"HCL Technologies Limited's Q4FY23 & Annual FY23 Earnings Conference Call"

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MANAGEMENT: **MR. C. VIJAYAKUMAR – CHIEF EXECUTIVE OFFICER & MANAGING DIRECTOR, HCL TECHNOLOGIES LIMITED**
MR. PRATEEK AGGARWAL – CHIEF FINANCIAL OFFICER, HCL TECHNOLOGIES LIMITED
MR. SRINIVASAN SESHADRI – GLOBAL HEAD, FINANCIAL SERVICES, HCL TECHNOLOGIES LIMITED
MR. VIJAY GUNTUR – PRESIDENT, ENGINEERING AND R&D SERVICES, HCL TECHNOLOGIES LIMITED
MR. MANAN BATRA – SENIOR MANAGER, INVESTOR RELATIONS, HCL TECHNOLOGIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the HCL Technologies Limited Q4 FY'23 & Annual FY'23 Earnings Conference Call.

As a reminder, all participant lines will be in the listen-only mode and 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. Please note that this conference is being recorded.

I now hand the conference over to Mr. Manan Batra, Senior Manager, Investor Relations. Thank you, and over to you, sir.

Manan Batra: Thank you, Aman. Good morning and good evening, everyone. A very warm welcome to HCLTech's Full Year Fiscal 2023 & Q4 Earnings Call.

We have with us Mr. C. Vijayakumar – CEO and Managing Director, HCLTech; Mr. Prateek Aggarwal – Chief Financial Officer, along with the broader leadership team to discuss the performance of the company during the year and the quarter followed by Q&A.

In the course of this call, certain statements that will be made are forward-looking, which involve a number of risks, uncertainties, assumptions, and other factors that could cause actual results to differ materially from those in such forward-looking statements. All forward-looking statements made herein are based on information presently available to the management, and the company does not undertake to update any forward-looking statements that may be made in the course of this call. In this regard, please do review the safe harbor statement in the formal investor release document and all the factors that can cause the difference.

Over to you CVK and thanks.

C. Vijayakumar: Thank you, Manan. Good evening and good morning, everyone. Thank you for joining us for HCLTech's FY'23 & Q4 FY'23 Annual Earnings Announcement.

When we started the year, there was good optimism around growth supported by strong market momentum but within an uncertain geopolitical environment. When we started the year, there was high attrition and increasing resource costs industry-wide. I'm pleased to share that we've managed to deliver good growth with good control over profitability during such a volatile period.

Our overall revenue growth 13.7% in constant currency year-on-year. The strong growth is attributed to good momentum both in our services as well as our software business. This was on back of strong and healthy growth across segments, sectors and geographies with a healthy margin performance.

As a company, we're very proud to cross the 100,000 crores revenue in INR terms. And I want to thank 225,000-plus HCLTechies all over the world, who contributed to make this very impressive milestone happen.

In FY'23, we delivered industry-leading growth for our services. We grew 15.8% year-on-year in constant currency. Almost the entire growth was organic. In the process, we've gained market share in the year in the services business.

HCL Software business grew 1.8% excluding divestitures in constant currency on a year-on-year basis.

Our operating margins came in at 18.2% for the full year. If you recall, we had started at 17% in the first quarter, and have improved significantly to 18.1% in the latest quarter. I think this was the lowest EBIT dilution among our peers when the resource cost was under stress initially. Things are starting to look better now.

In terms of our segmental performance, IT and Business Services grew 15.4%, Engineering Services grew 16.8% and HCL Software grew 1.8% during the year on a year-on-year basis.

Our software business continues to exceed expectations for the second consecutive quarter with 8.2% growth year-on-year, of course, excluding divestiture during the year. And this is a traditionally weak quarter. We are also very proud to announce that we've crossed an (ARR) Annual Recurring Revenue of $1 billion, which is a very important milestone. And we've also disclosed more metrics around our software business in our investor release.

During the quarter, our ERS business degrew and it is attributed to two verticals; Tech and Telecom, which contributed to this degrowth. We do have the capability to navigate this dynamic kind of environment, primarily based on a resilient business model, and more importantly, our portfolio mix.

Our geography growth was led by Europe at 20.5% year-on-year in constant currency, followed by Americas at 14.4% and ROW 11%, again year-on-year in constant currency.

Top performing verticals primarily due to the significant performance in the first half. Tech grew 22.5%, Telecom, Media grew 22.4% and Manufacturing 18.3% on a year-on-year in constant currency. During this quarter, Financial Services grew the maximum on good demand for cloud and data as well as ramp up of large deals. All of them were executed very well in a timely manner to ensure we transition clients as per the timelines that we had committed to. Manufacturing segment was impacted due to a one-off program coming to an end and associated SI work on that program.

We have had very impressive client additions during the year; we added 3 $100 million clients, now we have 19 $100 million clients; we have 46 $50 million clients where we added three clients during this year. Overall, $1 million client now stands at 939, which is an impressive

addition of 57 clients during the year. These metrics reflect the strength of our mining, cross-selling and up-selling in each of our clients. And also it provides visibility into the potential in a significant number of $1 million clients that we have signed up during the last financial year.

