the SG&A up to 16%. So you would see it in the range of 15.6 to 16%. So we will continue spending SG&A because we had focused on new business. On the EBITDA you are going to see as you have seen, you know you are going to see about the same EBITDA as you have seen this quarter, which we would manage between SG&A and gross margin, so you are going to see a similar trend on margins in the current future. Ranjit on BPO.

Ranjit Narasimhan

In BPO the SG&A is slightly lower because of the large size of individual engagements. Currently, the SG&A is about 12.7%, it is likely to remain at the same level going forward.

Sandeep Shah

Okay, and this RSU has been introduced from the second quarter of this year, right?

Vineet Nayar

Sorry, say that again please?

Sandeep Shah

Regarding the ESOP charges, the RSU has been introduced from the second quarter of this year.

Vineet Nayar

No, it has been introduced, Anil if I am right from 2005.

Sandeep Shah

Okay, so this is the additional employee, 1250.

Vineet Nayar

No, no, no this is the total employees under this span, as of this quarter.

Sandeep Shah

So do you expect this number to go up in the coming quarters?

Vineet Nayar

Yes.

Sandeep Shah

Okay, okay, thanks a lot.

Moderator

Thank you very much sir. The next question comes from the line of Mr. Hitesh Zaveri of Edelweiss Securities.

Hitesh Zaveri

Yeah, hi, my question is about the factor that contributed to the margin improvement. While realisations, the utilizations have gone up, one important factor that I found was the offshore proportion of revenue, both in terms of efforts and better revenues also have gone up, I think that could be significant here unless there are some other factors at play here. Could you break out whether offshore effort improvement lead to what kind of margin improvement for the quarter?

Vineet Nayar

I don't think we are commenting on this that specifically. I will ask Anil to walk you through the overall margin improvement chart once again. The margins might have, you know when a contract margin improvement happens it happens both onsite and offshore, so Anil why don't you walk through all the four or five factors once again contributing to the basis point.

Anil Chanana

As we have mentioned there is a 30 basis points expansion in EBIT margin, which has been contributing by higher utilization, which was in onsite in core software of about 3%, offshore was 1.5%, and it was 5% in BPO India operations. This had a impact of 120 basis points on the EBIT margin. I hope it answers your question.

Hitesh Zaveri

Sure, I appreciate it; I just thought may be the offshore would be more potent driver of margin improvement. Could you throw some light about the order wins that you have had in last 18 months and as you go in calendar 2007 many of these large deals would be at the early phase and you know preceding 12 months I assume and if you could throw some light on the scale of plans as you have over the next 12 to 18 months?

Vineet Nayar

Actually I will combine this question with some other question which people have been asking, may be this is the right time to answer that. The big deal strategy of HCL resulted into 6 large transactions, out of which one customers name we have not announced, but that includes Autodesk, Dixons, Skandia, Teradyne, and Celestica, and one more European banking customers whose name we have not announced. So a lot of questions have come as to what is happening on these deals and are these margin accretive or dilutive? Let me address this and combine this with the questions you have asked.

First is that these 6 deals have exceeded 10% of this quarter's revenue, so that is milestone #1 which we have achieved. Milestone #2 is the total EBITDA on these deals for this quarter is positive for the total EBITDA of the company and is not diluted, so that means EBITDA of these deals is more than the EBITDA average for IT services because these deals are in IT services. #3, these deals the way they work is that two of them are in steady state, some of these deals are currently in transition into offshore, so revenue for those will go down, and some of them are in scale-up stage, that means we are just ramping up and therefore revenue has not come in. So these deals would be in different stages and I believe that you can look forward to identical growth in these deals as the rest of the business.

Hitesh Zaveri

Sure, that is useful. One last question about the RSU point again, I think that it would be helpful if there is lot of clarity about the kind of charges you should be taking in 2007, 2008, and 2009 based on this, since you have laid out a long-term plans for employees, what kind of RSU is going to be distributed, I think providing a number here will be helpful.

Vineet Nayar

Just give us one second please. The answer to that is that we have a total charge of $6.17 million in October, November, and December. Out of which what you are calling RSU is $3.95 million, please understand these are not stocks which have been given but these are options.

