HCL TECHNOLOGIES LTD

Q3 FY07 Earnings Call

17 April 2007, 6 pm (IST)

Moderator

Good evening ladies and gentlemen. I am Pratibha, 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. I will be standing by for the question and answer session. I would now like to hand over to Mr. Vineet Nayar. Thank you and over to you sir.

Vineet Nayar

Good evening everybody and welcome to HCL Technology Q3 result announcement. I hope you are having a wonderful day and I hope you like the results. We have a very interesting agenda today that the way we would like to run this conference is as follows, so that you make a decision. I would like to share with you the business outlook of the complete company and IT specifically. Ranjit is with me and he will share the business outlook for BPO and explain the numbers, and then we have scheduled a special session today with Anil, and Anil is going to share eight specific topics with you, which I believe that he would like to walk the results with you so that you understand the granular details of results. This is consistent with our trust and transparency and corporate governance standards which we want to set in the industry today. So he is going to walk through a detailed revenue analysis of where the revenues have come from, and EBIT analysis of the margin expansions, the positive and the negative factors, the detailed analysis of treasury and the way the treasury income has come, our outlook on forex hedging and gains associated with that, our outlook on capex, our outlook on taxation and how the taxation has increased, the implications on tax going forward, our explanation on ESOP charge this quarter and going forward, and our views on EPS dilution. So we are trying to see if we can preempt some of the questions you may have and answer them in a more structured and efficient fashion so that we can have more questions. And then I would also share with you some HR matrix and how the HR is looking and that is what we are going to try and do. So with that brief let me kick start the conference by giving you from an outlook perspective six key messages. The six key messages which you should note in HCL Technology are as follows.

Message #1 is HCL stands for growth. So not only the revenue has grown 44% Y-on-Y and 9.5% Q-on-Q, net income has grown at 77% Y-on-Y and 18% Q-on-Q and I believe that as of now we are one of the few companies which despite the dollar impact have expanded our EBIT by 120 basis points, so that is growth.

The second message I wanted to give to you is consistency. Consistency in the last four quarters if you see, we have grown our revenues by 8.3%, 10.3%, 10.2%, and now 9.5% quarter against quarter, that is consistency for you. And the net income growth Y-on-Y over these four quarters is 36% year-on-year, 43% year-on-year, 61% year-on-year, and now 76% year-on-year and that is as good as it gets.

The third message which I wanted to give to you is that this has largely been driven by the transformation initiative which we started 24 months ago and the point that we appropriately ____the blue ocean thinking. So while you saw the global delivery model have been created been HCL BPO in Northern Island and we expanded that there were three new ideas which we came up with. The first idea was the infrastructure services led industry and we started talking about the infrastructure way ahead of everybody else and we dominate that space, and the impact of infrastructure we started using a multi service outsourcing. So HCL was one of the first people to start talking about the multi service outsourcing as a blue ocean in creating uncontested market spaces, and the results is for all of you to see that the new value proposition has expanded the IT services market space, which is always good for everybody, and now all the Indian IT companies are in what I call the total IT outsourcing markets, and because we are leading this initiative using infrastructure services, where we dominate, we are having a large percentage of interest in this area. The third which is not adopted by the industry so far but you will see it very quickly adopt in the next few quarters you would see this vocabulary coming in with the risk reward pricing model, software as a service, and concept to manufacturing; they are still small, even for HCL, but you know these are what I call big ideals from a 2010 perspective you need to watch this as how the total market for the Indian IT industry will get expanded by each three additional frame of reference.

So after growth, consistency, and thought leadership, the fourth message I want to give to you is what I call strategic outlook. So instead of adopting a Sten gun approach, we adopted a rifle shot approach making a good adjustment of our strength in businesses, our ability to win in different market spaces, we have focused on some micro verticals. So I am happy to share with you that life sciences grew 97% year-on-year and 18.4% on a CQGR basis for the last four quarters. So in the investor release this time we have added the CQGR for the last four quarters so that it gives you an indication of where we are focused and how we are performing against some of our strategy. So life sciences grew by 18.4%, retail grew by 15.7%, and financial services grew by 13.5% on a quarter-on-quarter CQGR basis. But an interesting fact there which is not there because we do not talk about it, but I do want to mention this to you, that the aero segment for HCL has been a micro vertical which has done phenomenally well and we have grown 95% year-on-year plus we have expanded our relationship with multiple customers there. So that is the focus on micro verticals for us. Our geo diversity focus fortunately is helping us preempt some of this dollar impact which is coming in. So Europe growing at 70% year-on-year and 14% on a CQGR basis and we are also now reporting ANZ as the next growth market and you will see some deals flow coming through ANZ in the next few quarters or next few years. ANZ is growing at 16.3% on a CQGR basis on quarter-on-quarter again encouraging trend of lesser dependency on US.

