"HCL Technologies Limited Q4 FY19 Earnings Call"

May 09, 2019

MANAGEMENT: **MR. C. VIJAYAKUMAR – PRESIDENT AND CHIEF EXECUTIVE OFFICER, HCL TECHNOLOGIES LIMITED**
MR. PRATEEK AGGARWAL - CHIEF FINANCIAL OFFICER, HCL TECHNOLOGIES LIMITED
MR. ANAND BIRJE – CORPORATE VICE PRESIDENT – GLOBAL HEAD, DIGITAL & ANALYTICS, HCL TECHNOLOGIES LIMITED
MR. KALYAN KUMAR – CHIEF TECHNOLOGY OFFICER, HCL TECHNOLOGIES LIMITED
MR. RAHUL SINGH – HEAD, FINANCIAL SERVICES, HCL TECHNOLOGIES LIMITED
MR. DARREN OBERST – CORPORATE VP, PRODUCTS & PLATFORMS, HCL TECHNOLOGIES LIMITED
MR. GH RAO – PRESIDENT - ENGINEERING AND R&D SERVICES (ERS), HCL TECHNOLOGIES LIMITED
MR. SANJAY MENDIRATTA – HEAD, INVESTOR RELATIONS, HCL TECHNOLOGIES LIMITED

Moderator: Welcome to the HCL Technologies Limited Q4 FY19 Earnings Conference Call. As a reminder, all participant' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. I now hand the conference over to Mr. Sanjay Mendiratta from Investor Relations Team. Thank you and over to you sir.

Sanjay Mendiratta: Thank you. Good evening and good morning, everyone. Welcome to the HCL Technologies Earnings Call for the Q4 and Fiscal 2019. We have with us Mr. C. Vijayakumar -- President & Chief Executive Officer, HCL Technologies, Mr. Prateek Aggarwal -- Chief Financial Officer and the other members of the management team. I now hand over the call to Mr. C Vijayakumar to take it further. Thank you.

C Vijayakumar: Thank you, Sanjay and good evening and good morning to all of you and thank you for joining us for our fourth quarter and full year earnings commentary.

We have just a small deck to take you through this, I am moving to Slide #5 which captures the "Performance Summary for this quarter and the full year." Fourth quarter has been a very good quarter for us; 3.3% constant currency growth and this is coming after a 5.6% sequential growth in Q3, so it has been a very good quarter driven by several elements. I will talk about it in the subsequent section. Our EBIT percentage came in at 18.9%, lower than last quarter and net income was $360 million for this quarter.

When you look at the full year, what I would really call it as a blockbuster year in terms of performance. If you look at the two previous years, FY17 and FY18 we gave a guidance and we met the guidance and FY19 we exceeded the top end of our guidance. It has been a fabulous performance from HCL, delivered through several initiatives and several good progress that we have made over the year. Our constant currency growth is at 11.8%, which translates to 10.1% in US dollar terms. Our EBITDA is $1.68 billion which is 19.5% in the operating margin. This is an industry-leading growth, I am sure all of you would agree and exceeding the upper end of the guidance is the pride moment for all the HCLites.

Moving forward, I wanted to just capture the three-year trends. While this year has been a great year, if you look at the three-year trend again, HCL has delivered the highest growth among all top service providers in the industry. So, we are very happy with the outperformance that we have seen over the last three years.

Our EBIT growth over three years stands at 10.4%, net income has grown 8.8% from a three-year CAGR perspective. We have also had very healthy cash EPS three-year CAGR of 16.5%. Our EPS has also grown from Rs.60 to almost Rs.74 this year.

Moving on which is Slide #7, some of the key highlights for this quarter, once again we hit a record booking this quarter. This is the third time we have set an all-time booking record in this fiscal. So we are really seeing a good accelerating trend in terms of bookings. While we have done very good bookings, the pipeline at the end of March 2019 is at least 10% higher than the pipeline that we had at the end of March 2018, and this is the qualified pipeline that we measure through our internal systems. Q4, we won about 17 Transformational deals led by Retail, CPG, Manufacturing, Public Services which is our Utilities, Government and Travel, Transportation and Logistics vertical and Financial Services. We won 78 deals during the year which constitutes to a significant uptick in the total booking performance compared to the prior year.

This quarter we also closed an acquisition on the Digital space. Some of that we will talk about in the subsequent session.

We also launched one of the industry's leading products called Actian Avalanche. Actian is a company which we acquired a few quarters back. It is all quite integrated and it has created a good momentum in the data space. So, Actian Avalanche is a cloud data warehouse operational data store which delivers breakthrough levels of speed and performance. We expect this to be a game changer for the Actian's business going forward.

Moving forward, some of the key wins, some of that we have announced during the year; one of them of course is a very large technology manufacturer in the US, which is an integrated deal consisting of number of services from technology to engineering to business services, what we now call as "Digital Process Operational Services." This has been one on back of very high competence that we demonstrated and bringing in automation to the enterprise operations. So the extension of what we do in IT operations into enterprise operations with significant amount of Robotic Process Automation, Process Simplification and Machine Learning which is driving the wins.

Some of the products that we have created in our digital process operations business over the years, specifically a product called EXACTO is that the pivot of transformation that we are delivering in this deal.

We also won a large deal, a Danish pharmaceutical giant. This is a truly an end-to-end digital deal, which is where they have several service providers and they have kind of changed the landscape with HCL having the prime place for the digital opportunities that we are going to execute on this client.

Of course, we also won a large integrated telecom and media conglomerate in the US which is digital workplace deal.