Hitesh Zaveri

Sure.

Vineet Nayar

Fair value grant, the charge is about $2.2 million, which adds up to $6.17 million. Now this next quarter would be around $6.39 million, and the quarter after that will be around $6.43 million. The split for that would be about $4.2 million in the RSU equivalent and about $2.2 million in the fair value grant, this is with an assumption that no new stock options are released. So if you take only the 1250 employees as I shared with you, this is the straight line charge which will happen for the next few quarters, I mean next few years. So I hope that helps you.

Hitesh Zaveri

Yeah it does, I appreciate it. Thank you and good luck for the year ahead.

Moderator

Thank you very much sir. The next question comes from the line of Mr. Pankaj Kapoor of ABN Amro.

Pankaj Kapoor

Yeah, hi, congratulations on the numbers, I just want a quick clarification on the services revenue share in our infrastructure business, if you can give me a sense of how much was the equipment sales and how much was the services?

Vineet Nayar

Okay, I will answer that question along with the previous question from the gentleman, I am sorry I took some time to answer this.

So the previous question was the enterprise package implementation revenues why has it marginally grown in dollar terms and come down in rupee terms? The answer to that is April-May-June to July-August-September we grew 22% quarter-on-quarter in dollar terms. So that was resultant on some orders, which we had taken on, that was offshore. So, you know, you go onsite and then offshore would start, so you see that trend. I continue to be extremely bullish on enterprise consulting to be a growth driver for HCL and therefore from an year-on-year total year when you see it, you would see a very positive and healthy and you would see it amongst the growth drivers. So, I hope that gentlemen's question is answered, if it is not I would be very happy to answer that again.

Your question of how much material business do we do? In this quarter, our material business is around 3% of the total IT services revenues which we have declared.

Pankaj Kapoor

Okay, 3% of the total revenues, out of the IMS alone.

Shiv Nadar

Of IT services.

Pankaj Kapoor

That means 3% of my total revenue declared for the quarter, which was at 331 million.

Vineet Nayar

Yes.

Pankaj Kapoor

Okay. And for the BPO business can you give me a sense of how much was the revenue from the offshore and how much was onsite, Northern Ireland?

Ranjit

It's about 70% of the business is from Indian operation and 30% of the revenue is from Northern Ireland operation.

Pankaj Kapoor

Okay, thank you.

Moderator

Thank you very much sir. The next question comes from the line of Mr. Prasad Deshmukh from DSP Merrill Lynch.

Prasad Deshmukh

Yeah, hello sir. My question was about Infrastructure Management business. How long do you think the above average company growth in Infrastructure Management would continue, and how long will it take for the margins in this business to crawl back to the company average?

Vineet Nayar

I don't have a vision of the future, but I have always seen in 30 year's history of HCL that whenever we have been out in the market in the first the growth rates are always higher than the industry. So, all I can say on behalf of infrastructure team is the fact that we will grow way ahead of the industry average. Largely because, (a) we have the best customers, (b) we are winning most of the deals which are coming in the horizon, you know we have hardly lost any new deal which was coming up, and therefore the growth will continue, and (c) this service is very nascent, very young and still has to catch momentum.

For the second question, I don't have the specific number for you, but I believe the infrastructure in the next 3 years will continue to be one of the key growth drivers which will grow higher than the company average.

The second question in terms of margins, I believe we still need to focus on investments, creating new business model, software as a service as you can see in the IDC report and I and therefore I would believe that the margins from here on for infrastructure will be around these levels.

Prasad Deshmukh

Okay and what is our differentiating value proposition in infrastructure?

