# "HCL Technologies Limited Q1 FY19 Earnings Conference Call"

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**Moderator**: Ladies and gentlemen, good day, and welcome to the HCL Technologies Limited Q1 FY'19 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 telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. C. Vijayakumar – President and CEO, HCL Technologies Limited. Thank you and over to you, sir.

**C. Vijayakumar:** Thank you. Good Evening and good morning to all of you. Welcome to the commentary on our first quarter performance for fiscal FY19. Overall, our performance continues to be very consistent. Over the last 12-months basis, we crossed revenue milestone of $8 billion, we continue to deliver consistent margins in line with our desired margin range which is what we have guided in the street in the beginning of the year.

Our overall strategy around Mode-1, 2, 3 continues to work very well. We are monitoring all the dimensions of our strategy and every dimension is delivering in line with our expectations or even better. What is most striking, is our revenue per employee is the highest among our peers and even among the global competitors, it is among the top-three revenue per employee. Our EBIT per employee is also the highest, better than some of the largest consulting companies in the world. So, all of this is very good trends that we have been tracking and we are very confident of how we are executing the strategy.

Now, I will provide you the highlights about this model. Financial performance in Q1 FY'19 has been largely in line with what we had in our plan. We also had the highest ever booking this quarter, led by next-gen infrastructure services and a variety of our Mode-2 services, primarily driven around Cloud-Native and our digital offerings. This highest ever booking is significantly higher than the bookings that we did in the OND quarter when we also mentioned that it was the highest ever booking quarter.

There were 27 transformational deals, including the large strategic programs like Nokia and the booking number and the number of deals excludes renewals. All of these are additional business from existing customers or net new logos. One of the largest programs greater than $0.5 billion in TCV that we won this quarter was Nokia networks. Here, the biggest win theme was our next-gen infrastructure capability which is really driven around modernizing the legacy IT estate and consolidating applications, rationalizing applications and reducing the footprint. That was the big win theme. Through this program we are consolidating from at least four significant service providers, consolidating all of the infrastructure and application services under our fort.

The bookings were also significantly broad-based. At Telecom a couple of good deals including Nokia. Financial Services four large deals which is also delivering strong momentum. Retail, CPG and Utilities were other segments which delivered significant momentum in terms of the size of the deals and the value of the deals. Our client partner program continues to deliver good benefits. Our client pyramid has improved. $100 million client gone up by one in the technology segment. $50 million plus client has gone up by four this quarter. So, we continue to cross-sell and up-sell in our existing clients to deliver the better client metrics.

India SI business, we continue to go down the path of reducing our exposure there and we are as per plan. As indicated this quarter, there is a reduction of 12 million in our India SI business which has now come down to 0.5% of our revenues.

We also successfully integrated the C3i acquisition which started early in the last quarter. We are also happy to report that quarter's performance of C3i was in line with what we expected.

As you would know, we announced a new acquisition, H&D international in Germany. We have been highlighting that geographic expansion is one of our inorganic strategies in addition to IP and digital or Mode-2. So, this really helps us get good in-country presence in Germany and will also help us in the automotive sector where there were some disruptive infrastructure transformation programs to enable autonomous vehicles and things like that are the prime drivers behind this acquisition.

Moving to the next slide: We are very happy to share more details about how we are doing in our Mode-1, 2, 3 performance metrics. We were the first in the industry to share the revenue share across Mode-1, 2 and 3 and at this point our Mode-2 and 3 revenues stands at 26.6% of our total revenues. This quarter as we had committed earlier we are sharing an additional information which is really giving you the EBIT percentage by Mode-1, 2 and 3. As you can see, our Mode-1 margins continue to remain stable around the company margin levels; approximately 20% is where we are driving and continuing to deliver on our Mode-1 business.

Mode-2, while we continue to do very well, it has grown 8.2% QoQ, the margins in Mode-1 are below our company average and this is primarily driven by significant investment in talent and capability building through organic means in the last two years. We have built several innovation labs across the world for Digital, Analytics, IoT Works and Cloud-Native; we have invested significantly in the pivotal Cloud-Native partnership. So, some of these investments are very deliberate. Some of the initial projects that we picked as large digital transformation projects, as a strategy we are continuing to overinvest in those programs so that we can really deliver a very high level of business outcome for the client which will help us to deliver extremely good showcases, which are going to become the foundation at this particular point in time scale digital programs which Anand will talk about a little bit later.

We are also seeing significant resurgence in the next-gen infrastructure services. I was alluding to the fact that in H1, we will definitely see a revival primarily from the general trends that we were seeing. While some of those decisions were getting delayed last year, but I think now we feel a lot more confident about the resurgence in the next-gen infrastructure services, largely riding on the way of software-defined stacks, hybrid cloud, a significant traction in digital workplace and significant transformation opportunities in network and cyber security which will also now classified under infrastructure services.