We also won a large deal in the government segment in the US which is delivering security operations which will get delivered through our Cyber Security Fusion Center that we recently launched in Dallas, San Francisco and Texas. This also encompasses enterprise architecture services for the customer which is promising to deliver a lot more downstream work in terms of digital development and scale agile operations.

We also won Fortune 10 British multinational investment bank where we had significant component of DryICE which is a cognitive virtual assistant embedded in this deal. So there are several deals I just took this opportunity to call out a few that we concluded in the last quarter.

If you look at our Mode-1, 2, 3 performance, when we had the analyst conference about three years back, we said, our aspiration is to grow the Mode-2 and Mode-3 business to about 35% of our revenues in three to four years. Right now, we stand at 28.4% of our revenues come from Mode-2 and Mode-3, 17% from Mode-2 and 11.4% in Mode-3. And with the current acceleration that we are seeing we are well on way to hit the 35% mark in our Mode-2 and Mode-3 services as we move forward in the subsequent quarters.

The very interesting or very important thing that I want to point out is our Mode-2 services which is all organic growth is 28.7% YoY which is Digital Analytics, CloudNative, Internet of Things and Cyber Security Services. Significant growth across all and Internet of Things we have almost doubled our revenues last year driven by very strong capabilities in embedded engineering which is core to our engineering business which is really pivoting us to be a prime player in IoT Works where we are the leader across multiple segments. Similarly, the Digital and Analytics practice is very-very strongly getting embedded in all our client engagement. We have chosen top clients and we have been very successful in modernizing our services portfolio in the top client which is showing significant traction to our Mode-2 business as well as our Applications business. Our Mode-3 business is about 11.4%, it is 44% YoY growth.

If you look at the rest of the color of the revenues, all the geographies grew in double-digits, you will see ROW at negative 0.9%. Excluding India, it would have still delivered a double-digit growth. Our Applications Services is a highlight of the quarter which grew 5.2% QoQ on back of strong scale digital projects that we have won which has got into execution phase and then some of the accounts that we won are nicely scaling up as we speak. Of course, the icing on the cake is the Infrastructure Services which has delivered solid 7.3% QoQ growth and this is on the back of 10.4% sequential growth in the previous quarter.

Overall, while we started with the little bit tentativeness in our Infrastructure business in the beginning of the year, we delivered a good 11.1% YoY growth which is quite satisfying.

In terms of verticals, across the board, we have done very well; Technology and Services, Retail, CPG, Telecom, Life Sciences and Healthcare and Public Services, all of them clocked in very impressive growth rates from an LTM constant currency perspective. Financial Services as I indicated earlier, we had two client-specific situations which is continuing to make the growth soft. But if I exclude those two clients, we have a very good growth which could be somewhat similar to the company average growth rates. However, from the pipeline and the momentum, we are seeing strong traction for not just digital BUs but integrated stack is what is really giving us a lot more optimism in this segment. Manufacturing, I think, worst is over, I expect to see healthy growth moving forward while this year we have remained more or less flat.

If you look at the client wins, we had a very impressive progress in clients; we added two clients in the $100 million category. I only see this accelerate as we get into FY'20. We added four clients in our $50 million category, 25 moving to 29, we added four clients in the $40 million and close to 37 customers in the $5 million plus category and 13 additional customers in $10 million plus, taking the count to 166. If you look at our top-5, top-10, top-20, very good growth and top-10 customers contribute to about quarter of our business and our top-20 customers contributes to a third of the overall revenues, it is a very healthy growth and of course the top-5 is about 17%.

If you look at the recognitions that we have had, we have been rated very-very prominently across Gartner, IDC, Everest, Genome, ISG, all industry analysts have rated us very-very highly in most of the quadrants. We had mentioned 56 Mode-2 reports, it is a 51% increase over FY'18. We were very subtle in our marketing for our Mode-2 services but now the analysts are recognizing the value that we are bringing to our clients. And it is again while the services are the same, lot of digitals engagements are also outcome-based engagements where we are putting a lot of skin in the game and we are executing to what the client really wants to achieve in the Digital Transformation program. And this is where some of the aberrations on consulting and organizational chain management have become very important and we prioritize that and acquired stronger generation during the last quarter.

I will spend a little bit time on the FY'20 and what business trends that we are seeing. I would want to categorize this into four categories:

One is market opportunity. I am sure all of you know but to kind of put a context to what is giving us the optimism as we get into FY'20, Digital Transformation as a spend is growing at 18% to 1.2 trillion in 2019 while the traditional spend is moderating at about 2-3%, the Digital Transformation is what is picking up. And if you really break down the Digital Transformation spend, there are two very key themes which are becoming very obvious:

One is of course the modernization in the Financial Services, that is one big trend. Actually 25% of the spend is going into the Financial Services.

Second big trend that we are seeing is some of the laggards like discrete manufacturing and process manufacturing. They are using IoT and Industry 4.0 solutions to significantly modernize and transform their businesses, and that is an area which is big strength for HCL, while we have demonstrated significant proof points in Internet of Things, our core engineering capability and PLM and all the capabilities that we have today, puts us in a very strong footing to capitalize on the digital transformation spend in both discrete and process manufacturing segments. Of course, it is very obvious the shift in market buying patterns is more driven towards as a service outsourcing and our CloudNative capabilities is not just private cloud but platform as a service, our investments in pivotal, all of that is driving significant traction with our customers. I think it is becoming quite evident. Most large enterprises are gradually pivoting towards hybrid operating model while it is very good to adopt public cloud to improve agility. When you want to balance the total cost of ownership and agility, the obvious choice seems to be driving the businesses to adopt hybrid cloud with an emphasis on building software-defined stacks within the enterprise while creating a hybrid model extending into the public cloud. Cyber Security, IoT Works and Digital Reality, Virtual Reality and Augmented Reality are driving good transformational opportunities in multiple industry segments and our Engineering, DNA along with our strong capability that we have built in all the mode-2 proposition, puts us in a strong footing to capitalize on this.

