"HCL Earnings Q3 FY14 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the HCL Technologies Earnings Conference Call. As a reminder, all participants' lines will be in a listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Anant Gupta. Thank you. And over to you, sir.

Anant Gupta: Good day to all of you, and welcome to the 3rd Quarter Earnings Presentation. Another good robust quarter of performance broad-based across the board.

Our revenues for the last 12 months closing March '14 grew by 14% Year-on-Year to close at about $5180 million which is roughly a 16% CAGR over three years. Our EBIT grew by 38% Y-o-Y to a little over $1.2 billion. Net income grew by 40% to touch $943 million three year CAGR of 43%, and Return on Equity grew from 31% last year to 34% for the 12 month closing March.

This growth has really come in from broadly if you look at it from a service line perspective: Infrastructure Services continued to punch in a little more than 5% sequential growth at 37.9% LTM growth of March 2014 to March 2013 12 months. Application Services grew by 2.9% this quarter on back of a 2.1% growth in the previous quarter coming in both from Enterprise Application Services as well as Custom Application Services. Business Services largely flat on top of a very strong performance in the previous quarter of a little over 13% pretty much in line with expectation and flat in terms of a very strong growth in the previous quarter.

From a vertical standpoint, our momentum verticals of Financial Services continue to contribute to significant growth in this quarter as well. So 6.8% growth on top of 20.3% on an LTM basis. Public Services which includes Public Sector, Energy, Oil Utility and Gas industry continues to do well and the Travel, Tourism and Logistics really part of that. I think we got significant wins in the Utility segment as well as the Public Sector in that specific area contributing to about 13.9% growth sequentially.

From a geography perspective, growth kicking in largely continuing from Europe 4.8% sequentially, about 24.8% on a Y-o-Y LTM basis. ROW kicking in at 11.1% largely driven by some lumpy System Integration work in the region. America is largely flattish on top of 13.5% growth on a Year-on-Year basis.

Looking at some of the performance trends over the period of the last 10 quarters – it continues to be the 10th straight quarter of both revenue expansion and net margin expansion. So if you look at consistent performance over the period in revenue terms, pretty much 3%, north of 3% in all the quarters in that period. If you look at net margins consistently growing up from 14.2% all the way to 19.4%, so it continues to be really an outcome of consistent performance and execution of our strategies in various areas which we have articulated earlier. I will touch upon them and the relevance to them in the currently changing dynamics which we see in the marketplace.

If you look at the marketplace, the way we have looked at the market triggers and the way we have responded, some of these we have already talked about in the previous quarter as well. Enterprise of the Future (EOF) in terms of our response to the strong rebid market. So when we looked at 2009 we kind of foresaw that we will come into a period of strong rebid market between the 2009 to 2011 era we have seen about $200 billion of contract getting renewed. If you look at the next three years we believe another $128 billion will get renewed, and these are from some external sources, and our response to that specific market trigger is really our proposition around Enterprise of the Future which is the next-generation IT Infrastructure to manage hybrid IT landscape, especially if you look at the emergence of Cloud and infrastructure-as-a-service how will this new ecosystem of suppliers working and delivering comprehensive IT Management Strategy, and center to that piece something which we already talked about is the MyCloud Architecture which is the service orchestration and aggregation layer from HCL.

The second wave which we saw really was the 2013 wave where we kind of started seeing the as-a-service business models come into play whether software-as-a-service, infrastructure-as-a-service or platform-as-a-service, and really our response to those two triggers were generation-2 sourcing model around ASM, which is the ALT ASM proposition, and the second one around the front to back end-to-end and the integration of technology and operations in the BPO space with EFAS and some very strong wins in the previous quarters that we have announced. So this is what we believe should be our foray and to continue to be our foray in the as-a-service wave as we see. Of course, it will continue to evolve as the market play and the landscape continues to change.

Earlier this year, we looked at and we repositioned and we repackaged what we saw as our response to the digitalization wave in the marketplace by the launch of the digital system integration or Digital SI space where we see really it to be a three-pronged strategy. On one side it is enhancing customer experience using technologies around Mobility, Cloud and some of the other disruptive technologies, but at the core enabling corporations to kind of what the journey of digitalizing themselves by actually migrating legacy to cloud or new app modernization at the foundation level itself. So this is the way we are trying to address our market strategy, and you will hear commentary on progress on each one of these from respective business leaders as this is really the centerpiece of the way we see our service going forward.

With this I will hand it over to Steve Cardell who will walk us through both Enterprise Services and the Diversified Industries.

Steve Cardell: Thanks Anant. Let me just come through Enterprise Services first: We had a strong quarter this quarter at 4% Q-o-Q growth and really the story very similar to what we discussed in the past that we have seen momentum coming into this quarter. So to take the divergency between the

Americas marketplace and Europe it also outlines the shift in the market. From Americas we have continued to see a good response to our BSI proposition and the elements that sit on the new SAP including SaaS new wins for us in the marketplace Big Data and Analytics wins and Mobility wins. In Americas we continue to see growth in the disruptive technologies, and in Europe we continue to see the sort of larger consolidation and roll out projects. And that really reflected two main growth drivers from a discretionary spend standpoint of view in the Enterprise Applications marketplace.