The third is the service offering. Infrastructure continues dominating at 14.4% CQGR, and the way you should look at infrastructure is as a catalyst both for application services and enterprise application services, so that is why you see in EAS which the enterprise application services is growing at 11% on a CQGR basis and almost 52% on a year-on-year basis, because most of the SAP and Oracle deals are getting clubbed with the infrastructure, so that is the reason infrastructure has been a catalyst to the growth in some of the other's segment.

A lot of conversation have happened on slow down and may be we will get sometime to talk about that, but when you look at our engineering and R&D services the great news for HCL has been that we have kick started this growth, and remember if you go by historically in our growth the engineering services was slowing down and if you see across the industry the CQGR growth for engineering services was only 6%, and the fact that HCL is growing at 9.3% on engineering services is because of our concept to manufacture, our value based pricing, our risk reward sharing, so a lot of those concepts has kick started the engineering growth which augurs very well for HCL going forward and this is another space where we really be and dominate.

The next part on the strategic outlook is existing customer focus during multi services. Now you see that vocabulary in virtually all companies talking about selling to existing customers using multiple services, I am happy to report the top 20 customers are 9.9% CQGR and 45.6% Y-on-Y growth, which indicate that we have been able to leverage our multi services approach to existing customers, so that was the fourth message from a strategic outlook or rifle shot approach to do fewer things and do them well and make that expand our organic revenue growth.

The fifth which you know is close to our heart is the big deal concept which we started, and actually we created and increase the aspiration of Indian IT companies win big deals and some of you had concerns about the viability of Indian companies executing them and the viability of profits from those big deals, so I am happy to report that we are on milestone on all our six big deals which we had announced. All milestones means that whatever milestone we set we have achieved it, whatever SLA were set we have achieved it, whatever top growths were set we have achieved it. I have already shared with you our EBIT margins continues to be higher than the company average for these big deals, and I am also happy to share with you that we have announced six more deals, one greater than $50 million and the other smaller than $50 million, and the fact that they have come from high tech industry, four of them, also gives you an indication of the fact that high tech and manufacturing continues to be a growth area where we dominate from percentage market share perspective.

The last message which I would like to share with you is the whole emphasis on trust, transparency, and flexibility. The whole investor release if you see and it has taken us time to reach this place, but I believe it would be amongst the best benchmarked across the world and that is our emphasis to try and share more and more with you to try and give you more predictability of the data which will flow in your way and remain consistent with the data, and we have been trying to be more transparent in our disclosures and when Anil walks you through all the financials you will understand the approach we are adopting, we are not waiting for your questions but we are adopting an approach of explaining to you our results in detail in the evening so that by the time you hit the market in the morning you understand the results in complete thoroughness.

The same transparency we have adopted in our employee policy, which is what we call the employee first, and we have adopted in our customer engagement; hopefully over years you will see HCL customers closer to HCL compared to our competition, that is a wish statement but that is the reason the trust, transparency, and flexibility as a core value which we have instigated and has been very successful and we hope to continue doing the same. With this I would request now Ranjit to walk you through the business outlook on BPO and I congratulate Ranjit for spectacular BPO results.

Ranjit Narasimhan

The BPO services completed one more successful quarter. Our strategy of moving up the value chain and focus on improving operational efficiency is paying off with initial growth ____ on a Q-on-Q basis and the EBITDA grown over 37% last quarter. _____ we had a net head count addition of over 3000 people in the BPO front, which after training_____NI centers were operating at almost full capacities and stopped focus on budget improvement ___ which has increased the operational margin significantly during the last quarter. During last quarter the ____ and as we move forward we shall have a breakthrough focus on going up the value chain, so that is the focus on ____. Thanks.

Vineet Nayar

Thank you Ranjit. Now I will request Anil to take through the financial numbers.

Anil Chanana

Thanks Vineet. Good evening everybody. I will walk you through the eight items which Vineet described. I will first take up the revenue analysis. If you look at the revenue, the revenues have gone up from $331 million to $362.4 million, that is a increase of $31 million in the revenue. Core software, the revenue have increased by 8.1%. This 8.1% increase in revenue is coming, 3.9% out of this is coming from the effort base revenue growth, higher realization is giving us 1.7% increase in revenue, this higher realization could be multiple factor including the strengthening of British pound against $ in terms of rate increase which is happening, in terms of geo mix which is happening. Another 1.7% increase in revenue because there is a change of mix in favor of onsite this quarter. There is a non-effort base revenue like bonus and expense reimbursement accounting for 0.8% of revenue growth, so the total growth in core software in revenues have been $19.7 million.