And of course, last but not the least, the Infrastructure business is going through significant transformation. Infrastructure is becoming the digital foundation of any modern enterprise which is really a hybrid cloud and the platform-centric approach which is also helping generate some good momentum in the Infrastructure business and which is reflected in the last two quarters, while traditional outsourcing deals are having a certain rhythm on its own and dynamic which plays into it. But there is a significant modernization spend in Infrastructure where we are well equipped to kind of grow the business.

And Digital Workplace where the emphasis on shifting from device to user to Experian that is another area where we have differentiated offering and close to 60%, 70% of the Infrastructure deals that we have won have been on the Digital Workplace.

So overall FY'20 will continue to be a good year, enable by the Digital Transformation spend. However, a couple of points of caution which is around geopolitical factors. I am sure all of you are aware, delays in visa, increasing rejection rates and request for evidence, of course, it just creates a little bit of pain in the execution cycle.

While 2019 was a good year from a spend perspective from US customers, I would think that the expansion beyond the normal economic cycle would be a little bit limited compared to calendar '18.

We are also seeing some client businesses getting impacted by the trade tariff situations in the near-term and that puts a pressure into the existing clients who would be expecting to reduce the spend on typically run the business kind of scenarios. Of course, there are certain uncertainties on the currency driven by geopolitical factors. However, the most relevant thing is cost drivers, I mean, industry attrition is increasing. I think if you look at the India heritage providers, overall attrition has gone up by 2% while our attrition the way we measure it is coming down from YoY perspective. And of course there is a big shortage in digital talent, US unemployment rates are the lowest at this point. So there is going to be some dynamics around our cost structure. So while there is a positive trend from a digital transformation and momentum in the market, there is going to be challenges around labor market and labor mobility during the year.

We have built the strategy around this which really drives around four dimensions. We are looking at two elements -- Key growth opportunities and integrated proposition. Given the press of offerings that we have, the Infrastructure, Applications, Digital Process Operations and the products and platforms strategy, coupled with the strong engineering capability, is helping us drive significant success in the integrated full stack deals. If you look at the pipeline now, close to 40% of the pipeline is on integrated stack. And I do believe that is the way industry is going to move forward, creating more platforms which really enable grow our engineering and digital engine platform engineering services, along with all other investments that we have made. We believe we are well placed to capitalize on some large integrated deals that would come and we are trying to build around the same strategy.

We have a very focused cost management strategy including increasing freshers, onshore in different geographies, scaling up the fresher adoption in India, lot of emphasis on cross-training, all of that is the big focus area as we get into FY'20.

We continue to increase our localization, not just by hiring local people, but inducting talent right from the colleges in different geographies to enable this. Of course, diversity is a big agenda, diversity and inclusiveness. All of this is going to help position us differently in the changing geopolitical dynamics and we have several strategies revolving around these four themes as we get into the next year.

With that commentary, I will hand it over to Prateek for the next set of updates.

Prateek Aggarwal: Thank you, CVK. Good evening, good morning, good afternoon wherever in the world you are. I will go through some of the financial numbers in some detail and carry on with some important messages towards the end as well in terms of further guidance.

So Slide #17 CVK has already covered it. The highlight of this page is obviously the 11.8% constant currency growth which is beyond guided range of at the top end 11.5%. So we have exceeded that.

The great news also is that the organic growth guidance which we had provided are 4.25 to 6.25, we have been able to beat the top end of that guidance as well. So great story on the top line.

On the bottom line as well on EBIT we have been within the guidance at 19.5% for the full year.

Looking just at Q4 March quarter, again a great story on the growth side; 3.3% on QoQ basis which is on top of 5.6% last quarter and on YoY basis that is actually 15.3% which is kind of hitting the ball outside the park. EBIT was flat on QoQ basis in dollar terms. EBIT percentage came in at 18.9%. That is 63 basis points lower on QoQ basis and two-thirds of that is really the impact of foreign exchange, largely the rupee but also some of the European currencies which impacted our margins on QoQ basis by 43 basis points. The balance 20 basis points is really the seasonality in our products business both the IP partnerships as well as Actian and some of the other products as well which because the March quarter tends to be seasonal weakness, that is where the 20 basis points basically came from.

Moving on to the next slide, this kind of shows the balance portfolio that we have, whether you look at as Mode-1, 2, 3 which is the fastest growing part is Mode-2 at 70%, 11% for Mode-3. This is the full financial year that I am talking about and the others are on the slide in the interest of time I am going to skip more commentary on this slide.

Moving to the next slide, I will request Anand Birje who is here with us for the call today to talk about acquisition we closed on 1st of April, Strong-Bridge Envision. Anand?

Anand Birje: Thank you, Prateek and good morning, good evening to everybody. As Prateek mentioned, we have had a fairly strong year in our Mode-2 services, the year gone by and most of our digital capabilities we have thus far, built organically and I think we are now poised to look at acquisitions and this was one of our first. It is a company that is headquartered in Seattle and operates largely in the US market which is the prime market for us. They focused on helping enterprises develop digital transformation strategy, prioritization of digital spend along with Agile program management which is really how do you manage programs on more iterative spend basis and doing benefit realization more iteratively in the digital execution that enterprises adopt. And finally, underlying all that is the organizational change management. All of the three elements are becoming very key as enterprises are adopting scale digital programs and we were really getting pulled into a lot of conversations with our existing customers where we are doing the execution. So, it is a strong consulting company that bring strong capabilities in each of these areas and the teams are distributed across geographies that we operate in across the US. Over to you, Prateek for the rest of the presentation.