If you look at our growth drivers really we have seen progress because we are aligning into two segments. Firstly, we are aligning to the emerging players in the market who bring the disruptive technologies to the likes of Salesforce and Ceridian and Cornerstone. And secondly, we are aligning to the SMAC strategies of the existing players. So SAP and Cloud, Oracle Fusion and the Microsoft end-to-end Cloud approach. So in this quarter HCL was awarded the SAP partner of the year for the manage cloud offerings. So we are SAP largest provider in the Cloud space which indicates the success of our alignment there.

IDC ranked HCL as a leader in the Mobility marketplace putting us ahead of all of the competition by Accenture, and again that demonstrates the progress being made on the disruptive technologies that we have got. And more broadly, the BSI strategy that Anant referred to is picking up very strong momentum in the marketplace pulling in both early wins and building pipelines strongly for the next few quarters. Overall, the EAS strategy continues to perform as we would expect it to, and we look forward to what lies ahead there.

If I then move on to the diversified industries, say Consumer Services, Manufacturing and Public Services, firstly, the profile of the industry also continues on the same trend. So Retail and Manufacturing hotline territories for us, we continue to see growth in line with the marketplace. Manufacturing particularly we are seeing a resurgent America and a strong growth in Central Europe, last 12 month revenue at 18.7%. So Retail and Manufacturing continues to be strong for us. Public Services we outlined two quarters ago being a momentum growth for us emerging in some areas, particularly in the Oil & Gas, Utilities market, so 38.9%, 12-month growth, 14% growth in the quarter continues to be very strong growth vertical for us. And then the laggard Telco, Media & Publishing particularly driven by the huge cost reductions going on in the Publishing industry as it becomes subject to competition to digitalization.

In terms of awards, HCL was named customer experience leader by Consumer Goods Technology, again an accolade for the strength we have seen in that vertical Consumer Services, and across the board particularly in core verticals of Retail and Manufacturing, the ALT ASM™ proposition that we launched some five quarters ago really driving new wins for us and ensuring that our yields in that marketplace are very strong. And then finally the iMRO solution that we have had for two years now, that is a differentiated offering for Enterprise Asset Management. We extended that solution with a new release for complex assets, particularly things like commissioning and decommissioning in nuclear plants and oil rigs and that is driving some of the momentum for us in the Public Services growth that we see there. So with that let me pass over to Rahul.

Rahul Singh: Thanks, Steve. I will first talk about Financial Services and then I will talk about the BPO. Financial Services we had a good quarter. Our Quarter-on-Quarter revenues was up by 6.8% to aggregate $365.8 million on a reported currency basis. Also, on a Year-on-Year basis and LTM basis we have notched upwards of 20% in both. Our momentum has been largely driven by ramps in the new wins that we have executed in the past, and as you look at the future we have a good pipeline across geos and across service lines.

In terms of the demand environment, Financial Services performance continue to be challenged on cost, and that is leading them to vendor consolidation and application consolidation, and we are trying to position ourselves in both those areas from vendor consolidation perspective as well as some apps consolidation. Obviously, we need to be different; our differentiation is being driven by more transformation program and by creating productive propositions which can attract a niche market.

We are looking at growth in the regions both in US and in Central Europe. And Central Europe region is led more by growth in terms of cost reduction while in UK we are seeing an increase of discretionary spend coming in as well, especially in areas around Omni-channel, customer centricity and apps modernization.

From the point of view of recognition and value proposition we have been mentioned as a leader in the Forrester Wave. And our recent partnership of HCL-CSC has also been mentioned in IDC. That partnership does focus in particular to the Financial Services sector and we hope to leverage that going forward.

If I look at the BPO, the BPO had a muted quarter; there was a slight degrowth. But this is on the back of a very strong quarter in OND where the BPO business grew by about 13.7%. So if I take an average across the two quarters, about 6% growth per quarter. The revenue is again being driven by ramps on wins from the past, and our pipeline for the future is around two areas: One is as Anant mentioned, Enterprise of the Future is around EFAS which is Enterprise Function as a Service, where we are offering services to clients by bundling in business process along with IT as well as some focus on verticals especially in the Banking and Insurance area. As you look at the market the demand environment continues to be for more transformational BPO, which focuses on higher skills, more flexibility, and certain business outcomes which the clients are looking for at this point of time. We have seen growth in Financial Services and we have also seen growth in some businesses around procurement, finance and accounts.

In terms of our focus areas that mentioned earlier, we continue to focus on what we call is next-generation BPO Services which focuses on higher domain, innovation and an outcome-driven business model. We are continuously seeing recognition coming from multiple industry analysts including ISD which is now rated as a leader in January 2014 and across Nelson Hall we had case studies around banking transformation. With that I will hand over to Srikrishna.

R. Srikrishna: I will first talk on Infrastructure Services where we had another strong quarter of sequential 5% growth and almost 38% LTM growth. This business now contributes 34.4% of the company's revenue. While rebid market continues to be the most important contributor for demand what we are seeing in the horizon is software-defined data centers and transformation by software data and defined data centers will begin to become the focus over the next few quarters. We had multiple mid-size wins this quarter, but the quarter was landmarked by two large mega deals, both in Europe which will yield revenues in quarters going ahead. We continue to see a strong win rate and strong success in the rebid market. We continue to get recognized as leaders in this service by all major consultants.