Vineet Nayar

Fantastic question. So, differentiating value proposition #1, we were the first off the block in infrastructure management, so we launched the services by signing the AMD contract in 2003. #2 is we are the only company amongst Indian IT services companies, which have done data center migrations. Data center migrations we have done for Dixons, Teradyne and Autodesk, which basically means that taking the data center of a customer and moving it away from just data center into a shared services mode. #3 is that we have as per last count, close to 125,000 devices which we are monitoring and managing out of India, which is more than all other devices put together being managed out of India. If you look at the TPI report, which has recently been come out, it is very interesting report, and you know two questions I am always asked; #1 will these strategy continue, and #2 what is your competitive differentiator. The TPI report which our investor relations team will be very happy to share with you, says that there is $90 billion of deals in play out of which $14 billion or I think $5 billion or some crazy number is going to get decided in the next one year, and they have rated 6 companies which are playing in these deals. Remember TPI is a buyer, I mean he is the biggest consultant in the world for customer buying, and out of the 6 vendors they have listed, HCL is the only Indian IT company, rest is IBM and Accenture and all that stuff. So, my belief is that we not only dominate remote infrastructure management but we have very successfully leveraged our leadership in the remote infrastructure management to go after this multi-services deals and participate in a completely new blue ocean market called total IT outsourcing, and I have also proven to you in my conversation today that the total IT outsourcing revenues are big growth drivers for HCL by contributing in excess of 10% of this quarter revenue, and at EBITDA margins which are more than company average. So, all these three things combined together, hopefully will answer a lot of questions which some of you have in your minds.

Prasad Deshmukh

Okay. Sir, I joined the call a bit late, I don't know whether it was clarified. What is the reason for so much of higher forex gain this time?

Vineet Nayar

We had clarified that, and if you go through the text you would be able to see the answer.

Prasad Deshmukh

Okay fine. Thanks a lot.

Moderator

Thank you very much sir. The next question comes from the line of Mr. Joseph Foresi of Janney Montgomery.

Joseph Foresi

Hi guys, just a couple of quick questions here. My first question is about the demand front. Could you talk about the demand environment heading into 2007, any specific trends you are seeing such as market contract, and do you see the spending environment continuing to be positive on the IT services in '07?

Vineet Nayar

I think it's an interesting question and it has multiple answers, depends on who you are talking to. I believe in what TPI is saying, I believe in more and more total IT outsourcing deals happening. Customers focusing on costs and wanting more costs out from infrastructure and application combined. I see geography is slight Europe, especially Germany, geographies like Asia especially Australia leading the charge on growth. I see customers wanting to reduce IT intensity as percentage of revenue, so if you take a typical financial services company, which used to spend about 14 to 15% of their revenue on IT, they are closer to 10% of their revenues now. So, people want more bank for their bucks, so therefore the Indian IT services companies have a lot to offer to them. They want a flexible business model in terms of that they don't want to pay only for application development but they want a larger say in what is going to happen. So, these are interesting trends which we are seeing. We are also seeing interestingly and I don't want to spend too much time there, interestingly we are seeing some trends in SOA architecture, which will impact custom application development. We are seeing enterprise consulting, which will impact customer application. We are seeing testing and automation, which will impact the testing revenues. So we are seeing multiple factors impacting the demand scenario and hopefully this quarter we would be with you doing a meet with you and we do intend to spend about a hour or two hours time in explaining to you from our perspective how we see this demand and what are the various 5 or 6 factors which are going to impact the demand and I think you will find that analysis quite interesting.

Joseph Foresi

Sure. And my second question is on the labor supply or the labor environment. Any comments on the availability account, may be how you see attrition shaping up, and on the wage front do you expect the '07 percentage increase in wages to be the same as '06?

Vineet Nayar

I think the first, is talent a limitation today? The answer is no. Will talent be a limitation tomorrow? The answer is yes. Fortunately for us, the IT services industry is spread so wide that there is first an absolute talent issue, and then #2 there is a talent issue between companies. So, I believe the talent will move away from smaller companies into bigger companies, as long as bigger companies offer the same compensation environment and growth and I believe that the new talent will move towards bigger companies. So the pressure on talent you would see moving up from smaller companies into bigger companies and therefore, I believe we are still a few years away when the talent crunch is going to come, but it is definitely going to come. #2 the pressure on compensation will continue. It really depends upon how we address it. I believe it will be a factor of compensation plus a lot of other things which we will have to bring on the table. For example, HCL focused on monthly compensation, rather than an annual compensation and converted a substantial amount of engineer's compensation into monthly compensation, so that the take home salary on a monthly basis is larger than industry average, and that resulted in people at HCL, fresh engineer, looking at monthly compensation and comparing and when they wanted to move out they started trying to get more monthly compensation. It didn't fit into some of the other IT people where 15-30% was variable compensation to be paid on annual end. So strategy is like this, giving better training environment, better career path, those things I think are going to be playing a major role.