Prateek Aggarwal: Thanks, Anand. Moving on to Slide #20, a quick look at the cash conversion. For FY'19 we had cash conversion of 93% net income to operating cash flow and we have (EPS) Earnings Per Share which is at Rs.73.6 per share which is a healthy growth of 17.5% YoY. We also published the cash EPS which is basically adding back to amortization expense in the P&L as well as adjusting for the (MAT) Minimum Alternate Tax payout versus the tax cost taken in the P&L. So adjusting for that, the cash EPS is at Rs.84.90 which is again a very healthy 15.2% increase on YoY basis. The return on equity for the year is at 24.9% and return on invested capital is at 28.6%. We have added the exact definitions that we have used towards the end of out Investor Release document for your reference. The payout ratio for the year was in line with the commentary of 50:50 capital allocation. This year in rupee terms it came out to be 52.6% for the fiscal year.

Going forward, the guidance for the next year while the total guidance is at 14-16% in constant currency, the break-up of that between organic and inorganic, organic is 7-9% out of the 14-16% and the balance 7% is really what we expect inorganic to be. That 7% includes obviously the big deal which we announced in December of the seven products from IBM, that is included assuming that the deal closes by end of May and therefore we are building in basically 10-months. That obviously is subject to regulatory approvals as you are aware. It also includes flow through impact of all the acquisitions that we closed last year because some of the acquisitions, Actian and H&D were not there for the full year and Strong-Bridge Envision that Anand just spoke about we just closed in 1st April. So, we have factored in all the benefits from all the deals that we have announced so far and 14-16% is what the total works out to, including those two parts. That EBIT guidance is at 18.5 to 19.5 that is factoring in the 19.5 that we achieved for the full year fiscal 2019, as well as the last quarter which is at 18.9%.

Having given the commentary on all of that, I do want to flag off that as we move into this current quarter, April to June, and as we get nearer to the closing of the deal that IBM's seven products, we have and we continue to invest in additional people, processes, technology systems and facilities and everything to keep us ready so that we start the new deal on a very strong note. We are kind of just weeks away from it and we are well prepared for this, we believe. And given that we expect the deal to give us the revenue only for one month out of the quarter, and the investment is pretty much there in most part for the full quarter, we do expect the Q1, which is June quarter, margin to be lower than the guided rage. So that is all factored in. And I just want to sort of flag that off in advance. It should not be a surprise the next quarter.

I also want to flag off that once we close the acquisition we will have 912 million of payable on the books, which is obviously a monetary liability. And we might take up to about 200 million of additional debt. This debt moment when we announced the deal was about 300 million, we have been able to bring that down to 200 million. So, total we will have about 1,100+ millions of liability. And as is common for monetary liabilities on the balance sheet, these will be revalued at every balance sheet date, giving rise to FOREX gains or losses as the case may be. It would, therefore, make sense to hedge this FOREX exposure, which we plan to do in line with the Board approved hedging policy.

During the 12 months post close, so for the period from June to May therefore, this will therefore give rise to FOREX cost, given that there is typically a premium on the on the rupee-dollar exchange rate. And that FOREX cost is expected to be – it's for the one time because it's only for the period between when we close the deal to the one-year period beyond that. So the 12 months, it's a onetime cost, which is estimated to be something like $30 million for the 12 months. And given the 10 months in this fiscal year, we would expect that amount in this fiscal year to be near about $25 million or so.

The third thing I also want to flag off as we go into the next financial year is, some changes that we are planning in our segment reporting going forward. Given the changes, significant changes that have happened in our business over the last three years, we are planning to change our segments going forward. Products and platforms, as you know, has become a larger part of our business, it's already at 11% for the full fiscal year, and especially once the acquisition of the seven IBM products closes end of this month, that will take it even higher. And we are, therefore, planning to start reporting products and platforms as a separate business segment going forward. So that's the first change.

The second one is engineering and R&D services, ERS, as we call it. Most of yours is also related to developing or supporting and maintaining our customer's products. So, that's another business that we would classify as a separate business segment going forward. We have reported the ERS revenue cuts for the longest time separately, but now we would like to carve out ERS as a separate business segment in its entirety. So that's the second segment, which would appear in our reporting going forward.

As far as the rest of the business is concerned, which is basically IT and business services, that would be the third segment. As we have seen in the last several years, and as CVK also mentioned in his commentary a little while back, a lot of the deals that we see, which we have already closed, which we have signed in last few quarters, and the pipeline as well, we find that they are more and more and more integrated across service lines. The Mode-2 businesses that we started four to five years back, typically also tend to be across service lines. So, it is becoming, lines are blurring as far as those service lines are concerned. And we believe this is the right time to collaborate it into one business segment called IT and Business Services or name to that effect.

And over and above those three business segments, we will continue to report Mode-1 and Mode-2 break up off the ITS business services, because more three is the P&P business altogether, anyways. So Mode-1 and Mode-2 is what we will continue to report going forward as well.

That's it from my side for now. And we can now go to Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. First question is from the line of Divya Nagarajan from UBS Securities. Please go ahead.

Divya Nagarajan: Thanks for taking the question, and conduct to a good end for fiscal 2019. Just trying to understand the key assumptions behind growth for your Mode-1, Mode-2 and Mode-3 in your fiscal 2020 guidance, if you could just give us a breakup? And in terms of margins as well, given that we also have the IBM IP dealing coming in as part of the guidance, could you help us understand what are the key investment areas that's driving down margins? What should we expect as margin acquisition from the IP deals, some clarity on that would be helpful? Thank you.