From a Life Sciences and Healthcare perspective, we had a flat performance this quarter essentially, and this flat performance was driven essentially by a single large project winding down which was there last quarter too. We still have the customer, it is one program that is winding down that caused the flat performance, but that impact will go away from this quarter, and the LTM growth is still reasonably strong at 9.4-9.5% demonstrating a strong underlying performance.

Pharma – we are continuing to see lumpy opportunities because of patent cliff issues, and in the healthcare industry however what is expected is new customers enrolling into insurance still lag initial projections quite a bit. There are as many as 30 million new patients expected is more like 6 right now. So there is some pause on discretionary spending there.

We did win one major European deal. It is an integrated deal for Infrastructure Application Services. There are two other logos aside from that win at this point.

There were a few recognitions. The most important one was that we were rated a leader in ITO and Life Sciences by Everest Consulting in their most recent market report. With that I am going to hand back to Anant Gupta.

Anant Gupta: In line with our objective of giving a little more granular visibility on our service lines and the performance and commentary on the market, we thought of having a separate and additional section on Engineering Services. We are joined with Sandeep Kishore who heads the Sales and Business Development for Engineering and R&D services and he will walk us through that session. It is 16% of our business, so a very relevant piece, a very unique element, and therefore we thought it would be good to introduce this in a little bit more depth to all of you. Sandeep, over to you.

Sandeep Kishore: Thank you, Anant, and good afternoon everyone. The Q3 performance for Engineering and R&D Services, we were at 7.8% from a yearly growth perspective; $290.4 million is what we delivered. We continue to see strong performances both in the traditional area of strength for Engineering Services which is around full system development as well as the new areas of engagement which we are seeing as an increasing trend of engagement across industries and across the customer set.

Some of the critical wins which we had in the last quarter across the Automotive segment was around the M2M platform development for new telematic systems, for industrial customers leveraging our internet of things framework. For the embedded software platform development we are seeing continuously strong engagement in the Mobility and Cloud area from performance and test engineering perspective.

The demand environment continues to be strong and we are seeing the engagements moving from traditional piecemeal to full system development, which includes the hardware, the software, mechanical, thermal, complete systems which the customers are chasing from a time-to-market global launch of their products.

The other trend we are seeing is the software centricity of the product itself across industry. Software being the critical driver for both innovation as well as differentiation in user experience across industries which our customers are driving. It is just no longer being in the business of products, most of the trends which we are seeing now are becoming increasingly aligned to service monetization and hence the shift from product to product plus services. Platform Engineering across the board is coming out as a major trend which allows companies across the board to onboard newer services which they can provide to their customers. Growth drivers from our perspective in addition to being the traditional strength area for the hardware and software mechanical engineering is around the IoT, the M2M, the software-defined networking and core analytics which is playing a more pervasive role across the industry segments today.

US continues to be strong if you are tracking the Manufacturing PMI index, the last 10 consecutive months of expansion in manufacturing activity, that is the bedrock of the Engineering Services which we provide to our customers across manufacturing segment. Europe and Japan for us is traditionally been in the 1.0 outsourcing. We are just seeing some very early signs of bigger transactions and bigger deals coming up in Europe and Japan, but US remains the bedrock and the main growth driver for us.

We were recognized by Forrester as the leader in the Forrester Wave, and we are the only IOP in that category, which Forrester very recently announced here. We have also continued to focus strongly on the innovation, because that is a critical element on the engagements with the customer, and keeping in line with our focus on aligning with new technologies and disruptive areas. This current fiscal we have actually filed 19 patents for HCL taking the total patents to be at about 130. With that I will hand it to Anil.

Anil Chanana: Good day, everyone. I think it has been a fantastic quarter as Anant started explaining 3% Quarter-on-Quarter growth, 14.3% if you look at quarterly Y-o-Y, and at net income level 9.4% Quarter-on-Quarter, and 40% Year-on-Year. This was the tenth straight quarter of margin expansion. If I take this period as a year and say that what we have grown, we have grown

14.1% in US dollar terms Year-on-Year and we have grown 40% in dollar terms on the net income side. So 14.1% revenue growth, 40% net income growth, I think this is one of the best of the results which have got announced so far.

If you look at the return-on-equity it improved from 31% that it used to be one year back to 34%. And our earnings per share are up by 59%. If I look at the rupee numbers, they are more interesting because here the revenue growth is 27%. If I take the March 2014 as a full year and net income growth of 54%.

Then I take you to the slide which talks about how our revenues and basically the margin walk. We had a positive impact on account of currencies of only 10 basis points. Euro went up but GBP aided by 22 basis points and Australian dollar sort of took away 12 basis points. So the net-net was only 10 basis points. So from 2.9 which is a constant currency we reported 3%. In terms of margin it was a very interesting quarter. We had two head winds: One was the wage which we had alluded earlier. So it came to 34 basis points and the exchange you would have seen the movement in the average rate going down by 80 basis points which sort of impacted our margins by 60 basis points. So 16% basis points, the exchange impact at 34 basis impact, the wage impact was more than neutralized by the efficiencies happening on the direct cost side, on the G&A side, and on the depreciation and amortization side. The business efficiencies of 82 basis points kicked in this quarter. This is the change in the revenue mix which is happening that a lot of infra engagements which are entering into the steady state. The ALT ASM™ engagement in the software side with higher offshoring, and then the facility consolidation program which we are running where we have already consolidated something like 11 facilities and sort of given up something like 6000 seats, and consolidated them into our campuses, and removed some of the inefficiencies which were there while they were small.