From a booking perspective, our bookings grew 4.3% on an ACV basis, and 6.6% on a TCV basis year-on-year with 13 large deals across products and services. As you would know, the booking numbers that we call out, which is roughly $2.08 billion in this quarter. These are all net new booking, which is all the incremental business that we signed in existing customers and new customers.

We also want to note that our total bookings, which includes net new booking, and renewals, grew 19% during the year on a year-on-year basis. We've had excellent renewals. We've had 99% renewal in our portfolio during the last 12 months.

We continue to expand our reach in G-2000 clients, which is one of our strategic objectives. We believe we have a great opportunity to address the larger market with increased reach. I want to call out a few things that are really helping us in this context.

Our brand transformation is starting to give us the edge, from being the best kept secret to the best-in-class service provider. Started seeing good synergy opportunities for the services business from a few of our product clients. You would remember the mega deal I mentioned earlier in the year.

Presence in many geographies through our focus and new frontier countries from a go-to-market perspective. The deal I'm about to mention is one such deal. This is also the largest deal in this quarter for us and a big one as we look beyond our core geographies.

A Global Top 100 Banking and Financial Services firm in our new frontier markets, who's obviously a new client selected HCLTech to transform its customer relationship channels. We will implement a modern Salesforce CRM and an omni channel solution to enable the bank to deliver hyper personalization to its clients.

It's also a deal during a period when Financial Services globally is in a state of flux. We won a few other large deals both in the US and Europe in the sector, which is a sign of our propositions, which are seeing good demand in this market in Financial Services.

Another deal that reflects our goals, a Fortune 500 existing client expanded their partnership with us to accelerate digital transformation across its operations through convergence of IT and OT. We will modernize the OT environment to drive automation, enhance the safety of employees and productivity of equipments, leading to more sustainable operations.

On the product side, one deal I want to call out is a US based digital solution provider for healthcare providers. They expanded their partnership with HCl Software for use of portal and content management software to meet the growing demands of its clients. The application on

HCL digital transformation DX platform is at the core of the client's business. Our pipeline continues to remain close to a record high and is well distributed across the service lines.

After a period of optimization, I believe, clients know the value of technology and what it brings for the overall business. Still early days for some green shoots, but I'm optimistic of the future outlook.

Our people ramp up continues; we had 3,674 net new additions in this quarter and 4,480 freshers during the quarter, which is lower than the last quarter, adjusting for the market conditions. Overall headcount crossed 225,000 people. We've added more than 25,000 freshers in the year, the highest in our history. While we're scaling fresher intake, we still have an opportunity here. We will have a sustained focus on this over the next two to three years to improve this further.

Our attrition started trending down and continued in the right direction. On an LTM basis, our IT Services voluntary attrition is now at 19.5%, which we believe is one of the lowest in the industry.

We now have dedicated leadership to drive the growth in nearshore locations, which is a very important component of our business strategy. It's starting to show results both as people and revenue ramp up and as profitability improvements.

Morocco is a new near shore center for us aligning with the opportunities that we are seeing in Europe.

In the last quarter, we won many awards. Some notable ones: We've been recognized as the Fastest Growing India Headquartered IT Services Brand among the top 10 IT Services Company Globally according to Brand Finance. HCLTech positioned as a Leader in Avasant SAP S4 HANA services. We were positioned as a Leader in Avasant Digital Commerce. We were positioned as a Leader in Gartner's Magic Quadrant on Outsourced Digital Workplace Services. We are also positioned as a Leader in the Forrester Waves, Multi Cloud Managed Services Providers. We have also received Gold Award at the Economic Times Human Capital Awards for Innovative Hiring and Unique Practices for our TechBee Program, which is HCLTech's early career program.

I'm also glad that the progress has been very good with the dedicated leadership that we have in place on the ESG front. A few recognitions we received this quarter for our efforts: MSCI has rated HCLTech as an ESG Leader in the Software and Services Industry and upgraded our ESG Rating from A to AA. We've also been included in the S&P Global Sustainability Yearbook 2023 as an Industry Mover, for demonstrating sustainable business practices.

In terms of the overall demand environment, there is still evergreen demand for a lot of relevant services, be it the IT operating model change proposition, data modernization, cloud and cybersecurity. We have successfully embedded CloudSMART as a part of all our propositions and leveraging the ecosystem strategy. More than 90 CloudSMART services offerings built

existing services across service lines are also mapped to support the CloudSMART factory delivery model.

We also wanted to remind you that we are the only service provider in all 6 IT Services Gartner Magic Quadrant to be positioned as a leader, a great pole position to be in for next year's race. We were anticipating a cyclical trend change from early last year and we are well prepared for this section of the economic cycle as we move forward.

Though there has been some stress and uncertainty from the system, be it as booking delays or ramp up delays, it's largely restricted to the discretionary spend. While modernization is running into some near-term headwinds due to cost pressures, this is also the right time for clients to look at optimizing mature digital estates and optimize cloud costs.