C. Vijayakumar: Divya, thanks for your questions. Let me get started with the first one. In terms of how do we expect the growth to be starting up into the next year, of course, the inorganic contribution is very, very clear, it's a flow through impact of what we did last year and the consummation of the IBM deal, that will contribute to whatever numbers in the respective segments. Now, if you look at the organic growth of 7% to 9%, I would expect it would definitely be significant amount of the growth would come from our Mode-2 services. Even if you see FY19, almost 35% of the incremental revenue has come from our Mode-2 services. I expect that trend to be to be impacted from a larger team perspective, how much of the business momentum gets converted to billing and revenue recognition and things like that is secondary, but the business momentum will continue and we will see a very favorable contribution from Mode-2. And of course, Mode-1 has its own dynamics, of course, due to various elements. But we still expect to see a good, maybe a low single-digit type of growth in Mode-1. That's the commentary on the color of growth. While we don't really commit to a certain number of each of the Modes, but the directionally this is where we are heading. And, as I said, Mode-2 and three will be expected to contribute to 35% of our revenues in the in the next year, which is FY20.

Now, coming to the margins of the investments. I think a lot of emphasis is, I mean, of course, we started this focused investment around the Mode-2 propositions three years back, and it has given us some stellar results, we have really created some compelling propositions, we have created a huge mindshare among analysts on some of our new capabilities, and which is specifically in IoT. And in digital and cloud we have created a very strong mindshare in our existing customer base on our ability to be a digital foundations' partner and digital transformation partner, which is reflected in our client partner accounts, growth and things like that.

So largely, the investments will continue, given that it is helping us to accelerate our organic growth and we are seeing good outcomes. We are not scaling down our investments in Mode-2, we continue to invest while creating competencies if something which we have done. But you need to have these competencies available across the globe in all your segments or markets that we are operating in. So, to that extent we will continue to invest in Mode-2. And of course, since we have had a good booking momentum, a lot of new deals will mean a little more investment in the early parts of the deal to ensure that we transition well and we meet the client expectations and some of the optimizations will follow through.

Actually, these are the two broad elements which is really contributing to the margin guidance from where we are today.

Divya Nagarajan: Thanks. Just as a follow-up to that, as the years progress, we have seen margins kind of dip below what we had guided as a range for fiscal 2019. Could you kind of break it up into the main rationale for why that happened? And what gives us a confidence that we don't see a similar phenomenon in FY20?

C. Vijayakumar: Divya, our margins full year is 19.5, Q4 is about 18.9, which is well within the guided range for FY20.

Moderator: Thank you. The next question is from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: If you could maybe elaborate a bit more on the margin question asked. First of all, in the quarter we have seen Mode-3 margins decline quite sharply and revenues were also down, and Mode-3 especially, margins had been falling almost every quarter. So, where should we expect Mode-3 steady state margins to be in the first part? And second part, in your margin commentary you did say that the combination of large deal expectation and Mode-3, I would expect Mode-2 is also lower margin, so maybe a mix from there. If you could elaborate how much of the margin deflation built into the FY20 guidance comes from these parts?

Prateek Aggarwal: So Ankur, margins on Mode-3 for the full fiscal are 22.8%. And I would expect that number to sort of remain in that region going forward as well, because that is the inherent profitability of that particular business. To your question about Q4, that's just the seasonality playing out. So they were quarters, previous quarters which were at 25%, 23%, and so on so forth. JFM, which is Q4 just happens to be sort of seasonally weak quarter for those businesses. Going forward, we would expect this to actually trend up, especially with the deal closing which would be a little higher than the Mode-3 overall 22.8% that I spoke about.

Ankur Rudra: The second part of my question, Prateek, if you could potentially quantify what the weakness builds in for FY20 guidance, how much is it from continued weakness in Mode-3 versus large deals ramping up, which you alluded to? Versus also Mode-2 mix increasing, which is a lower margin business?

Prateek Aggarwal: Yeah, so on the Mode-3, I already said, it would actually be accretive. So it would increase beyond the 22.8 on overall basis. And while I won't get into specific numbers, if that's what you are really looking for, because the guidance is at a total level and we are not kind of, for example, on the top-line we are not going to split it by vertical, geos, or service lines and things like that. Similarly, on the bottom-line we are not splitting it really across modes. But as I think CVK already alluded to, and you also mentioned, Mode-2 continues to be an area of focus where we will continue to invest strongly from an organic point of view. I wouldn't call that the low margin business, as he just said, that's not reflective of the reality of that business. It so happens because of the extra investments that are going into that business, the EBIT is where it is as we have published. But inherently, that is a high margin business just like the rest of our business. Mode-1, equally where we have a lot of large deals already announced, plus large deals in the pipeline as well, does tend to get affected when the growth is so high as it is, and guided to be going into the next year. There is always some impact in the initial quarters. And already I talked about in my commentary about Q1, which is June quarter, would be lower than the guided range. So we have factored all of that in because of those circumstances. Because that large deal, we have to be ready for it to execute on the date of closing of the deal, it is not a switch that you can turn on and off at will. You have to be ready for it when it closes and you can time it to the dot.

Ankur Rudra: Understood. Just last question for my side. IBM, you had said in December would be earnings call accretive, now that you have had time to digest the amortization mathematics around it, would you stick to that statement? Could you clarify how much is it earnings accretive now that you have more visibility?