In infrastructure space we have recorded 8.2% growth this quarter, which consists of effort-base revenue growth of 7.3% and about 1% growth in terms of realization. I would also like to add here that if you see the man power sheet, the man power in infra have increased by 11.3%, however, on an average basis which is the average of JFM quarter as compared to OND (Viz October, November, December) quarter, the head count increase is only 9%, and this increase in manpower is to meet the project requirements, this has impacted the utilization slightly which we will talk about when we talk about the EBIT margins.

Coming to the BPO which has grown by 18.4%, in absolute terms by $7.7 million, the effort-based revenue growth in BPO is 7%, higher utilization led to 4% growth, higher realization per billed person per month lead to 4.8% growth. The non-effort based revenue, which are the bonus and pass through and expense reimbursements, led to 2.6% revenue growth.

Look at the BPO manpower, the BPO manpower this quarter has gone up only by 64 employees. However, on an average basis the head count in this quarter has been up by 7.2%, so this is the reason why the effort-based revenue growth has been of 7%.

If I summarize of $30.3 million revenue increase which has happened in this quarter, 56% of that is accounted for by higher efforts including the higher utilization in BPO, 21% is accounted for higher realization per person month, and 13% is accounted for by change in mix in favor of onsite, and the balance 10% is non-effort base which is the bonus, expense, reimbursement elements.

I will now take you to the increase in EBIT. The EBIT margin has expanded by 125 basis points. All the businesses, which is core software, infra, and BPO, have shown an increase in EBIT margins; core software by 80 basis points, infra by 20 basis points, and BPO by a phenomenal 490 basis points.

I am just now going to analyze these numbers. The core software, 80 basis points, is accounted for by higher utilization, the onsite and offshore both utilizations going up, which has given us the additional 20 basis points. Higher realization per person month has given us 74 basis points. SG&A leverage has given us in core software 50 basis points. The negative has been, we have been hit here by the strengthening of the rupee and the impact of other currencies by 64 basis points. So net-net core software goes up by 80 basis points.

Infra has grown by 20 basis points. There has been a saving on account of SG&A and depreciation, which have given 120 basis points. The utilization as I talked about has impacted by 100 basis points negatively and so the net is 20 basis points.

If you look at BPO, higher utilization, particularly in offshore, has given us 160 basis points. Higher realization has given us 197 basis points, leverage on SG&A and deprecations has given us 270 basis points, so total for positive is 627 basis points. On the negatives, the strengthening of Indian rupee and other currencies has led to an impact of 37 basis points negatively. There were increments given in January, which has impacted the margins of BPO by 100 basis points, so we have 137 basis points negative and 627 basis points positive in BPO. On a net basis, 490 basis points of improvement in the margins

If you take the company as a whole, SG&A and depreciation gave us 90 basis points positive, higher realization per person per month gave us 75 basis points, higher utilization gave us 29 basis points, so total on the positive side we have 194 basis points. On the negative, the appreciation of the rupee and some other currencies gave us a negative of 54 basis points. The increments in BPO gave us a negative of 15 basis points, so we have total negative of 69 basis points, net-net EBIT margin improved by 125 basis points in spite of a negative impact of the rupee appreciation at 54 basis points. I would also like to add here that 1% appreciation of the rupee versus dollar impacts our EBIT margins by 35 basis points. This quarter rupee appreciated by 1.55%, if I take the average rate for January to March and compare it with the average rate of OND quarter. This impacted our margins by 54 basis points.

I would now move on to other income. Other income is essentially the treasury income. If you see the treasury income this quarter it is 4.5 million. It was 3 million last quarter. However, we have a huge accumulation happening on the unrealized gains. The unrealized gains are now at 18.1 million up from 15.3 million last quarter, and if I account for that increase in unrealized income and do a apple-to-apple comparison in between January to March and the last quater which was October to December, there is a increase from 6.6 million to 7.3 million. Three reasons primarily, the quantum of funds under treasury has increased. The treasury investments as of 31st of March were 422 million. The return on treasury went up from 6.7 to 7.7. The receivables in terms of number of days of our sales have gone down, they came down in September quater they were 77, in December they came down to 70, and now they are at 68.

I will now talk about the foreign exchange gains which we have recorded. We have recorded a foreign exchange gain net of the impact of restatement of assets and liabilities at 9.6 million. This is on top of 7.8 million which was recorded in the quater ended on 31st December '06. As of March '07, we had 900 million of forward covers primarily to cover our dollar and other currencies inflows for one year and beyond. This position as of December '06 was 516 million. So in terms of forward covers, we are up by 75%. I am also happy to report to you that these covers in this quarter, which is January to March, have been taken at average rates which are better than the rates at which we had covered outstanding as of December end.

I will now move capital expenditure. We had at the beginning of year said that we would be spending 100 million on capital expenditure this year. I am happy to report that we are on track to meet that number. We have 35.7 million to incur in the last quarter.