We don't see so much stress on the run the business side, and it gives us good confidence given our spend in a number of areas, which are very, very mission-critical in running the business for our clients.

There is obviously a huge uptick in the efficiency-led large deals. Cost optimization and vendor consolidation continue to be very, very strongly visible in our pipeline. We also believe the spending will increase in areas like applied AI and analytics, edge computing, sustainability, supply chain optimization, and data and app modernization.

Amidst all the volatility, I want to call out Financial Services, which the industry has been very concerned about. We've had very strong growth, 6.9% sequentially. And we continue to remain very optimistic about our outlook for Financial Services. We see good opportunities with clients seeing relevance of our propositions, especially taking over existing digital foundation landscapes and modernizing them and the target state of hybrid cloud or predominantly public cloud kind of solutions. Our recent wins in this space of course spans across all geographies, Americas, Europe and even Latin American countries.

To summarize, there is a slowdown, but still, we believe there is a floor level which will be higher than the pre-pandemic cycle. And the time to recover also should be shorter. And this message about recovery being shorter is based on the pipeline and the decision timelines that we've seen in all the opportunities that we're working on.

In terms of FY'24 guidance, we believe the technology spend which has continued over the last many quarters, it's time to kind of review and consolidate for our clients to consolidate to the most efficient and impactful technologies and the most efficient and scalable service providers. And we are gaining significantly in vendor consolidation opportunities, not only in our existing clients, but also as a differentiated challenger in few of the clients where we are not there. So, our guidance for FY'24, we expect the revenue growth to be in the range of 6% to 8%. Our operating margins to be in the 18% to 19% range.

And I will request Prateek to cover some more details about the financials and then we will take questions. Thank you.

Prateek Aggarwal: Thank you, CVK. So, wish you all good evening, good morning, good afternoon, wherever, whichever time zone you are.

From our perspective, the key milestone for the quarter and for the year really is the one lakh crores of revenue in rupee terms.

So, having mentioned that key milestone, let me go on to the Q4 overview, and then I'll follow it up with the full year numbers – a lot of numbers to be discussed, so I'll try to make it as rapid as possible.

HCLTech revenue for the quarter stands at $3.2 billion, which is a reduction sequentially due to the seasonality of HCL Software, which hits a peak in the December quarter.

For the quarter, services revenue stood at $2.9 billion, which was an increase of 0.6% sequentially in constant currency. The year-on-year growth in CC is 10.6%.

ITBS reported decent growth of 1.6% sequentially and 11.4% year-on-year in constant currency.

ERS, however, showed a sequential decline of 3.8% due to customers cutting back on some of their discretionary spends, leading to project ramp downs and paused or delayed programs. But in year-on-year terms, they continue to show 7.3% increase in constant currency terms.

HCL Software reported a year-on-year growth of 7.9%. But if you exclude the divested business from the base, that growth was actually 8.2% in year-on-year constant currency terms.

In the software business, we have been talking about publishing some additional metrics. So, we have a new page that we've added to this quarter and the annual investor release.

So, apart from providing the revenue by type of sales, we have also added the annual recurring revenue as a new metric, ARR, which I'm sure you know that typical software businesses and relevant stakeholders tend to focus a lot on. So, we've started publishing that from this quarter. As on 31st March, the ARR stands at $1 billion plus and has shown a growth of 5.2% on a year-on-year basis in constant currency.

For the quarter, EBITDA margin came in at 21.9% and EBIT at 18.1%. I will shortly explain the quarter-on-quarter variance in EBIT. Net income for the quarter came in at $481 million, which was 14.9% and up 1.3% year-on-year.

The walk from the previous December quarter to the current March quarter is actually a very simple walk. HCL Software seasonality in fact itself is about 125 basis points, which basically reflects most of what changed. There was an additional 30 bps drop in the services margin and

that was entirely due to ER&D margins coming in lower by 50 basis points, which was partly recouped from operational efficiency and improvement in EBIT in the ITBS segment, which grew by 30 basis points, at a services level that contributed 20 basis points. So, 50 minus 20, 30 bps is what the services QoQ margin walk was sequentially.

You will see that ERS basically had $18 million revenue impact towards the last month of the quarter, and basically flew down to EBIT without providing the ability to sort of really manage cost in the last few weeks. So, that's something which will obviously improve going forward, but for this quarter, the $18 million pretty much flew down to the EBIT margins.

On the ROIC front, which is the other additional metric that we have been publishing in the last two-three quarters. We are focused on improving ROIC. The Last Twelve Month (LTM) ROIC is now at 30.4%, which has increased 150 basis points on a year-on-year basis, and services now is that 37.3% and software given the good quarter is at 15.5%. Additionally, I would like to indicate that the incremental ROIC, so incremental growth in margin, divided by the incremental additional capital deployed is in the last two-years and three-year periods is more than 50%-plus. So, that's an additional factoid I thought I would share with you. We've been publishing the ROIC and incrementally it has grown at 50%-plus.