Prateek Aggarwal: So, Ankur, it remains very accretive. See, the nature of these things is the numbers we had at the end of December were based on September, October, November kind of timeframe. Those numbers change every day, every month, every quarter. So, when the deal closes is when we can actually do a proper purchase pricing, allocation as it is called. And that is when it determines how much is customer relationships, what is the value of the contracts we are getting, what is the deferred revenue, and what is the goodwill and so on, so forth. Based on which then the amortization gets determined. Obviously, we have a good idea of what that range looks like. And therefore, we have obviously baked something in into the guidance that we are providing. So based on that, I am reaffirming that it is accretive, it is much more than the 22.8% of the Mode-3 profitability, which is showing for FY19. FY20 will be much beyond the 22.8%.

C. Vijayakumar: And I want to just to add to what Prateek is saying, Of course, nothing materially has changed since December from our assumptions and the overall business case perspective. The only variable is, there is going to be some hedging cost, as Prateek explained, that is only an FY20. That's the only variable. Other than that, it continues, all the projections and expectations that we provided, holds true.

Moderator: Thank you. Our next question is from the line of Srini Rao from Deutsche Bank. Please go ahead.

Srini Rao: Two questions. First, any feedback, and you have given some opening commentary on that, on your geographic splits U.S. seems to be weak and looks muted. So that if we can speak about that. And also, your Financial Services vertical which also seems to be a bit weak. So that's my first question.

Second, you talked about hybrid cloud and the fact that that underpins sort of digital services. I know you haven't given that in the past, but can we get a sense of are you expanding your datacenter footprint physically, are any investments going into that, if you can either quantify or give any color of that that would be helpful?

C. Vijayakumar: Okay. Srini, good questions. Geography perspective, U.S. quarter-on-quarter is 1.1, but look at the year on your numbers, 15% plus. FY19 over FY18 is 13.8%. There is seasonality impact on the PNP business is largely sitting in the U.S., so that could be one reason why it is softer. Across geographies we are seeing good momentum. In fact, in Europe, especially in Germany, we are seeing a lot more opportunities after our H&D acquisition, not just in the traditional services but we are even opening up accounts and client engagements on our Mode-2 services, even in a geography where we are making baby steps. So, that is on geographies.

Financial Services, if you take out the 2 clients, it is growing somewhat closer to our company growth rates. Maybe after I finished this commentary on hybrid cloud, I would request Rahul to provide a little bit more color on Financial Services. On hybrid cloud we are definitely not building data centers, we never did it and we will not do it. It is about building solutions, which drives agility and it's really a good balancing act between agility and total cost of ownership. And if you look at even the public cloud providers, almost every large hyper scale providers have launched a hybrid stack, either it is an Azure on-print stack or AWS has got a version coming, pretty much everyone is launching a hybrid stack. That's really the trend that you are seeing in the industry. It does not require us to build datacenters, it is modernizing the infrastructure in our client datacenters, building software defined stacks, peering them with public cloud providers and being able to manage workloads with the end objective of providing agility and a meaningful total cost of ownership. Maybe with this, Rahul, if you can provide a little bit more granularity on the Financial Services, I am sure it will help everyone a lot.

Rahul Singh: Thanks, Vijay. So a quickly on Financial Services, I just want to add to what CVK just mentioned. So the muted growth that you see this year really is a reflection of two of our accounts where we have had certain amount of challenges. But if you were to exclude that, the business continues to perform exceedingly well. A lot of our banks, especially the bank in the retail segment, have started adopting digital in a big way. And we are seeing a lot of digital analytics deals in those segments. In fact, if you have been following HCLT's Financial Services vertical, you do know that we had a large number of wins which came in last year, and our Financial Services business had grown almost 12% to 13% last year. So, the banks which came in, which we acquired new in last few years back, have also grown exceedingly well this year, especially around digital and analytics. So if you exclude the impact of the two banks, mostly in the capital markets area, where we have had certain amount of challenges, the rest of the businesses performing exceedingly well.

Another thing to note is that, CVK spoke about integrated deals, and at least some of the integrated use both in the funnel as well as what we have executed are in Financial Services. So, we have been booking quite well. However, numbers this year have been impacted, as you mentioned earlier, on the account of two banks. Thank you.

Moderator: Thank you. The next question is from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Prateek, just persisting on the margin question, again. You mentioned in the first quarter FY20, you are baking in the investments in preparation for the transaction. So I am just curious to understand, does it mean that given the acquisition is going to have a materially higher margin profile, this margin decline in the guidance, the lower guidance of margin is only for this year? And does it mean that we can go back to the 19.5-20.5% kind of a band in the years going forward?

Prateek Aggarwal: So, Pankaj, first of all, the impact that I am talking about is only for the first quarter, which is the June quarter. And thereafter as we have discussed before, the deal itself is margin accretive. So it's only a timing factor really in the first quarter, because, obviously, we have to prepare in advance to be ready on day zero to be executing well on the deal. And in this quarter it happens to be two months, or rather three months of investment two months in advance, and one month of revenue is what we have baked into the forecast. Going forward, I don't want to hazard a guess, you are giving the guidance for the fiscal and we will like to stick to that and deliver to that.

Pankaj Kapoor: But you are saying that this is something more of a one-time kind of impact that we are seeing, especially in the first quarter which could be adjusting the trajectory? And there are no structural or any kind of a long-term investment or something which we are planning that is driving this kind of lower margin guidance?

C. Vijayakumar: I think we should at this point possibly take it as year specific, I mean, of course, there are some elements of first quarter impact in investments in the anticipation of the deal. And our continuing investments in Mode-2 is another one. And of course, we have large deals under execution and we want to make sure we are doing all the right things to transition them safely. I would, at this point, treat it like this year's elements. And obviously, I don't think anyone is in a position to provide a view, the year after there are several positives and negatives that will come into play as we get into the next year.