I will now take you to taxation provision. Provision for taxation this quarter has been higher. In October-December it was 4.7 million, and this quarter it has been 6.5 million, which if you look at the income, the earnings, ignoring the exchange gains, I am just may be simplifying it, it has gone up from 8% to 8.8%. The elements are one of the major factors which has a play here is the type of other income, which is the treasury gains, whether they are dividends or they are capital gains and short term or long term, so they keeps on impacting, and then there is a differential between how the depreciation is recognized for the purpose of the US GAAP versus how it is recognized for the purpose of income tax. So these two factors have led to the tax charge going up from 4.7 to 6.5, which is 8.8% of the profits. We had said earlier that we will expect the charge to be between 8% and 10%, so this is where we are.

I will now take you to the charge on account of employee stock option. On the employee stock options we had given you guidance that the charge for the full year is going to be 22.8 million, and I am happy to report that this is going to be 22.8 million for the full year. For the next year, we are expecting the charge to be about 22 million based on the current options which are outstanding.

I will now take you to the dilution impact on the EPS. We have in the first 9 months of the current fiscal year allotted shares on exercise of stock options which were 16.8 million, it is like 2.6% of my opening share capital as of June '06. Out of this 16.8, something like 14.2 have been allotted in January to March alone. While calculating the earnings per share, the basic number, we calculate the number of shares using the averages means the number of days for which the shares have been outstanding, however, if I take the figure which is at the quater end, there will be an impact of 2% on the EPS on account of the issuance of shares in January to March period. With this I have covered the eight points.

Vineet Nayar

I would very quickly cover some HR matrix data, which is not there in the release, so that some of the questions I can preempt. There was a requirement by some of the analysts asking us what percentage of our core application division has experience greater than 3 years. We are giving this data as one off data right now, we don't intent to continue, because we don't see the relevance of this. But responding to the query, it is 51% this quarter, 51% of our employees are greater than 3 years. Once again we do not wish to continue with this data, because we don't see the relevance. Hiring in the last four quarters has been 10,500 people have been hired, which is run rate of about 2500 people. We had hired about 3800 last year from campus. The offers which have made to campus this year is about 5000, which will be joining us starting June and ending in October, November, and December. The salary which we offered in the campus last year was 2.2 lakhs per annum, we are offering this batch of people who are joining in 15% higher salary compared to last year. Our wage inflation which will be other than BPO, which Ranjit has already explained, for this year will be on 1st of July for the executive cadre and 1st of October for the senior manager cadre. We expect an overall wage inflation of 12-15% for India and about 3-5% for onsite. There is no mid-term correction which is planned in the compensation of the freshers. With this I am happy to transfer this session back to you for question and answers. Operator, please start the question and answers.

Moderator

Sure sir. At this moment, I would like to hand over to Zainab to conduct the Q&A session for participants at the SingTel bridge. This will be followed by Q&A session for India participants. Thank you and over to Zainab.

International Moderator

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

Vineet Nayar

Operator, can we move to India if there are no questions?

International Moderator

First question, Mr. Joseph Foresi from Janney Montgomery Scott, USA. Over to you sir.

Joseph Foresi

Hi guys, and thanks for breaking down all the number here. Just one or two quick questions here. First is on North America. The other two vendors, Infosys and TCS, have sort of seen a little bit of a pull back in sequential growth numbers. It looks like you guys have experienced sort of the same thing. Is there anything to look into this? How are you seeing the demand in North America and in financial services?

Vineet Nayar

I think the way to look at it is that I think the other geographies like Europe and Australia are growing faster and we are seeing larger number of big deals coming from Europe and Australia. Am I concerned about the slow down in America? The answer is no. Because we have polled our customers, especially the high-tech customers, and four of the deals which we announced are in the high tech area. So as we speak, I do not see a slow down trend, and obviously the base of America is higher and therefore the base of Europe and ANZ is lower, that is in my mind is the explantation of our results. At the same time, we are very focused to try and reduce our dependence in US.

Joseph Foresi

Is there some reason for this happening in March may be seasonality or clients taking all the time before they start spending?

Vineet Nayar

Sorry, seasonality for the American?

Joseph Foresi

Yes.

Vineet Nayar

I don’t have a logic for it, but historically we have seen JFM to be a lower number in the four quarters for the industry. I don’t have a reason for you. I don’t have an intelligent reason for you, I would like put it that way. But historically we have seen JFM to be lower number in four quarters.

Joseph Foresi

And just a general outlook for fiscal 08. May be you can give us some color, specially like on hiring. Do you plan on hiring more people this year than you did last year? Is they going to be about the same? Any kind of general commentary on fiscal 08?

Vineet Nayar

The fiscal 08 commentary we will give when we come up with the June result quarter. Right now we are focused on the fiscal 07, we have still one more quater to go, and there we had given a guidance of hiring 10,000 people and we could be significantly in excess of those numbers, and I only think about fiscal 08 is the hiring should obviously be substantially higher than the hiring this year.