I also wanted to share, there have been questions about some of the events that have happened in the banking sector in the last month. In the current operating environment, there are concerns on the stability of some banks. We want to clarify that our exposure to these events and risks to our business and projected growth is frankly minimal. As per our health assessment of our banking clients, based on the credit rating and detailed working that we have done, including the impact of mark-to-market hits on held-to-maturity investments etc., our banking clients with below average or lower credit rating is about 1% of the Financial Services business that we have, which as you know is about 20%-odd of our overall revenues. And the discretionary spend is even smaller than that 1% data point that I shared.

Moving on then to the full year numbers, just a few bullet points. The full year revenue came in at $12,586 million, so $12.5 billion, revenue growth of 13.7% in constant currency terms, somewhat in the middle of the last guided range that we had given you, 13.5% to 14%.

HCL Software grew at 1.8% excluding divested business. Services growth came in at 15.8% year-on-year in constant currency. EBITDA margin came in at 22.3% for the full year and EBIT at 18.2%, again, somewhat in the middle of the guided range of 18% to 18.5% that we had given. Net income for FY'23 is $1.8 billion, which is 14.6% of revenue, which is up 1.7% year-on-year. Our guidance for the year is services at 6.5% to 8.5% and for the company as a whole it is 6% to 8%.

I would just like to point out that this is constant currency and based on the exchange rates at the end of March, there is an additional 70 basis points that we expect in reported US dollar terms. So, the constant currency guidance translates to 6.7% to 8.7% for the company as a whole and

for the services part it is 7.2% to 9.2%. And EBIT as you know we've guided to an 18% to 19%, a narrow range.

On the operating margin guidance, assumes dollar-rupee currency rate of about Rs.82 per dollar, and other currencies at average FY'23 exchange rates.

The tax rate for FY'24 will go up; we expect it to be between 25.5% to 26.5%. The last year FY'23 came in at 23.9%. So, at the midpoint it's going to be an increase of about two percentage points. We will see increased ETR simply because of certain new units moving to different slab in the SEZ regime and some coming out of the SEZ tax benefits as well.

However, the important point, which I've always maintained with all of you is, the cash tax rate will be significantly lower by about five percentage points. So, in cash tax terms, we will continue to be in 20.5% to 21.5%, say, 21% at the midpoint. So, there is a 5% point difference between the cash that we actually pay out as we will continue to pay MAT in India, using about half of the accumulated MAT that we have in the balance sheet as on 31st March, which is about $225 million. So, we expect to use that over the next two years; about half of it in FY'24 and the balance half in FY'25. So, I just want to flag off once again that the ETR in the P&L and the ETR in actual cash flow terms is going to be wide variance of that five percentage points.

Cash generation for the year came in at $2,230 million for operating cash flow on a last 12 months basis, which is at 121% of net income. So, that continues to be at that range of 120%-plus that we have been mentioning in both of our investor days in the last year and as per the promise that we have made to you. And free cash flow as well came in at $2 billion plus; $2,024 million to be precise, and that comes in at 110% of net income. So, both those metrics are extremely good to look at.

Our balance sheet therefore continues to strengthen with gross cash now at $2.8 billion and net cash at $2.5 billion. Remember, in this quarter, we actually retired $248 million worth of bonds that we had issued two years back and that reduces the gross cash. Without that, the gross cash would have been $248 million higher and therefore is $3,058 million to be precise. But net cash obviously remains the same because it is post reducing the impact of borrowings. Overall DSO reduced by two days on a sequential basis, including (UBR) unbilled revenue, it now stands at 88 days.

Shareholders aspects. Ultimately, the net income or profit after tax on a EPS basis, diluted EPS for the last 12-months comes in at Rs. 54.79, which is a 10.1% increase on a year-on-year basis.

And looking at that, and all the financials and projections, the board is happy to declare dividend at Rs.18 for the quarter, that brings up the full year dividend to Rs.48 per share as we have paid Rs.10 per share per quarter in the first three quarter so, 30 plus 18 for this quarter makes it 48, and against the 54.79 of EPS the payout ratio stands at 87.5%. We had promised a minimum of 75%. So, we are staying fairly high compared to that. So, hopefully shareholders should be happy with that.

I just want to take a minute more on explaining the deal wins narrative because there have been some questions and everybody does it a little differently, so I want to be clear on how we in HCLTech publish these. So, bookings for the quarter have been $2.1 billion, that is on a constant currency basis. And ACV growth of that number, the annual contract value, has actually grown by 7.6% on a sequential basis. Just for clarity and for your understanding, we have what we call budgeted exchange rates. We refresh the currency rates at the beginning of the year based on our study of the last quarter and the last year and what projections are available. So, based on that we refresh the currency rates and booking numbers and the deal win numbers that we report are carried at the same rate throughout the year. So, there were some questions on that. That is the reason I'm getting to that level of detail. And also, FY'23 budgeted exchange rates were the same as the FY'22 budgeted foreign exchange rate. And therefore, all the $8.9 billion of deal wins that we've published are actually at constant currency rates because the budgeted numbers were exactly the same, the forex rates.