We also sort of hosted the US GAAP results, and you would have seen our margins on business line wise, and the software has moved up by 30 basis points this quarter. So the software margin is at 25.6. The major benefit came in the Infrastructure side where the EBIT margins moved up from 23.5 to 25.4. Now the infrastructure is equal to the software in terms of EBIT margins. The BPO was below from 6, it came down to 5.3.

In terms of the G&A optimization, I just wanted to add basically we spend in the establishment side and the seat consolidation, which is helping us on the G&A side, there is no softness from our side so far as the spend on sales & marketing is concerned. We continue to sort of a spend and put our pedal there. In fact, we are ahead when we track with acceptances over budget on the sales and marketing side. There is a very marginal increase in the utilization from 84.1% to 84.2%. So it is within the range from 82% to 85%.

Since we are on margin I would also like to highlight that our business model is not very highly sensitive to the USD/INR movement. So, for every 1% change we get impacted by basis, our current cost structure at 23 basis points, last quarter it was 21, this quarter it went up to 23 basis points because you would have seen the offshoring and all those sort of things also things also kicking in.

Moving on to the receivables – this quarter were at 82 days; we are in the range of 77 to 84 days in which they normally are. This quarter about a half day was impacted because of the strengthening of the INR and Australian dollar in particular. Certain big lumpy collections of about close to 80 million got pushed into 4-5 days of April month. Currently, there are a lot of SOWs because this is the first quarter of the financial year, and the customers issue the SOWs once again, basically to as part of their payment system, and there was a delay in getting those and then raising invoices. So it sort of impacted the receivables slightly. So, these couple of factors which were responsible, but this is very much within the range.

Now, I take you to the profit to cash conversion on LTM basis. The operating cash flow to net income 111% on LTM basis same as this was last year, free cash flow to EBITDA much higher than last year from 61% to 73% it has moved.

If you could see that the cash position has improved significantly from 1050 million last quarter to 1250 million. Also, you would have seen there is a bank line of credit which from last quarter was 27 million, has moved to 57 million. I have been asked by an analyst why you are borrowing when you have cash in hand. This is basically availed at the end of the quarter when the collections are still coming in. So, this is more of a bridge arrangement and we do also a lot of cash pooling with the banks.

So moving on, in terms of the CAPEX spend this quarter was 59 million, what you see on the cash outflow is 43 million. So it has elements which are very clearly articulated in the PPT. Funded out of extended vendor credit is 46 million, funded out of internal accrual is 13 million, so total is 59 million. There are acceptances which are getting paid because of the extended vendor credit and the net-net cash outflow is 43 million which is out of internal accruals and on account of acceptances, totaling to 43 million. If I look at it for the first nine months the CAPEX spend as a percentage of revenue is 3.4%. So, we will be in the range between 3-4% so far as CAPEX is concerned. So far as supplier's credit is concerned, it is at 202 million, and you will find that in the liability side of the balance sheet.

In terms of hedges – we had slightly above a billion dollar of hedges; cover us to the extent of 40% of our annual inflows. This is in line with the layered hedging policy we have. The booking rates and the M2M rates, etc., are all depicted on the slide and are also there in the detail financials we have hosted there on the website.

If you look at the FOREX this quarter, loss was 23.3 million. When we had presented December numbers we had said that the cash flow hedge loss will be 17.5 million, it turned out to be 18.5 million because of the significant movement in the currency because the rupee in the first month had actually depreciated and then from February onwards started appreciating, so that mid-quarter movement in fact led to this increase. On the other side, it was 4.8 in terms of mark-to-market hedges. So total was 23.3 million.

If you look at the OCI position, if we take in the next 12 months it will be 33 million and in the period beyond 12 months it will be again (-30) million, so totaling to 62 million, assuming that we apply the mark-to-market rate and then take the premiums into account and put in time value of money. However, if you just take the March end rate which was 59.90, it will be (+14.9) million. For the next quarter we estimate the negative to be 10.9 million, but this is using the 59.90 the quarter end rate.

So far as our tax provisions is concerned, this quarter it was 20.9%, so far our effective tax rate is concerned, we continue to estimate it will be between 21-22%, in fact our first cut estimate even for the next year and year thereafter and it continues to be 21-22% we think we will be able to maintain that rate, and we will continue to true it up as we go forward.

With this back to the operator.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from Nitin Mohta of Macquarie. Please go ahead.

Nitin Mohta: My question was on margins. Great job there. If I look at the commentary from last two years, we have gone from 14% target band to about 20-21% that Anant talked about on the last earnings call. While you mentioned that the model is less sensitive to USD/INR movement, what should we take as a stable margin profile for the company, assuming currency remains in a tight (+/-3%) band? Would you be closer to 21% number or you would want to take this opportunity to raise the comfort band higher to say 23%?