Moderator: Thank you. The next question is from the line of Ashish Chopra from Motilal Oswal Securities Limited. Please go ahead.

Ashish Chopra: CVK, my first question was actually around the organic growth that's baked into your guidance. So last year you did almost close to 6.5% and maybe excluding the voluntary India discontinuation, it could have been closer to 7.5%. So, my question really was that after quarter after quarter of a record deal wins, the 7-9% growth still looks to be in more or less the same range as we ended up in the last year, were we to exclude the India piece. And plus, if we look at the exit growth, or the 15% growth on an organic basis even that would be double-digit. So, is this guidance maybe baking in some of the macro concerns of just caution as well, like you highlighted in your opening remarks? Or why should it be still slightly in the range of last year's?

C. Vijayakumar: Ashish, I just wanted to correct, our organic growth in FY19 was around 6.5%. This is after including some reductions in the India business. So that is how the year was and India business will continue to decline to maybe even in the next year there is some decline. So I don't think we are getting any incremental BPS benefit due to India or North India. You should really look at the 6.5 and compare it to 7% to 9% organic growth. Of course, I know you possibly are multiplying 2278 x 4 and possibly you will add incremental revenue from IBM acquisition. I do believe even after all that we will have some good growth and of course some of the businesses have seen very strong acceleration in the last couple of quarters, so you will see some softness of that in the first quarter. So generally, all that is baked in and the increasing momentum, of course the momentum has also created some good growth in the current year, I mean, especially the deals that we booked in the first 3 quarter. Two quarters are completely into the run rate. The 3rd quarter, a very large part of it is in the run rate which is why you would see a higher than expected growth in this quarter and we exceeded the guidance. So just given all that 7 to 9 I think is a good organic growth momentum from what we have seen now. And while I talked about the overall commentary, I mean certain macro elements, but as I always said, when we do that planning more than the macros, the biggest driver is what we seen in each of our clients, their budgets and their outlook for what they are expecting to do through the year and some of that has changed from December to now. So all of that is baked in, I would say. I am not really baking in some macro pessimism apart from what we are really seeing from our specific clients and their spends.

Ashish Chopra: Fair enough. And even on the margin seems to have alluded to the issues around maybe attrition being highest for the rest of the industry and some geopolitical issues around visas, would that have any role to play in this guidance which is maybe 100 bps lower than last year?

C. Vijayakumar: Yes. I mean, there is definitely cost are going up. That is, some of it is baked into our run rate because if you see this quarter we are at 18.9%. The cost of replacement, the cost of fulfillment on site, I mean you have been hearing this from the industry. So, some of that impacts us as well.

Ashish Chopra: And just lastly maybe to Prateek on the bookkeeping side. Since you mentioned that you are pretty much, you have got the range in mind of amortization expense from the IBM IP purchases, could you share with us what would that ballpark range be?

Prateek Aggarwal: Ashish, purchase price allocation takes to be a very involved exercise and it is more the same number for each year. I think the best thing to do is to wait for the deal to close. We are weeks away from it hopefully and once the deal closes we will come out and in the accounts we will in any case give you the required details. At this point of time, I would continue to guide that it will be north of the 22.8% of Mode-3, it will be significantly north of that, the EBITDA is what I am talking about.

Moderator: Thank you. The next question is from the line of Parag Gupta from Morgan Stanley. Please go ahead.

Parag Gupta: I just had two questions, CVK firstly for you. You talked about some caution in the market but not necessarily building that in. But if I were to just think about your organic growth rate, do you think this will likely be back ended more in the second half, say the first half just as the way it was in FY19 or are you seeing a different trajectory for FY20?

C. Vijayakumar: Thank you. I think that was a very good question. I do see the growth pattern to be somewhat similar to what we saw in FY19. The growth would be back ended which is the core organic growth. Of course, the impact of acquisitions you will see the surge which is mostly in the first half. The organic growth, you will see some softness in the first quarter because we have had a good uptake, some projects are executed and some are under transition. So second half I expect it to be better than the first half, very similar trend I would say as we have seen in the last year.

Parag Gupta: Yeah, okay. And the second question is on margins. So based on what I have heard so far it seems like Mode-3 margins will go up, Mode-2 margins while there are some investments should improve. So it seems like bulk of the dip in margins is likely to happen in Mode-1 which you characterized coming from ramp up of large deals. But if I were to just breakup the impact of the large deals, you know how much of this is because of higher cost, how much of it is because of lower realization, how much of it is because of additional investments. If you could just give us some sense of what is leading to the lower margins on the back of these large deals ramping up?

C. Vijayakumar: So just one point, Parag, before I answer it more broadly. I think while Mode-2 margins are whatever it is, but the proportion of Mode-2 revenue going up also has a certain impact to the overall margin profile, while Mode-3 will be significantly more accretive. So there is going to be pressure in Mode-1 because of scale up of deals. Obviously, this whole cost structures are changing. Some of that is built into our run rate. So that would also cause some pressure on Mode-1. That is the way you should look at it. I don't think, I mean of course there is from a Mode-2 perspective I don't see any change in realization, in fact we are getting better and better rates and our objective will be to improve the gross margins, but not really cut down on the investments that we need to make to make sure we are continuing to build our capabilities here. Mode-1 renewals usual pressures are there. Of course, we have kind of mastered the way of dealing with it. It may impact us in one quarter, but we will bring in the optimization levers. Nothing more to add on this front, Parag.

Moderator: Thank you. The next question is from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: first of all you spoke about hybrid cloud here, so just wanted to get a sense of you currently in the IMS business, do you think that we have passed that, actually the hump of, threat of hybrid cloud or public cloud option cannibalizing some of our data center operation?