So having clarified that, let me elaborate on some of the other attributes. So, as I hope all of you already know, the TCV that we report includes only the net new deals. We do not include any renewals in that except, of course, if there is any incremental work that comes in as part of the renewal, we'll report only the incremental part. And this includes large, medium, small, all kinds of deals.

We don't sort of differentiate, but all the numbers that we report are only the net new deals for both services and products. And this number comes in only when they are committed by the customers. So, we don't take projections given at the time of RFP and during the discussions and we don't publish that till it actually converts into a signed SOW or purchase order. So, rate card deals, we don't publish any TCV upfront. Only when the work actually is granted, I mean when the purchase order or the SOW comes in, that is when we publish the TCV and related ACV.

And also, we do use the term large deals. So, large deals, the threshold that we use for that characterization is, for the services business, it's greater than $25 million and for the products business, it is $2.5 million. So, in the year, we signed 57 large deals. So, 32 in services were all individually greater than $25 million each and 25 in software were each individually greater than $2.5 million.

So, with those list of clarifications, I am happy to sort of take a pause here and open up for questions and answers. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. First question is from the line of Girish Pai from Nirmal Bang Institutional Equities. Please go ahead.

Girish Pai: I wanted to know the 6% to 8% guidance you've given. Is this front loaded or backloaded? And what is the volume size mix that you have?

C. Vijayakumar: At this point, we don't want to call out how it is going to pan out on a quarterly basis. But I think the best reference point will be to look at our past years' performance. We do believe it will follow a similar trend. Usually, you see our quarterly growth rates, low in the beginning of the year and it starts from JFM, it's probably at the lowest and then it keeps going up and it will peak in December. That's the trend that you've seen in the past and I do think that will reflect.

Girish Pai: And in terms of the volume price angle to your guidance, is it completely driven by volume?

C. Vijayakumar: Yes. I don't believe there is going to be a price expansion in this environment, and I don't think we have baked in that in the revenue or the margins. It's primarily due to volume.

Girish Pai: On the margin side, what do you think are going to be the key headwinds in FY24? Because the general impression has been that there are going to be lot more tailwinds for you to expand margins in FY24, but that doesn't seem to be kind of coming through?

Prateek Aggarwal: So, I think Girish, we are factoring in the fact that it is a very different macro that we are facing at the beginning of this year as compared to last year. We do hope and expect to some extent that it will change for the better fairly quickly as it has the last few times that we've seen this kind of turbulence. So, we are factoring all of that and we've given you a pretty tight range. There are tailwinds expected and foreseeable from the supply side. But at the same time, there are potential headwinds that we might have to factor in. So, that's all factored into the guidance that we've given. And we will see how it plays out and see if there's a need to correct later on.

Girish Pai: Just to push this a little bit more. Besides salary increases, what else do you see as headwinds?

Prateek Aggarwal: I think I don't want to really get that specific, Girish. I think there is an environment that I already called out. Beyond that, what do you want me to say?

C. Vijayakumar: Yes. I mean, apart from regular wage related dynamics, there is also productivity benefits and things like that. And I think these are the 2 things which we think are significant to be called out, nothing more.

Girish Pai: Lastly, on HCL Software, it seems like you're kind of building in a little bit of decline in FY24. Can you throw some light or color on the product space?

C. Vijayakumar: I don't think we're building in a decline. I mean, we do believe it's been a great year for the software business. From a negative trajectory, we are well into a positive trajectory. And our general expectation is we will continue that kind of trend. Obviously, there are always lots of puts and takes, and we provide some kind of easy numbers from a guidance perspective rather than going to the second decimal and things like that.

Moderator: The next question is from the line of Kawaljeet Saluja from Kotak Securities. Please go ahead.

Kawaljeet Saluja: Just a couple of questions from my side. First is on the guidance. CVK, what gives you the comfort on guidance when you're coming off bookings growth which was just 4% in ACV in FY23? I remember when you gave guidance for FY23 at the end of FY22, it was coming off of fairly robust bookings including $3.1 billion somewhere in March 2021, whereas the bookings trends are fairly muted at this time around. So, I just want some qualitative color as to what gives you that comfort.

C. Vijayakumar: So, Kawal, first is that $3.1 billion has really kind of contributed to the growth in FY22. And if you look at the bookings during FY22, I think on a year-on-year basis, it has grown probably about 10% or just in that range. As you know, we report only net new deals. So, renewals are not counted. So, net new deals really, technically, they add to the overall revenue. But the headwind there is, there could be project completions and there could be ramp downs and things like that. Now, what gives me the confidence, I think, even from an exit perspective in the services business, I think we would have a tailwind of about 2.8%. So, with that kind of an exit, 6% to 8% really factors in a very modest sequential growth rate. Even if you assume Q1, which is a little soft for us. Even if I factor this in, Q2 to Q4 is a very manageable kind of sequential growth rate for upper and lower end of the guidance.