Anil Chanana: I think we will stay put with that 20-21% band, and the reasoning being that initiatives like DSI which we have announced and we would like to invest and we would like to further sharpen our offering, and sort of create offering which are relevant for the marketplace. So, these investments will happen over a period of time. The movement is not going to be a sudden like 1 or 2 quarters, it will be a slow unless and until a very big sort of a deal come then which sort of causes a disruption in the margins, in the medium term I think 20-21% is a comfortable range.

Anant Gupta: Just to add to that…historically, we have always talked about the ratio of large deals coming in a quarter and the number of deals going into steady state. So for a while we have reached a very strong equilibrium between these two, but there could be situations where we enter into very large engagements which may cause a certain dip in our specific quarters as well as the lifecycle of such large engagements, but to the point we would be comfortable in 20-21% range.

Nitin Mohta: On the demand side, very strong show in the Financial Services. Also, some of your international peers have talked about BFSI expected to do well in this CY14. So just any broad comments on that? And discretionary spend in general either you are seeing it accelerating or status quo?

Anant Gupta: Let me just pass this on to Rahul and he can respond on the Financial Services and maybe he responds on the discretionary more coming in through the DSI story would be a better approach in my view. I think Steve can allude too.

Rahul Singh: As I mentioned our growth has come on the back of primarily focusing on areas where the clients kind of have issues; the first is obviously, around cost. So Financial Services firms across the board are looking at cost in a dramatically different manner these days and that is driving them to platform consolidation as well as vendor consolidation. So long as our proposition tend to focus on cutting cost for example are ALT ASM™ proposal, focuses on cutting the maintenance cost for large enterprises, and Anant spoke about DSI, which focuses on platform transformation on a longer-term basis. So, so long as the propositions are focusing on the needs for the customer I think we should be okay. We had a good year this year; 20% growth rate, but that is on the back of another 20% growth rate we had previous year as well. So, the momentum shows that the clients that we are focusing on and the strategy that we are following is bearing fruit. Another important point to note is that in Financial Services we are now selling a good cross-section of service lines. So, we have Infrastructure Services which are doing well, we have got BPO Services doing well in Financial Services, so that is also adding to the top line growth being at a constant 20-22% level on a Year-on-Year basis. With that I will hand over to Steve to talk about DSI as well.

Steve Cardell: I think the only comment I would make on DSIs is firstly, yes, we are seeing discretionary spend come back in the marketplace; it is primarily to do with technology that has a high customer engagement. So, the CRM 2.0, the Mobility, anything has a high UI engagement component to it is where we are seeing money come back. The one trend though is that the budgets for this are not necessarily coming to IT. So, what we are seeing is a return to the business spending on new technologies. And so, our competition for that discretionary spend is typically not the traditional players we come up against, but many of the sort of new and niche players who are setting their stall out in the disruptive technology there. So, yes, the spend is coming back, but is not necessarily with the same budget holders who we think selling to in the past, and that is why part of the DSI proposition is targeting a broader base of business stakeholders rather than just the IT function.

Nitin Mohta: A follow-on to that, interesting point you touched about competing against new companies. How exactly does the value proposition and cost angle play over there, because clearly those startup guys would have a much lower overhead costs associated, and does that really put you and some of the established IT companies at a disadvantage?

Steve Cardell: So all I was going to say is that actually the cost position is less relevant and in fact more niche players have almost entirely local based delivery which means from a price point of view that is not a concern for us. The decision-making on procuring services tends to be more around capability and alignment to some of the more emerging software companies. So, I think the process of the sale is quite different to some of traditional services but I do not see cost is being a concern for firms like us.

Moderator: Thank you. The next question is from Pankaj Kapoor of Standard Chartered Securities. Please go ahead.

Pankaj Kapoor: Sir, just a couple of questions on the order booking for the quarter. This has been stabilizing at about $1 billion per quarter for I think 5, 6 quarters now. So I was just wondering, is it a reflection of us becoming more selective in the kind of deals that we are participating in, in which case maybe this run rate could stay same, but the profile could shift more from IMS to apps oriented deal, which I think you have referred to? Or do you think that this is more a reflective of the market realities and there could be acceleration of that, if you can give some sense on this, please?

Anant Gupta: In my view, it is a function of both. So, if you look at this specific quarter we kind of clocked in a little over a billion dollars over 12 transformational engagements, I think two of our strong propositions momentum which have been in the marketplace continue to drive significant booking there which is Infrastructure Management Services and ALT ASM™ which was launched pretty much about the same time last quarter. Early signs of traction of Digital SI and continuing EFAS and Engineering Services continues to drive the booking profile. I would say that it is a mixture of both; it is we continue to be selective, the rebid market is large, whether it is for $50 billion or ISG has up that number by another 14%. I think the fact is it is large and therefore we want to play in markets and in customer engagements where a) we are significant to them, b) we can deliver and execute to the transformation that is required, and thirdly, deliver the transformational value to them. So, we will continue to play selective in this marketplace. Deal sizes may go up, may go down, that is not the criteria which we are looking at, but the fact is it needs to be in one of the five proposition themes that we have outlaid for the company which is like I said around RTB it is ALT ASM™ and Infrastructure Management and EFAS, and around the discrete side it is Digital SI and Engineering Services.