In 2007, will our compensation be higher than 2006? I don't have an answer for you right now because we have not thought that through, but early indicators are I do not think there will be a substantial difference, because compensation is not an answer to the problems which we are facing.

Joseph Foresi

And my last question here is just on the BPO front. I was just wondering if you guys can comment a little bit on the trends you are seeing in that business. Are you focusing on any particular growth areas and do you expect margins and attrition rates to stand up? Also is that a single process or you are seeing multi-processes on that side? Thanks for taking my question.

Ranjit Narasimhan

In BPO, we are seeing a continuous increase in the realization which we get. We are moving up the value chain. We are moving from voice-based services to transaction-based services and then later on to knowledge-based services. We do not foresee a significant increase in attrition rate. We expect it remain stable during 2007.

Moderator

Thank you very much sir. The next question comes from the line of Mr. Anthony Miller of Arete Research.

Anthony Miller

Yes, thanks very much. I have got a few questions, could you help me please. One is a clarification; because the line wasn't so good I couldn't get the numbers down for how the margins, the margin difference might have, how that net plus 30 basis points comes from? I had written there on high utilization gave plus 120, price realization gave plus 240, foreign exchange was minus 150, and it sounded like SG&A and the rest was minus 90. Can you just run through the numbers, because I cannot get the add up to 30. Sorry, can I just run through the full and then you decide which one to answer.

Shiv Nadar

Please go on.

Anthony Miller

Okay, the second one was, I would like some more clarification, although you answer twice, on Enterprise Application Services, because I didn't exactly understand what you were saying. You seem to be implying that because you had 2 or 3 good quarters that's why it is not so good now. Then in your performance in enterprise has been very lumpy whereas others has been pretty good. So I would like some clarifications on that please.

Finally, on the attrition, you mentioned many times the compensation wasn't the answer to attrition, but I am keen to understand what ideas you may have as to what the answer will be and if you could just elaborate a little bit on whether you are seeing any different trends between voluntary attrition and involuntary attrition? Sorry that is so much but thank you for bearing with me.

Anil Chanana

Let me explain that EBIT margin expansion by 30 basis points. The higher utilization, which was in core software, onsite 3% and offshore 1.5%. In BPO India, there was a higher utilization of 5%. This all lead to an increase by 120 basis points on the EBIT margin. The increase in realizations per man month basis led to a 140 basis points increase in the EBIT margin. The negative factors, rupee the exchange put together 150 basis points, and the other factors like SG&A, higher depreciation, put together 90 basis points negative. So that gives us 30 basis points positive. Does that answer your question about EDIT margin?

Shiv Nadar

One more thing we can do is we can just mail this to everybody and fax it to everybody.

Vineet Nayar

Let me just try and address you know the second and third question. I am just computing the EAS, let me talk about the attrition. My comment on attrition is the compensation does have to be increased. It is not the only answer. So the point is that would increase in compensation, I do know that there is an industry trend in increasing compensation. Is that the only answer? I believe, no, that is not the only answer. Would we have to increase compensation? Yes, marginally. But I do not believe that will address the attrition issue and attrition will come down, and therefore you need to do a lot more. This call is too short but if you come down to our office sometime I will show you what employees first and customer second philosophy at HCL really means, and because of which how we have been able to reduce the attrition for key employees as I say, about 5000 of the employees are very key, which are project leaders and above, and how we have been radically drop their attrition and retain them and help them participate in what we call the vision ‘2010 Plan’.