Joseph Foresi

Okay, all right, thanks guys.

International Moderator

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

Moderator

Thank you very much Zainab. We will now begin the Q&A interactive session for participants connect to WebEx India. Participants who wish to ask questions may please press *1 on your telephone keypad. Participants are requested to kindly use only handsets while asking a question. To ask a question, please press *1 now. First question comes from the line of Mr. Sandeep Shah with Motilal Oswal.

Sandeep Shah

On the BPO, the growth has been sequentially double digit at around 16.4% in the Indian rupee terms and if we just compare it last year, in the third quarter, it has suddenly grown at 17% Q-on-Q. So is there seasonality in the BPO revenue for this quarter or do you believe that the restructuring is giving us more visibility going forward and you expect this growth rate to sustain but not at this rate but at a higher rate than earlier quarters?

Ranjit Narasimhan

_____ we have significantly high hiring during the _____ of calendar year '06, and there is always a time lag between the date of joining and the time they start getting revenue, because _____.

Sandeep Shah

Sorry sir your voice is breaking, I am not able to hear.

Ranjit Narasimhan

During the second half of calendar year 2006, that is from 1st July to 31st December, we hired about 3000 people, who after training have got converted to revenue generating, and that is why you see an _____ increase in revenue generation in this quarter. We do not have a seasonality, but our business policy is to focus on large orders and consequently to some extent it is step function _____ till they reach steady state there will be a significant increase in the revenues.

Sandeep Shah

So can you give us some outlook on the BPO, do you believe that the restricting is over and now the growth rates could be little higher than the earlier quarters?

Ranjit Narasimhan

Can you tell which segment? BPO, there our guidance continues to be the same for the entire company, I cannot believe that we are giving any business specific guidance.

Sandeep Shah

Okay, and sir the billing rate increase or the margin increase which you have witnessed in the BPO, do you believe that is sustainable?

Ranjit Narasimhan

We have a very strong focus on moving up the value chain and as we move up the value chain realization continues to increase and we have seen a continuos quarter-on-quater increase in the billing rates, which is resulting in margin expansion, and our policy is to continue to move up the value chain and consequently this increase in billing rate is a sustainable figure.

Sandeep Shah

Okay, so you expect the higher billing rate and the higher margin is sustainable going forward?

Ranjit Narasimhan

Billing rate will definitely sustain, but the focus is to increase the margin also.

Sandeep Shah

Okay, and within the IT services purely without the infrastructure management, the volume growth at 3.9% is little lower, is it a seasonal factor or you expect because of the March quarter, generally the volume is slower or you expect in the sense if you look at overall volume growth in the last 4-5 quarters, more or less in the IT services it has been little lower than the other industry players. So is the risk reward model is playing a role right now or you believe that the pricing growth is giving us the growth in absolute terms in line with the industry?

Vineet Nayar

My belief is that the effort-based growth at 3.9% is consistent in what I have been saying is that we do hope to, the only way HCL can create itself as a value leader is for the revenues to go beyond the effort. That is themes I am talking about the last few quarters, and I believe that you are seeing the reflection of the core software results, so that is all I have to say for this. I am happy with the results on the core software, which has consistently been good, and as long as the revenues outstrip effort, I am very happy.

Sandeep Shah

Okay, thank you.

Moderator

Thank you very much sir. Next in line we have a question from Mr. Anthony Miller of Arete Research.

Anthony Miller

Yes, good afternoon gentleman. My question is about infrastructure management. At the gross margin level, it appears to be the only service line where the gross margin actually declined quarter-on-quarter, even though the EBIT margin is obviously up and up quite substantially. I think you said in your earlier discussion breaking out the different service lines, which by the way was excellent, thank you for that, that the utilization in infrastructure management cost you about a 100 basis points, so it sounds like you had a utilization problem in infrastructure management. Can you just talk through what is happening in IM there therefore please at the gross level and whether that is significant trend?

Vineet Nayar

See what is happening is the infrastructure is going gang busters, if you are growing business consistently at 15% quarter-on-quarter or 70% YOY the operating efficiencies do get impacted on quarter-on-quarter basis, and this time what really happened was they ramped up in view of some of the big deals I have announced are actually infrastructure lead, they did not start billing and therefore the people who were on bench and because of this their utilization got impacted and their gross margin got impacted. But that is a smart bunch of management and therefore they were able to leverage their SG&A and make sure their EBITDA keeps improving. So that is what they did very smartly.

Anthony Miller

So all those projects or contracts that you ramped up in anticipation for, are you saying that those will actually then commence this quarter and therefore we would expect the utilization to once again increase?