Pankaj Kapoor: Anant, if I extend this just further, then does it mean that the run rate could continue to be around the ballpark number, but given that the profile of the deals is shifting, we should see some more stability coming in on the margins. Is that a fair assessment or you think that given the pipeline that you have currently, we may see some acceleration in the next few quarters, which is the reason why our guided band of 20-21% on the margin front?

Anant Gupta: I think the market is that whether it is going to happen next quarter or will happen towards the end of the year it is difficult to say. I would say the pipeline continues to be robust and from our perspective we are investing and making sure we are able to take the requisite market share in the markets we are applying. So, yes, it could accelerate, we do not know, but like I said the market is large enough… and in fact, the players in the market interestingly is fewer than what it was if you take a snapshot two years back. So, from that standpoint I would say that the global market players are lesser than what they used to be let us say two years back because of various reasons.

Pankaj Kapoor: Another just one small clarification… when we speak of this 20-21% of EBIT margin band, what kind of a currency level that you are factoring in?

Anil Chanana: This quarter it was 61.5 was the average, and I would say that (+/-5%) it can easily sort of sustain.

Moderator: Thank you. The next question is from Divya Nagarajan of UBS. Please go ahead.

Divya Nagarajan: Just a couple of questions. Your fixed price in Managed Services is now almost 56% of revenue. Where do you expect this to reach steady state over the next few years, could you give us a sense on that, please?

Anant Gupta: It is a difficult one, we have not got a number on that, I do not know.

Anil Chanana: We do not have a number in mind, but our focus is there…

Anant Gupta: The focus is there, I am saying it is something which has engrained into what we do. Let me put it this way… most of the rebid market that we bid in today is largely Managed Services or fixed price concept. I would say majority of the engagements in there would be coming in in that model. I would say the increased penetration is really around some of the discrete spending which we are seeing moving into more of fixed price, and that is where the needle needs to move up. So, it is around the DSI space and some of the Engineering Services space where we should see some slow uptick.

Divya Nagarajan: My next question is on the Infra Services business. We have had another quarter of about (+5%) growth. Last quarter I recall we have been used to a much higher quarterly run rate in that business. The last quarter, you had mentioned that the slowdown to about 5% was a function of some large projects basically having reached completion and we were expecting this to pick up into this quarter. How do I read this number? Is this a base effect catching up because 5% number is not a bad number per se, and therefore this is the kind of trajectory we should extrapolate for Infra going forward or do you expect to come back to 8-10% number that we had sometime last year?

Anant Gupta: Srikrishna respond to that.

R Srikrishna: First is 5% is still industry-leading growth. There is certainly some amount of base effect, we had a much larger business now; however, we would say that we signed two major deals apart from some mid-size ones this past quarter. So, the revenue for future does look strong and the pipeline also does look strong. I let you make your conclusions on whether it is going to grow up or not.

Divya Nagarajan: Could you give us some sense of the TCV of the deals that you won this quarter?

R Srikrishna: It is a subset of the billion, which is little over a billion, which is the overall number which Anant spoke about. It is a good portion of it.

Anant Gupta: Unfortunately, we do not disclose numbers by business lines, but what I would say is the booking pipeline in Infrastructure also continues to be very strong and with the increased acceleration as reported by ISG. We continue to be a lot more bullish on pure Infrastructure deals as well as integrated deals between Application and Infrastructure Services.

Moderator: Thank you. The next question is from Ravi Menon of Centrum Broking. Please go ahead.

Ravi Menon: One is around the number of seats that is being built up. I see that a lot of it is in NCR and there is some more in Chennai. Do we have a timeline of roughly when you expect this to come to steam, what SG&A improvement we can get from that?

Anil Chanana: So we go year-by-year; for this financial year which was FY14 we had taken a task of consolidating something like 14 facilities leading to savings of about 15 million p.a. when the full closure happens. So, I think we are on target; we have already achieved 11, some we need still because of the increased business which is coming in, so we are retaining probably….

Anant Gupta: Also, the construction of the new facilities and the campuses.

Anil Chanana: I think the new facilities, new seats will start coming in towards the latter part of this year and into the next year I would say.

Ravi Menon: I had seen that the attrition is a little bit higher maybe now. So would you rethink your policy of this rolling wage hikes or would you want to increase the margin impact for this year from the wage hikes?

Anant Gupta: My response in that would be…looking at the industry, looking at the changing dynamics of the industry, the skill requirements, we did take a view on this more than I would say six quarters back, that is the time when we introduced a lot of changes, and we introduced certain new hiring practices and compensation reward practices. I think they are all tracking very well, in fact, yes, the attrition is high, but it is lower than previous quarters. So, I think it is trending in the positive direction which we would like it to move to.

Moderator: Thank you. The next question is from Ashwin Mehta of Nomura. Please go ahead.

Ashwin Mehta: On core software, we have seen some consistency coming in with (+2%) sequential growth for the last two quarters after being weak for some time. Do you see signs of acceleration there? And within the three services, where would you see the scope for acceleration coming in in terms of Custom Apps Engineering or EAS?