C. Vijayakumar: Thanks Ravi. I would request Kalyan Kumar who also was a CTO and also runs the Cloud Native Practice and the Cloud Native Practice to kind of give you a color on that.

Kalyan Kumar: Again as CVK mentioned that when we define hybrid cloud we are considering hosting. Hosting, I think lot of times are mixing up hosting and hybrid cloud. Hybrid cloud is the way you build your cloud platform so but leveraging software defined it's at the data center it could be hosted in the customer's data center or hosted in third party data center or it will be an infrastructure utility model. Then you have public cloud which is on a hyper scalar model. And currently if you see most of our deployments we are working with VMware on the IAS site to deploy software defined data center and that accelerate as either as VMware public cloud on it AWS EC2 or Azure. So you got architectures where we can create a hybrid architect at an IAS level or a PaaS level depending upon where the endpoint lie. So again it has zero impact from an operation perspective because you still managing the operating system in the layer above. Actually, going to happen whether you are on an IAS in the data center or IAS on the cloud. In the PaaS we are more higher order services like platform reliability engineering and site reliability engineering where we integrate and operate the whole stack as part of our hybrid cloud services. So I think as CVK said, the evolution continues to happen and we are seeing cloud providers like we have Azure stack in the data center, AWS just announced outpost which is putting gear back into the data center, google launched Anthos and hence we are clearly seeing that the direction is to go into the hybrid model, so I think the market will reset and continue to evolve in this way.

Ravi Menon: Great. Thank you. Secondly, on the margins in looking slightly differently, so you look at Mode-1 with some bit of downward pressure, something you addressed that and in Mode-2 while there are investments, margins continue to be suppressed. Do you think directionally as business scales up, we should see margins can expand because the investment in absolute term they might remain but as a percentage they should keep coming down?

Prateek Aggarwal: Mr, Ravi, if you look at from FY18 to FY19, the margins from this business, the EBIT margins have increased. So, obviously as we scale up, we expect these margins to improve. But we are conscious of making all the right investment because this is something which will define our services business in the long term, so we would not compromise at all. We will do all the right things. But of course, long term it will continue to improve the margins. Gross margin is already higher than our regular margins, I mean the regular business.

Moderator: Thank you. The next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: CVK, first I wanted to just get a clarification on the large deal wins which you guys have been declaring. If you look at 3 out of last 4 quarters we have had record deal wins and while I understand that you have start breaking out the absolute number, if you look at your earlier numbers which you guys used to report. It used to be around $1 billion - $1.5 billion quarterly. Should we assume if we look at couple of your large players, they are now close to one time trailing book to bill in terms of their deal wins? So should we assume that HCL Tech is also coming in a similar ballpark range in terms of quarterly deal wins versus revenues?

C. Vijayakumar: I have honestly not analyzed Mukul on how other providers book to bill ratio is translating. But I think we have toggled between giving you the TCV numbers to revenue guidance etcetera but I think you really need to have some degree in quantum mechanics to really arrive at the TCV to the exact revenue conversion. So the best, we thought that most practical way to do that is to bake that into the guidance and we have given you guidance last 3 years, we have met the guidance. So I think that is really the right metric we want to go. Any other metric would be misleading, will be quite gross in nature, so it is very difficult for you to make a direct correlation. I would leave it at that, Mukul.

Mukul Garg: Sir, sorry to push back on this, when you talk about record deal wins from historical perspective and compare to earlier when you used to provide them, is it fair or would you be able to provide a ballpark range between $2 billion - $3 billion quarterly or something like that or do you think it will be difficult to share even that kind of ballpark broad range?

C. Vijayakumar: I think the ballpark broad range you said is ballpark correct.

Mukul Garg: That is helpful, thanks. The other point as a follow up to this was, if we look at your commentary on Mode-1, you are talking about low single digit growth rate. So should we assume most of deal wins which are happening, which are going to provide incremental revenues are coming in, or have a very high share of Mode-2 or is it still the case that most of large deal wins are able to replace previous deals which are coming towards the end of their life. Ideally with this kind of a deal win profile your Mode-1 revenue growth should have been higher?

C. Vijayakumar: But our base is also increasing. It does have some good components of Mode-2 as well. So I find it very difficult to kind of breakdown this deal wins. Lot of them are integrated, only when we get into execution, the project planning, resource allocation all of that which will drive the revenue. I know the industry is classifying most of the mega deals even though they are taking over a traditional landscape and it is going to be the traditional landscape for the next couple of years till they modernize, they still classify it as digital or Mode-2. But we have consciously avoided doing that. We are completely focused on the work that we do to modernize and the revenues coming from that alone gets classified as Mode-2. So we are lot more selective about what we classify as Mode-2. So if you look at our proportion of TCV in Mode-1 would be still quite high, maybe slightly lower than the revenue percentage but it is still quite significant.

Moderator: Thank you. That was the last question. I now hand the conference over to the management for their closing comments.

C. Vijayakumar: Okay. Thank you everyone for joining and overall, we have had a great year, more importantly we are really looking forward to a fantastic year in FY20 continuing our industry leading growth momentum. I mean, as a team we are aspirationally chasing a $10 billion goal, so wishes all the very best for that. And in closing I just want to leave you with a message which is if you are a Man U fan, please try downloading the new app that will really show the power of our digital capabilities. With that thank you very much for joining the call and bye.

Moderator: Thank you. Ladies and gentlemen, on behalf of HCL Technologies Limited that concludes this conference call for today. Thank you for joining us and you may now disconnect the lines.