Vineet Nayar

I hope so, that is my focus to get another bunch of large orders in this quarter for which they have to gear up for. I would encourage you to look at infrastructure at EBIT level because there is lots of depreciation component we invest in, you know it is not a business which will be guided by utilization or gross margin. So you will get a better indication of how this is going if you focus on EBIT.

Anthony Miller

I understand, and just finally in relation to this, what proportion of contracts that you are signing now or indeed resigning now include infracture management?

Vineet Nayar

We are actually may be the only company which is declaring that and we believe that if I am right 46 of these customers are multi service customers, so they are customers of infrastructure application, enterprise consulting and engineering. I don't have a split of 46, how many are exclusive with infrastructure, but I believe substantially lot. I mean a combination which is working the best is infrastructure and enterprise application together.

Anthony Miller

Infrastructure and enterprise application.

Vineet Nayar

That is correct.

Anthony Miller

Thank you very much indeed.

Vineet Nayar

Thank you.

Moderator

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

Vineet Nayar

Hello.

Pankaj Kapoor

Yeah Hi. Congratulations on the quarter. A couple of questions, first is that if you can give me a sense of how much of our revenues and how much of the pricing growth that we saw in the quarter came because of the non-effort based pricing strategy that we have been working on for the past several quarters?

Vineet Nayar

I think we have you know, I am sorry, I believe you may have joined call a little late. We actually ran through in great details business by business on how much increase has come from effort and non-effort base. If you are okay, then I would get Vikas to you know provide you and walk you through those numbers once again?

Pankaj Kapoor

No sir, I actually was listening to that. My question basically pertains to that we have been talking a lot about having a non-effort based pricing in the sense of additional work sharing and things like that. So, I mean, my question was more related to how much of the business or how much of the revenue that we did in this quarter came from such kind of _____?

Vineet Nayar

I am sorry, I misunderstood your question. As I had reported last quarter to you that as soon as this becomes material, material means as soon as it increased 5% of our revenue, I would reporting it. Right now, it has not crossed 5% of our revenue. Hence I am not reporting it as a separate line item, but the day it crosses 5% of our revenues ______.

Moderator

Hello Mr. Kapoor.

Pankaj Kapoor

Yeah I am there. Is the management on line?

Vineet Nayar

Yeah, did you hear my answer?

Pankaj Kapoor

Okay fair enough. Then the other thing which you were mentioning while giving out the break up of the growth was the bonuses and other rewards/gains that we had, basically bonuses and reimbursement and things like that. Does this number include those kind of a risk reward sharing elements also or that is?

Vineet Nayar

No, this number does not include that.

Pankaj Kapoor

Okay, fair enough. And can you also give me the number of or the share of rather the six large deals that we did over the last few quarters, how much is the revenue share coming in from them?

Vineet Nayar

About 10%.

Pankaj Kapoor

Okay, so quarter-on-quarter both 8% to 9% kind of growth that we saw in them.

Vineet Nayar

No, I did not say that. I said that in this quarter, it constitutes greater than 10%. We are not reporting quarter-on-quarter growth on those deals.

Pankaj Kapoor

Okay. And what stage were those deals, I mean are they in a full ramp up stage or they are still ramping up?

Vineet Nayar

I announced that some deals are in the ramp up stage, some deals have already moved to transition, so Auto Desk is in steady state, Teradyne is in transition state.

Pankaj Kapoor

Okay, fair enough. Thanks a lot.

Vineet Nayar

Thank you.

Moderator

Thank you very much sir. Participants are requested to kindly use handsets while asking their question. Next in line, we have Mr. Rithesh Rathod from UTI Mutual Fund.

Rithesh Rathod

Hello sir, do you have any kind of RSU charges for the ESOP dilution which we had this quarter?

Vineet Nayar

They have been declared in our sheet, that is I think about $7 million.

Rithesh Rathod

$7 million.

Vineet Nayar

Sorry, RSU you are saying. I am so sorry.

Rithesh Rathod

Yeah.

Vineet Nayar

It is there in the investor release, which is $4.4 million.

Rithesh Rathod

Okay. Okay sir, thank you.

Moderator

Thank you very much sir. Next question comes from the line of Mr. Harshad Deshpande with First Global.

Harshad Deshpande

Hello sir. Congratulations for good set of numbers. I just wanted to know how the infrastructure services business environment is and can you comment upon the billing rate trends and how are you doing vis-à-vis your peers?

Vineet Nayar

Billing rate trends in infrastructure?

Harshad Deshpande

Yes.