The voluntary versus involuntary is an interesting conversation we are having, predominantly because we are increasingly finding that unless the quality is good there is no point of hiring the engineer, because it is not about billing but in our high growth industry it is very important that each should be able to contribute and become a project leader and project manager faster and faster than his colleague did may be 2 or 3 years ago, and therefore the quality is very very important. If you are hiring at such very large numbers, it is impossible for you to do quality hiring all the time and therefore what happens during training is very very important, and at times people do find that this is not the career they want to pursue, they are not able to cope with the technology demands, especially the technology development services, and therefore the involuntary attrition which happens in the first 6 months of a fresh engineer joining contributes to the involuntary attrition. As a philosophy we are not a hire-and-fire company and therefore the involuntary attrition is not coming from that. At the same time we have a very transparent appraisal system where anybody who is below expectation is expected to leave the company, predominantly because there is no salary increase, there is no promotion, there is no new project, and there is an automatic exit which happens within 6 months of it getting that rating. So we lose 98% of the people who get below expectation rating within 6 months of their getting that rating, so that is what really happens on the involuntary attrition.

If you go into the lumpiness of the packaged application, it is an interesting comment. What we really said was packaged application division at HCL was not performing to our expectations, and we undertook a radical change in leadership in January, so the current leadership of the Enterprise Application team was changed and we brought in a new leadership. The leadership team came from outside HCL within the industry, so we had the new head of Oracle practice, new head of SAP practice, new head of Microsoft practice, and new head of the entire Enterprise Consulting practice, and these 3 people combined took over in JFM. So in April-May-June you saw a 7.2% quarter-on-quarter increase over JFM. In July-August-September you saw at 22% quarter-on-quarter increase over AMJ. And in OND we have been flat on 2% because some projects have been moved from onsite to offshore. But the long-time view of this practice is that it continues to be a practice on which we believe a high growth will depend and that is what you are going to see in the coming quarters. I hope we have answered all the three questions.

Moderator

Mr. Anthony Miller? Thank you very much sir. The next question comes from the line of Mr. Shekar Singh of ICICI Securities.

Shekar Singh

Hello sir. Congratulations on a good set of numbers. Sir, while we continue to bother about the wage inflation and the attrition and all those things, but somehow it seems as if like we are at an inflection point where possibly rising billing rates should not just make up for the salary increase but can also lead to some amount of margin expansion. Do you have any views on that?

Vineet Nayar

I believe there are three factors, so let me try and tell you how we think about it. We think that the positive factors which should impact bill rates are bill rate increase, selling new services to existing customer at higher margins, selling new services to new customers in a packaged way where transformation gains come to you resulting into higher billing rates for yourself, selling new models like output based pricing, revenue gain, gain share, device based pricing, so that you can make higher margins. These are some of the strategies for what I call positive contribution to bill rates or gross margins.

The negative contributions are (a) compensation, where is it headed. #2 the amount of investment you have to make on training, so if you go down and hire science graduates for example, you would have to spend longer and more money on training and they will be on your P&L for longer without billing, so that is the second negative contributor to margin. Third is the amount of investments you will have to make to get projects where fresh engineers can be deployed, especially when you are focused towards higher and higher value curve. The fourth contributor is the SG&A, as the markets become more and more competitive these services become more commoditized, so application CMM level 5 anybody can deliver, I think there would atleast 20-30 companies in India who can deliver you CMM level 5 application development. So with commoditization happening you have to win orders, therefore SG&A spend has to be there. You have to built relationships so that you sustain that relationship with the customer and sell him more and protect vendor consolidation kind of strategies coming in, so SG&A has to be spent in.

So as of now and you know this view will change as we move forward, our objective is to try and make the positive more than the negative, but the early signs are that we are able to balance both of them, and there are early days for margin improvement and there are early days for the way the whole compensation and the whole scarcity of man power and the way the amount of SG&A spent will roll out. So therefore our longer-term view right now based on what we have on the ground is we will be able to match the positives with the negatives.

Shekar Singh

Okay sir, second is regarding some of the large deals, since you have mentioned that any ways after the ramp up and these accounting for 10% of your revenues, you are getting a higher percentage margins from these deals. Doesn't that look like a positive point, that is like the knowledge transfer phase and the initial cost period is already behind us?