Kawaljeet Saluja: I understand that CVK. But that's just math, right? Because for 4Q, in December, you called out a growth rate of 1.5% to 3% and you came in at 0.5%. So, this definitely can change depending on the environment. But okay, nonetheless, I'll drop this topic. I mean, the other aspect and basically just a couple of related question is that the first is you mentioned the time to recovery could be shorter this time around. Now what gives you that comfort, any data points, any anecdotes basically which you can relate to the past cycles, which gives you that comfort that time to recovery should be shorter. And a question for Prateek that does this quarter include, I mean, does Q1 revenue include that contribution from mega deal or has that contribution come in in the fourth quarter itself?

C. Vijayakumar: So, Kawal, let me first address the first one. See, first is in our business, we feel Financial Services will continue to deliver strong growth. So, let's keep the outlook for Financial Services outside this. So, the recovery is really focused on Tech because Tech is the vertical where we saw ramp downs in the last two quarters. And usually, I mean, what we've seen in Tech is, there is obviously significant layoffs and things like that which happened. And then when projects needs to be done, we see customers using lot of external vendors. And we've already started to see that in some pockets. And that's at least in 1 very large kind of client, like in those kind of clients we're already seeing. They start consolidating. Where they cannot hire, they use external providers like us. And usually, I think this kind of trend as you've seen in one or two quarters, we keep seeing this thing coming, not only when there is a cyclical thing. Even if one particular client goes through some restructuring, we've just seen in 3 to 4 months, lots of external service providers are used. So, I think that's the basis and we are also seeing some of that visible vendor consolidation opportunities in big Tech, which is one of our forte, and we believe that's definitely going to help us.

Kawaljeet Saluja: There was a mega deal signed which was supposed to contribute in 1Q. Is it slated to contribute in 1Q or has the contribution come in 4Q itself?

Prateek Aggarwal: So, Kawal, there are actually multiple mega deals. So, just to refresh, there was 1 mega deal we talked about at the end of September, which is what I think you're referring to which we said would start towards the fag end of Q4, which has started pretty much exactly on the dot where it was planned. So, yes, that has come in in this quarter itself, albeit for the last month of the quarter. So, the next quarter is going to be the full quarter impact of that. Also, you will remember there were large deals in Financial Services that we had talked about in the December quarter. So, those are going to be starting now and going pretty much as per plan. And that will again come in the Q1 of FY24.

Kawaljeet Saluja: Just a final question actually. Thanks a lot, Prateek, for those additional disclosures on products. I mean, I see that subscription and support has that quarterly volatility. Is it largely consumption-based volatility on a sequential basis? Or is there more to that of quarterly volatility in subscription and support, which is an annuity-based revenue in products?

Prateek Aggarwal: So, the volatility comes from the revenue recognition principles as per ASC 606 and the similar IFRS 15 kind of standards, which is why we've started producing the ARR metric for which we've given a definition, which I'm sure you would look at, but to put it very simplistically, it is more like an (ACV) Annual Contract Value, which is a term all of us are familiar with. So, that volatility is more related to the revenue recognition principles. But ARR is more like ACV just to put it very simplistically.

Moderator: The next question is from the line of Ravi Menon from Macquarie. Please go ahead.

Ravi Menon: Your revenue margins have come in below expectations and probably that's behind why the margin guidance doesn't seem to factor in your ambition to get back to pre-COVID margins. So, do you see a pause to that over the next few quarters? And should we think about this margin guidance as conservative and probably factoring in any further ramp downs or unexpected cancellations?

Prateek Aggarwal: So, Ravi, thanks for that question. Because I think I would like to reiterate, as we have been discussing in the last several quarters, our aspirational range of EBIT continues to be 19% to 20%. So, let not the guidance that we have given, tone down that medium term expectation and aspiration that we have. When we give guidance, we are obviously expected to be realistic. And given the environment that we are going through, especially in the first half of this year or whatever, we have factored all that in into the guidance. But over the medium term, our aspiration continues to be that 19% to 20% band. So, there is no walking away from that. We have to get back to that. It is only a question of when, not whether.

Ravi Menon: You spoke about ER&D margin recovery being a bit gradual. So, should we think about this as the pipeline has start converting into revenue as quickly, so redeployment of the people is not easy? Is that how we should think about ER&D margins and growth?

C. Vijayakumar: If you look at the revenue drop in ER&D this quarter, it is almost flowing into the margins almost entirely, the $19-20 million drop in revenue is almost visible in the bottom line as well. So, obviously, when customers ramp down or there are certain costs that we continue to carry, and we have various ways to redeploy and attrition backfill and all of that. So, we have some levers, but it may not be very quick because some of the skills are unique and things like that. So, there are location intricacies involved in this. So, it would recover more gradually.

Moderator: Next question is from the line of Sudheer Guntupalli from Kotak Mahindra Asset Management. Please go ahead.