Vineet Nayar

Infrastructure is an industry which HCL created. We conceptualized it. We created it. We have the first mover advantage and hence we have what I call the growth advantage, the market share advantage. So, what is happening in the infrastructure space is you are seeing I think the 70% Y-on-Y growth and you know 100+% growth in profits. So, you are seeing revenue growth and you are seeing a significant market margin expansion and that largely is happening because the bill rates are increasing. We are getting orders because of our capabilities and you can see the IDC report also talks about that and therefore there is a billing rate expansion happening in infrastructure. As of now the demand for infrastructure services continues to be very very bullish. The competition has definitely increased compared to what it was about two years ago or one year ago and that is the outlook. So, it continues to be a high growth industry, A) Because it is a low base. B) Because it is a new segment which is eating up at a pretty fast rate.

Harshad Deshpande

Okay sir and other question was related to supply side challenges. Are you facing any supply side challenges and may be if you can comment about the supply side scenario say beyond FY08 or kind of?

Vineet Nayar

I think everybody is facing a supply side constraint. Our industry is all about the quality of supply side and the quality of supply side is continues to be a challenge in India. The last count is that we would be hiring about 400,000 engineers or 400,000 executives as an industry over the next one year and that would go up to 600,000 and that will go up to a million the year after. The quality of these graduates is continues to be a concern. The amount of investment we make in hiring them in third year and training them over the fourth year and then bringing them in and taking them through a expensive training program in house continues to be a high overhead, and we as an industry have to keep focusing on increasing quality of education, going to the campuses early, training, getting people on E-learning, all that stuff which we are doing, so like in any manufacturing where you do backward integration here also we have to do what I call the supplier development, which is the engineering colleges and the maths colleges and the B.Sc. colleges and try and increase the quality. I mean that will continue to be a challenge and that is why guys like us are around in the business.

Harshad Deshpande

Okay, thanks a lot sir.

Vineet Nayar

Thank you.

Moderator

Thank you very much sir. Next question comes from the line of Mr. Hitesh Zaveri with Edelweiss.

Hitesh Zaveri

Yeah hi. Congratulations to the management team on this numbers and especially on the transparency part and even thanks for breaking those numbers out for us. My question is with regard to the blue ocean strategy that you are pursuing. In the established verticals you know such as financial services, banking, and then telecom, norms of creating your offerings and then selling them as so well established. My question is you know, how exactly would you be deploying your blue ocean there? And then related to that question is when you succeed here are you creating some kind of annuity revenue for you or this strategy enables you only to get some high value transactions and then that is it? Thanks.

Vineet Nayar

A very very interesting question and you know I need to answer that very quickly. #1. My emphasis is to create annuity revenue. It is not necessary that I have succeed in doing that, but our temptation is to try and see during infrastructure and applications or maintenance to try and as much annuity revenue as we can do that's attempt. The innovation is coming in three ways. First is try and focus on micro verticals within the whole segment, for example, loans, and in insurance we could look at. So what we are really trying to do is create micro verticals in largest verticals, do try and convert the pricing away from IT ______ let us say per quality per month per reconciliation number of transactions reconciled, number of delivery transactions completed. So try and see if we came towards transaction based pricing, and that is the innovation we are trying to bring into financial services, and if you see the 66% Y-on-Y growth in the financial services, I believe it could be amongst the highest in the industry and that is largely because we are adopting this rifle shot approach to growth.

Hitesh Zaveri

Sure. My next question is within your large deals and the other deals that you are pursuing, could you share about what kind of sustainability do you see in terms of maintaining the margins. Is it happening in the reverse that you did share that margins are actually higher than average. Are there any other factors that play here where or if I put it reverse are this margin sustainable for you for the larger deals?

Vineet Nayar

Yeah, I want to project in the future are they sustainable or not _____ if I found they were not sustainable, which does not mean they will be sustainable. All in we are going in assumptions is demands are sustainable. What I am saying right now is market sustainable. Future three months, you know _____ should make the margins non-sustainable _______.

Hitesh Zaveri

Sure. That is helpful. Thank you.

Vineet Nayar

Thank you.

Moderator

Thank you very much sir. Next question comes from the line of Ms. Priya with Enam Securities.

Priya

Yeah, hi, good evening to the management. My first question relates to the environment in engineering and R&D services, if you could give us some flavor on that in terms of the deals which you are pursuing and try to corroborate it more with the large deals wins pipeline which you have currently?

Vineet Nayar

I am sorry, could you repeat the question again?

Priya

In terms of one the business outlook on engineering and R&D services, pie of your business.

Vineet Nayar

Okay the engineering and R&D services is you know what I call the heart of HCL, this is something which we excel. You know I was hoping that I will talk about this in the next conference call, but two things which I want to talk about. We were focused on #1 restarting the engineering and R&D services as a growth area for HCL, that we did by risk reward, by core investment, by concept to manufacturing, by plant automation, you know there are lots of services which we have done in that area by taking whole plains and remodeling them and reengineering them, so there are some very very exciting stuff which we have done in the engineering. That was phase I of engineering and that is the reason despite the fact that the industry is growing at 6% quarter-on-quarter we are growing significantly larger, so our market shares are increasing. Actually our market shares are not increasing, but we are expanding into new markets. But the mother of all ideas is you know when we are able to link the engineering services to applications and infrastructure delivery, and you know hopefully I will talk about that in the next quarterly call with some successes of how we have been able to link our engineering services capability to deliver application and infrastructure orders which are fairly large scale, so if you watch out for what I have said in the past about software as a service and some of these new utility models which are coming in we are focused on leveraging technology to drive again enterprise application, custom application, and infrastructure, and more on that when we talk about in next quarter.