Vineet Nayar

You are right in saying that it is a positive point, however, again I will tell you that there is commodity business which HCL does which comes under threat on margins, and there is new value services which we would like to big deals which make up the margins which we lose there. So the business manager's role in IT services is always to make balances, and at HCL what we have focused on and actually you hit the nail on the head, if you continue doing the same services in a commoditization fashion there is a limit to which you can drive the efficiency improvement. So after the efficiency improvement these factors what you are talking about will start hitting your P&L, and our objective of Blue Ocean strategy of creating uncontested market space, focusing value, is to have enough values services which will make good, the losses which we obviously will face on more and more services will become commodity, and we are hoping that we will be able to match the positives with the negatives or hopefully increase the positive more than negative, but right now all we are willing to say is the positives and negatives will match.

Shekar Singh

Okay sir, lastly like one small question to the CFO. Just wanted to know like what are the adjustments you have made to arrive at the conclusion that the effective tax rate is more or less flat?

Anil Chanana

If you take the EBIT and add the other income and then compute the provision for tax on that one, you will get 8.18, so the numbers will be for this quarter, which is October to December, will be 62.3, on which the tax is 4.7, so it is about 8%, and if you take the July to September quarter, the profit number will come to 59.1, and 4.8 was the tax, so 8.1, so it is in the same range.

Shekar Singh

Okay sir, thank a lot sir.

Moderator

Thank you very much Sir. The next question comes from the line of Mr. Sourav of Kotak Securities.

Dipen

This is Dipen here. I want to understand what would be the steady tax rate which we should assume for the coming quarters, the next 3 or 4 quarters? The questions for the CFO please.

Anil Chanana

You should be assuming between 8 to 10%.

Dipen

For the coming quarters? Okay. Thank you.

Moderator

Thank you very much sir.

Vineet Nayar

We will take the last question.

Moderator

Sure sir. The last question comes from the line of Ms. Divya Nagarajan of Motilal Oswal.

Divya Nagarajan

Hi, my question relates to the full year numbers of software gross additions or to say you had spoken about 8000 to 10,000 for the full year. Does this number still stand or is there any change in that please?

Vineet Nayar

I am sorry. I did not hear your question.

Divya Nagarajan

The total gross additions that you have planned for the full year were earlier at 8000 to 10,000, considering that you have done over half of that in the first half this year, do you plan any upward revision in the same?

Vineet Nayar

We will come back to you. We do not have a ready answer to you right now. But we will do the computation and Vikas or Samrath will reach out to you and give you this answer.

Divya Nagarajan

Alright. My second question is related to your revenue across verticals, while BFSI, life sciences, and media and publishing have done well this quarter, some of the other ones especially hi-tech, telecom, which is hi-tech manufacturing, telecom which has grown strongly for other players, has not performed so well this quarter. Can you explain this phenomenon and how do you see these sectors performing going forward please?

Vineet Nayar

Our strategy is to focus on growth, so obviously when something is growing faster than others you notice that. I believe you will see when we come back into next quarter, you will see hi-tech back. I think there are different orders in different cycle drive quarter-on-quarter growth. The real test o f this will be when we come back to you with the annual numbers. You will see the micro-verticals which we have focused on to be driving growth. All I can share with you right now is we are not seeing anything in any vertical which leads us to believe that there is a negative in those verticals.

Divya Nagarajan

If you could you comment on IT spending that you are seeing with your customers. We have heard from other players that IT spending from customer likely to go up by 1% to 2% bias upwards. What is your experience in that area?

Vineet Nayar

My experience is IT intensity as a percentage of revenue is going down, so people want to spend less percentage of IT compared to revenue than they wanted to do last year. That is by making their IT more efficient. I am not aware of people wanting to spend more IT as their revenue, however, having said that what is ramping is people's revenue is increasing and therefore IT spending is increasing. At the same time they are rationalizing their budgets and moving away from expensive vendors into value vendors like us to provide better value for the same dollars, so that is what we are seeing, and all our customers are very focused on what is the IT spend as a percentage of their revenue and they want to only reduce that.

Divya Nagarajan

Right, that is very helpful. Thanks and all the best.

Moderator

Thank you very much mam.

Shiv Nadar

Thank you, and with this we will now close the conference. On behalf of HCL this is Shiv Nadar returning you to the moderator. Thank you and have a very good evening.

Moderator

Ladies and Gentlemen, thank you for choose WebEx conferencing service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines.

NOTE:

1. Blanks in the transcripts represent inaudible or incomprehensible words.