Anant Gupta: I'll let Steve respond to that and Rahul because the behavior of different sub-elements will be different in both the Financial Services and the diversified industries, and maybe also Krish from our Life Sciences where we can spend a minute deep-diving into respective verticals.

Steve Cardell: I think the first thing to say is there was a portfolio answer to the question. So, I think as we alluded to in the call and we talked about I think two quarters ago you can take our industry vertical for macro vertical, and we see some of them are very strong growth for us, we see some of them are core and we see some of them are under intense pressure and we see the reduction in revenue. So, we see a vertical play but it is very different depending on which vertical we find ourselves in. And from a horizontal point of view, we have these progressive trends to do with continued cost reduction for consolidation and platform deployment and also the growth in disruptive technology and headwinds against that is the decline of the traditional ERP marketplace and the competitive pressure on the renewal marketplace where greater efficiency is expected to be found this time, project comes up for renewal. So, it is a portfolio answer because we have growth elements driving one thing and headwinds against the second. I think the point we have always made is that we believe HCL will grow its market share ahead of competitors and the two main things that are enabling us to do that ALT ASM™ has significantly increased our win rates in the renewal marketplace and we are seeing some momentum in the last couple of quarters, and our growth in the disruptive technologies is not leading, that remains a relatively small portion of the revenue base, as adoption grow for disruptive technologies we will see more headwinds in there. So, I think my summary would be we have strong momentum with those in this marketplace, and as demand materializes we will gain more of our fair share of that.

Rahul Singh: In the FS side there are essentially three drivers:

#1 is that we have been uptick in Europe and UK in Application Services for the clients which are based there.

#2 is that in the US we have seen some amount of discretionary spend come back, it is on the back of existing clients. So we have got a couple of large decisions out there, where we have seen some of the disruptive technologies which Steve just spoke about, that uptick happening in the US.

#3 is that we have seen in the market consistent vendor consolidation opportunities. So, when you look at proposals like the ALT ASM™ which focuses on improved spend management in terms of services, maintenance, etc., on the contract, we have seen some wins coming there as well. I think it is on the back of these three that we have seen Application Services showing good growth in the current quarter and for the full year.

R Srikrishna: From a Life Sciences and Healthcare perspective, the two different markets; Life Sciences, Pharma industry is clearly in a trend to consolidate to larger platforms and that will hence tend towards improvement in the EAS business and consolidation from the Custom Application towards the EAS business. Healthcare, which is a smaller sub-vertical for us, but faster growing is actually more on custom application. So really on the balance more on Enterprise Application Services rather than Custom.

Ashwin Mehta: In terms of wage inflation expectations given that you have performed well, do you think the wage inflation this time around could be higher than the single-digits that it has been in the past, any indications on that?

Anant Gupta: So, we are yet to complete our full year, and then get into the planning, we will obviously take a stock of that and do what is right for the business, reward the performance, and look at skills which are scarce, so we will reward for performance and skills.

Moderator: Thank you. Our next question is from Nitin Jain of Ambit Capital. Please go ahead.

Nitin Jain: A couple of questions; first, on your EBIT margin outlook. So is it a long-term target or you expect margins at these levels in the next couple of years, so what is your outlook on this?

Anil Chanana: So it is more of a medium term target. As I said, from where we are today, we are not going to sort of come to that level in one or two quarters, it will happen over a period of time, unless there are very-very large deals which comes into play in a quarter or in a couple of quarters. So, other than that the margin destruction will not be so fast. So, this investment will happen, and we are in the annual planning cycle, and base is that we will continue to invest. Even on the sales and marketing side, as I said, we are sort of tracking ahead against our budgets, because we are letting that investment happen, because it is important for us. So I would not say it like a long-term guidance, I would say more of a medium-term guidance.

Nitin Jain: On CAPEX, so historically it has been in 2% range, and this quarter it was more than 3%, and you expect it to remain in that level. So where are you doing this CAPEX? Is it related to some deals or it is more related to facilities?

Anil Chanana: It is more related to facilities, I would call it, and the CAPEX which you see in the cash flow statement, is after taking into account the effect of the vendor credit we avail off and the extended vendor credit we avail off, which has a complete disclosure in the US GAAP accounts. But, if you see from a perspective of the expenditure being incurred, I would call it is between 3-4%. Sanjay can walk you through the numbers separately.

Nitin Jain: Third on your ERP business, so how is it doing so, how is your partnership with CSC shaping up, out of 4.2% Q2 growth in Enterprise Application Services, how much can be attributed to this partnership?

Anant Gupta: So I would say EAS is doing well, but it is independent CSC is different, I think the CSC partnership is relatively new, I think we have set specific objectives from that partnership and it is progressing well, contribution from that into the revenues at this moment is negligible. The performance from Enterprise Application which I think Steve alluded to was more around some of the shifts on as-a-service business models, which that specific client business is seeing in the marketplace.

Moderator: We will take a next question from Sandeep Shah of CIMB. Please go ahead.

Sandeep Shah: A question to Anil. Just wanted to understand the headroom in terms of the facility consolidation, which will help you to gain, what is the headroom in terms of direct cost as well as in terms of G&A through the facility consolidation?