Priya

Sure, that is helpful, and you also mentioned that the deal pipelines as far as the large deals go are quite strong and if you could give us some flavor in terms of the assignments which are on hand?

Vineet Nayar

You know I think I have worked out of the number game now. HCL started this big deal. I think we have enough in pipeline, enough to drive our growth, that is enough, I mean whether I am fighting 10 deals or 15 deals or 20 deals, you know it is like marriage, I mean unless the customer says yes you are not married, so it does not matter how many girls you are chasing I mean.

Ranjit Narasimhan

We have to win each one of them and it is pretty tough to win each one of them.

Priya

Just looking out from the success rate point of view given that you know you have won a couple of deals in the past, in terms of the success rate how has that improved rather?

Vineet Nayar

Our success rate is not improving, success rate is actually going down. When we started 2 years ago we were competing you know with a very unique business model, and as is true with every business model that business model gets copied and everybody starts talking the same language and therefore the competition has come in. So we were at what I call in obscene success rate, now we are on a reasonable success rate.

Priya

Sure, last question from my side, what is the breakup of exports and domestic business in the infrastructure business?

Vineet Nayar

The domestic business which is largely I think your indication is towards the material income which is coming out of the HCL com net. We had given an indication that it will be 3% to 4% of our total revenue for the year and I think it will be within that range.

Priya

Sure, and just one more thing on the number of diluted shares, would it be 701.3 million after exercise of all the options till 2011?

Anil Chanana

What you can do is you can add, I mean I can give you the numbers as of March 2006, give me a second.

Vineet Nayar

We could go to the next question and you know Anil will definitely answer this question in another one minute.

Priya

Yeah, thanks so much and wish you all the best.

Vineet Nayar

Can we go to the next question?

Moderator

Sure sir. Next in line we have Mr. Sameer Goyal from Alchemy Shares.

Sameer Goyal

Yeah, hi, good evening. Just a couple of questions, actually one on the large deal fronts, how does the rupee appreciating does have an impact on the large deals and do you have something called as rupee escalation clause in this, and could you elaborate a bit more there?

Vineet Nayar

We do not have a rupee appreciation clause in the deals.

Sameer Goyal

So how does it impact the overall profitability in these deals?

Vineet Nayar

The overall profitability because of dollar impact, for every 1% appreciation in the rupee it impacts us by 35 basis points.

Sameer Goyal

Does the predictability of revenues in this deal allow us to hedge it better and stuff like that?

Vineet Nayar

Yes, you have hit the nail _, it allows us to hedge better, yes.

Sameer Goyal

Okay and B it was more on the SG&A in the BPO business, could you elaborate a bit more on that how and what are the key expense heads which allowed sharp improvement in SG&A?

Ranjit Narasimhan

Earlier we had a very large pipeline of people and the head count increased by 3000 people in 6 months which has got convert the revenue stream, and second our North American centers operating almost on full capacity so the focus is on margin expansion, so we had done margin improvement program and the results which are showing here, because that was significant improvement in margin expansion coupled with the increased volume that resulted in a substantial increase in growth of EBITDA.

Sameer Goyal

Fine, thanks, and best of luck.

Vineet Nayar

Okay, so Anil will answer that last question which was raised.

Moderator

Sure sir.

Anil Chanana

What will be the number of shares once all the outstanding options get ____.

Moderator

Sir your voice is breaking up, could you please move closer to the phone?

Anil Chanana

Yeah I will. The question was what will be the outstanding number of shares once all the options which are outstanding get exercised? What we have given in outstanding options is an equivalent number of shares, so ______ and our number of shares as March 2007 was 63.7 million, so the total number ____ of whenever these options are ____ get exercised, we will reach 714.3 million.

Vikas

Okay, we will take the last question now.

Moderator

Sure sir. The last question comes from the line of Mr. Tushaar Jain with Shanthi ____.

Tushaar Jain

Hi sir, most of my questions have been answered, so thanks.

Vineet Nayar

Thank you very much. Ladies and gentlemen, thank you for joining us and look forward to talking to you again next quarter. On behalf of all the management staff of HCL and Shiv who couldn't unfortunately join us we wish you a great quarter ahead. Thank you very much.

Moderator

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

NOTE:

Blanks in the transcripts represent inaudible or incomprehensible words.