Sudheer Guntupalli: On the IT services piece, one of your competitors recently raised an alarm on unprecedented, unexpected and broad-based ramp downs and cancellations, which impacted the March quarter. Post that the industry perception which got built was that it's a blanket IT services industry wide trend, some companies may see the impact early on, and some may see later on maybe in the June quarter. Clearly, your March quarter results do not reflect any such trend. Two questions on this. First, apart from a general sense of caution which is quite well known, are you seeing any macro led shocking change in terms of the client behavior versus September and December quarters? Second, are you worried that if not in March, we may have to see some of it in the subsequent quarters over and above the normal seasonal weakness we usually see in June?

C. Vijayakumar: Sudheer, while I don't want to comment on any specific providers in the industry, I think the biggest indicator of how the spend pattern is going to play out is normally dependent on the client budgets. And in Q1, most clients have visibility to what their budgets are. And that's why you would have seen a little muted growth in Q1 because whatever plans that kind of got rolled out, customers were very quickly trying to kind of readjust their spend to be in alignment with their budget. So, a lot of our planning is informed by whatever visibility that we have, from our clients on the specific programs. And that's what we have factored in. And I do think, I mean, most of whatever pain has been factored in their client IT budgets. And if they had to inform us of some program for which they don't have funding, they would have definitely done it in the first quarter because that saves them more money throughout the year. So, I think we've done a pretty good analysis, especially in our Tech and Telecom verticals. We think the budgets have been defined and most likely that will continue.

I think the Financial Services between Banking, Capital Markets and Insurance, we feel very, very confident of the trajectory in both Insurance and Capital Markets. Banking could be a little muted based on the spend patterns and the understanding that we have. So, that's what we see. And I want to just be limited to our commentary at this point, rather than providing an industry outlook.

Sudheer Guntupalli: Just 1 more follow up since you mentioned about budgets. So, if you look at the budget trends that your customers would have defined in the first quarter and sort of contrasted with what the trends would have been a year ago, so are they significantly different or it's just a bit of moderation? What exactly you're seeing?

C. Vijayakumar: I think it's moderating for sure. In some segments, there is more moderation, especially where inflation impact is very high, the moderation is significant. And that's also the reason you're seeing a lot of big deals in the pipeline. We have many $0.5 billion plus deals in the pipeline across many verticals- Financial Services/Telecom. It is actually sectors where we see more pressure is there, we're seeing large deals.

Moderator: Next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: CVK, two questions. So, one is we seem to be seeing a very different trend in your results compared to those who have reported so far. So, the US appears to be very strong while, Europe seems to be weak. What's driving that differential? That is one.

And the second is I remember in the last quarter, you basically said that the way discretionary spends will move is anybody's guess. What are your thoughts on that now? And do you think that should sort of turn at some point. So, just wanted your thoughts on both?

And finally, on the margins, earlier, I think well, you did mention, Prateek, that it is not a question of whether it will happen, but when it will happen. For this year, is it more driven by the cost take out and large deals? Is that why you are relatively maybe a little more cautious versus what we thought maybe last quarter? These are the 3 questions.

C. Vijayakumar: So, maybe I'll take the first 2 and Prateek will take the third question. So, I think why Europe is weaker than the US. I think I did call out last quarter and even in the previous quarter, the booking has been stronger in the US than Europe then some of the decision making has been slower in Europe. And I did call out that that will start reflecting in revenue slowdown in Europe, and that's what you're seeing. I think it will take another quarter. I mean, we still have a good pipeline. I don't have a lot of near-term confidence on some huge bookings in Europe, but maybe the second quarter, we're likely to see something. But the US continues to remain very strong. Different trends compared to other industry players. I don't want to comment and as I said, I'm looking at my pipeline, my clients, the programs which we are working on, are they going to continue on those programs during this year. So, we have a good feel of projects which are ramping down and at least part of that is in the JFM numbers.

Discretionary spend, yes. Last quarter, definitely we had a lack of clarity on where things will move. But as we started working through this quarter, looking at our top 50 clients and all the key programs, there some ramp downs have been there and some comfort that other programs will continue has also been there. And then added to that are the large deals that we won in the last two quarters. So, I think some of this is all playing into our slightly better growth outlook for the coming year.

Prateek Aggarwal: Nitin, on your third question. The simple answer is yes. Yes, we are banking on cost take out projects and large deals. So, some of that is also reflected in the margin guidance that we have given.

Moderator: Next question is on the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: So, a couple of questions. Firstly, if you could deconstruct for us the outlook within Financial Services in US versus Europe, are there different trends? Secondly, you mentioned about market share gain. Have you seen any benefit from vendor consolidation opportunities? And is it specific to any 1 or 2 key verticals? And last question. You also mentioned about run the business being very resilient versus discretionary spending. Any color on what part of our business is more akin to run the business versus discretionary?

C. Vijayakumar: We have our Head of Financial Services, Srini Seshadri, on the call. Srini, would you like to respond to this.

Srinivasan Seshadri: So, I think CVK mentioned already the Financial Services results are on the back of good execution that we've done over the last 2 quarters. Prateek also mentioned that things went as per plan. So, we've already had significant successes in North American Financial Services. And Europe is also showing good signs right now, the pipeline despite what the macroeconomics might be is showing good signs. North America is definitely leading Financial Services. Europe probably is trailing. But we still see a good sense from there as well.