Anil Chanana: With this calculation, we had taken up this year, the task of consolidating some 14 facilities which we sort of made a determination both the direct cost, meaning the rental as well as the indirect cost associated there with, will be 15 million will be the impact. 11 have already been done, and we may not actually be doing it completely 14 because some of it, we were just on the verge of surrendering and then because the business is there, and while our facilities are not ready, the new ones, so we probably will end up in retaining that. So it is a target and once the facilities are ready, then we will look for another set of facilities which we can further consolidate.

Sandeep Shah: Just a clarification… as you said, our comfort range on the EBIT is 20-21% versus the current rate being 24.5%, which indicates a big headroom in terms of investment, which we are looking over a medium term, but you are also saying that if rupee goes up and down by 5%, we will have a comfort with that range, we will not be looking to change that range?

Anil Chanana: Correct, so that can be absorbed within that, so that is the intent.

Sandeep Shah: Can you explain why we are building such a big headroom in terms of the investment because currently, we are at 24.5% and like we are building almost like 350-450 basis points in terms of the investment?

Anant Gupta: I think a couple of things; obviously we are not going into very specifics, right, but I think the entire strategy around DSI is the Digital SI space is a big bet for us, we have already made initial investments in the mid-management leadership that we have, we have actually hired in excess of about 26 leaders in the last two quarters. So we believe that is a large bet from our standpoint. At this point we do not have a visibility as to the depth and the breadth at which we would like to address that. Estimates on market potential in each of the three buckets in that space are very large. So as we keep going in, we are expanding the differentiation that we have. Besides the people we have just created two innovation centers outside India to help and support some of these initiatives. So I would say one element is around investment for some of our new strategies around Digital SI. And the second really is around, it is a factor of large engagements coming in versus those engagements which will go into steady state. So what we currently have a situation where most engagements have moved into steady state, we anticipate now going forward a lot more new engagements, the balance tilting more in terms of new engagements flowing in. So we believe that will be a factor that will tilt towards some of that as well.

Moderator: Thank you. Our next question is from Dipesh Mehta of SBICAP Securities. Please go ahead.

Dipesh Mehta: Just to stretch it further about gross margin and how we are looking to balance it, so what kind of area we intend to invest in terms of capability? You mentioned around DSI. So whether geographically also we are looking to expand? And considering it is now sizably ahead of what our comfort range of 20-21%. So just want to understand how going forward we intend to manage growth versus margin kind of thing? And second is about depreciation. This quarter, it appears to have declined in absolute terms. So if you can provide some color whether there are any one-off in there?

Anant Gupta: Let me answer the first one from an investment perspective, this is across the board, it is equal, we are doing that already in Europe, we have started doing that in the US, but I quickly anticipate that we will need to make investments in certain markets even in the rest of the world. The adoption of digital system integration is a universal phenomena. The difference only being as to where do customers begin their journey in that space of Digital SI. So some of them start on the front end of enhancing their customer experience while there are others who start at the foundation level of doing legacy to cloud and application modernization. So I think the need is there universally. The approach to where customers would begin their journey will vary. Hence accordingly, our investments are kind of not restricted by geography. I think the core decisions going forward will be in terms of prioritization of the segments, the number of industry segments we would like to take on at the same time, and therefore that will be the factor of what we believe is short term gains versus short term investments which we will need to make and kind of balance both return and expense in that area.

Dipesh Mehta: Just to stretch it further, now, because we already are well ahead of our comfort or a targeted range of margin, I think some of the investment you already highlighted about mid-manage hiring around DSI area. So I just want to understand it because margin is already running high. So whether investment is happening at relatively slower pace and what benefit we are reaping from earlier investment or how one should read it?

Anant Gupta: I think it is a good question, I think you should read it, we are right now cautious, and we are hence a little slow in our investments, we could accelerate that much faster.

Dipesh Mehta: Should we expect it to happen in next 3-4 quarters?

Management: Absolutely, yes.

Dipesh Mehta: About depreciation, if you can provide some comment?

Anil Chanana: Depreciation I think, if you look at our depreciation policy, we sort of follow a very accelerated policy like computers being written off in three years if I remember correctly, and some of the other equipment beings written off in 7-8 years like that, while the useful life of those assets is much longer than that. So I think it is a result of that that it is falling, but as the new assets are getting on boarded that number will start flowing in. We have not done the computation in terms of what the next quarter or the next year will look like, but we will be happy share as we move forward.

Moderator: Thank you. Ladies and gentlemen, due to time constraints that was the last question, I now hand the floor back to Mr. Anant Gupta for closing comment.

Anant Gupta: Just summing up the quarter once again, I think we have had a great performance across the board; it is really performance which is being delivered consistently, and that is really the key focus. I think going forward as we see, I think the strategy is more or less are there in place, and attempts will be at execution right from client, customer acquisition, all the way down to delivery, and actual service delivery execution. Thank you very much for joining this call and look forward to seeing you again in the next earnings call in July.

Moderator: Thank you very much members of the management. Ladies and Gentlemen, on behalf of HCL Technologies that concludes this conference. Thank you for joining us and you may now disconnect your lines.