C. Vijayakumar: You talked about market share gains. So, which verticals we have gained market share? At least two good call outs. Financial services, definitely we are gaining market share based on the two large wins that we had announced. And even in this quarter, I mean, at least three wins have been in Financial Services actually in three different geographies, so it's more broad-based. And also, in one of the large Capital Markets players, we are consolidating another provider who is at least 1/3rd of our presence. So, that's, again, a very large consolidation in Financial Services.

The second vertical where we are gaining some market share from a wins perspective, it's still not reflected in revenue is Retail-CPG, where we had some wins. So, now it's going to start reflecting in revenue during this year. And Tech and Telecom, I think in both we're already in the midst of a number of consolidation opportunities, some of them consolidation from a number of small vendors into 1 large vendor. And again, it's not just vendor consolidation. It's also about how can we bring some of the newer automation levers in providing much better cost structures for the client is really a good challenge some of our clients have kind of given us and we are working through some of them and we are seeing some encouraging results.

Telecom- In all the large players, there are definitely big opportunities which we are participating in. And we do believe we will gain some market share in Telecom this year. So, four verticals, FS, Retail-CPG, Tech and Telecom is where we expect to gain market share during this year.

I think we have RTB spend across all 4 service offerings. Whether it is infrastructure, a lot of applications also. In fact, see, a lot of customers have expanded their digital landscape, and today they're looking at how can they optimize their digital landscape. Like, some of them have 200 plus SaaS providers providing lot of niche vertical solutions. So, can that be rationalized? It's

very similar to what you will see in a traditional landscape, we're seeing that in digital landscape as well.

Similarly, what are the ways to optimize the Cloud consumption spend and the operating costs around that. So, I think this means sometimes it's a small, fine-tuning program. But quite often, it's about making some significant changes in the applications to see how the consumption can be more optimized, which means there is a one-time program. Or sometimes they are even signing up ongoing fin ops where financial operations of the cloud spend which is contracted as a percentage of the cloud consumption to kind of provide some good revenue visibility. So, those types of opportunities are there.

Even though it's cloud consumption, we still see that as run the business kind of spend where we have a play in it. And similarly, in the engineering services, the product, sustenance, product professional services, all of them, we treat them as RTB, and we see some good opportunities there as well.

Gaurav Rateria: Thank you for the detailed answer. If I can squeeze in 1 more. The deferral in discretionary spend that you mentioned, which happened probably towards the end of the quarter in March, is this something which is still continuing and kind of likely to have the impact in June quarter as well?

C. Vijayakumar: So, I think largely that is in ER&D, you will see that in Tech and Telecom is where we had this challenge. We think in some clients, the pain is behind us, there is a little bit more in a couple of clients. We expect that to stabilize during this quarter based on all the ramp ups and execution that's happening. And some of this is also related to offshoring. While we continue to have people onshore delivering services, we have a commitment to kind of transition this to offshore and some of the higher end work does take some time. So, that also has some impact on this.

Moderator: Next question is from line of Manik Taneja from Axis Capital. Please go ahead.

Manik Taneja: Just wanted to prod you further with regards to that ER&D weakness that you've seen. When you have highlighted that hi-Tech and Telecom essentially have accounted for the bulk of the decline in the current quarter, how should we be thinking about other segments within ER&D?

C. Vijayakumar: I have Vijay Guntur who is the President of our Engineering and R&D services. I will ask him to provide a little more color.

Vijay Guntur: The spend in technology and Telecom, these are the 2 areas where we've seen some softening of that spend, mostly discretionary spend that we have seen softening in. And that's in specific accounts and areas. Some of it has been expected and we factored it most of that I would say. There will be a little more continuing in that in specific accounts this quarter. Other verticals, I don't think there is a big discretionary spend that we see coming in and getting hurt by softness. We think those are reasonably good.

Moderator: Ladies and gentlemen, due to paucity of time, that will be our last question for today. I now hand the conference over to Mr. C. Vijayakumar, for closing comments. Thank you, and over to you, sir.

C. Vijayakumar: Thank you for joining the call. In FY23, we delivered the industry leading services growth with the lowest dilution in EBIT margin, a number of our people metrics has come in much superior to our industry peers. In FY24, it's our aspiration to drive towards delivering industry leading growth. In the current macro environment and also if the macro environment improves, we want to be prepared to make sure we are able to capture all the opportunities and deliver superior organic growth with an improving margin profile. And we want to do all of this by being efficient in how we use capital, focus on organic growth, improving margins trajectory, right sizing our cost structures, continuous focus on all the 3 levers that we have, at least two major levers which is around continuing adoption of freshers and improving utilization and kind of streamlining the pyramid. So, we will continue to work on all of this. And we remain pretty confident of our outlook for FY24. And thank you for your support. I am looking forward to connecting with all of you in the subsequent quarters. And thank you for joining us today.

Prateek Aggarwal: Thank you very much.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of HCL Technologies Limited, that concludes today's call. Thank you all for joining us. And you may now disconnect your lines.