On the Digital and Analytics front and Cloud-Native services, customers are primarily looking for transformational service providers, primarily a lot of large spenders in financial services and non-financial services typically the Fortune 100, 200 category very large spenders who have multiple vendors in their ecosystem are really looking at consolidating their work with two providers with primary focus in the evaluation to see who has the right digital capability. The digital capability, I would say, there are two dimensions. They are looking at not only the skill and the talent, but they are also looking at the whole culture and the operating model. With a lot more onshore and near shore capability and the presence that we have, I think we have positioned extremely well to win large scale digital transformation programs. Cloud adoption is continuing and at this point I would say customers cloud adoption is more to drive, more innovation in their business model than cost out. The primary driver is innovation and it is not the cost out. I think a lot of large corporations with the CIOs are recognizing that public cloud is not going to deliver cost savings but the reason why they are adopting is quite different and it is all around innovation and some agility and quick delivery that they want.

The Mode-3 business is 11% of our revenues. The margins are 25.2% at an EBIT level, significantly higher than our company level margins. All the IP partnerships are performing as per plan or better. Darren will share more metrics. This time we are sharing how various products have performed, have taken pace and Darren will run you through that. This Mode-3 has IP partnerships where we have invested, and it also has a good amount of organic IP and the organic IP largely is around DryICE which is our autonomics platform which we have built over the last almost 10-years which we have deployed extensively in our Infrastructure business and in our application support and maintenance business. That is one component of DryICE which is being now taken to market as an independent product offering driven by a separate sales organization.

It also the case that some of the IP which we had in our application services like a couple of quarters back we announced that our higher model solution now is a part of SAP's product catalog which is made available to the entire client base of SAP and we see that as a good growth opportunity. We also have some of the telecom providers that we have invested in, in our engineering and R&D services. They are also contributing to the overall Mode-3. So, when we did an analysis of our Mode-3 portfolio, there are two themes which are emerging. You can actually classify Mode-3 products into a Mode-1 or Mode-2 like some of them are enabling Mode-1, they are matured products which are probably either mid-to-late life cycle in their whole life cycle and the second set of products are now, the products are automation, AI, lot of things that we built in DryICE as well as some of the IP partnerships that we entered into. So, there are two categories. At this point the split of the first and the second is 60% and 40%. So, 60% is in the matured product lines which could be stable, declining or some of them are growing at a single digit level but 40% of the portfolio in Mode-3 now is all in the new areas and given the right sales focus, go-to-market focus, this is going to give significant growth. I am very confident of 40% of our Mode-3 portfolio delivering a double-digit growth.

One word of caution; While IP revenues contributed to 11% of our revenues and EBIT stands at 25.2%, the whole IP revenues are cyclical, very-very similar to what the software product companies are seeing and the cyclicality I am sure all of you know, there is generally a higher momentum in the last quarter of the calendar year and probably the first quarter of the calendar year and typically the Q2 and Q3 of calendar years are somewhat soft, Q3 is probably the lowest quarter for most of the product companies. So, while we started falling out revenues every quarter as well as we are going to call out the margins, on both Mode-2 and Mode-3, you can expect some amount of fluctuations, these metrics will stabilize over a period of time and Mode-2 we need to scale up a lot more. Just a word of caution: These do not start extrapolating these metrics, there could be a cyclicality and you will start seeing it as we report this for more quarters.

So, overall it is a pretty satisfying performance, it continues to give me confidence that we will deliver to the guidance that we have provided on the revenue which is 9.5-11.5%. On the margin front, we remain confident of 19.5%-20.5% EBIT margin range. I am sure all of you know that dollar appreciation is providing us a little bit of a ticker on our margin front, but I am not very sure if all of the ticker is going to flow into the bottom line because as a conscious strategy we are open to invest on, the pricing of new deals is getting driven around the higher dollar/rupee conversion ratios. So, I do not expect all of that to flow into the bottom line. So, we remain confident of 19.5%-20.5% margin range.

With this broad commentary, I will request Anil to provide you a little more details on the financials for the last quarter.

**Anil Chanana**: Thank you, Vijay. Good evening, good morning, everyone. As Vijay mentioned, this has been a good quarter where we have built as per our plan, so our revenue growth is 2.7% in constant currency terms, in rupee terms it came to 5.3% QoQ and 14.2% YoY. There has been an expansion in EBITDA, operating margin as well as net income. The EBITDA margin expanded by 20 bps from last quarter and 110 bps from the same period last year. The operating margin expanded by 10 bps and the net income margin expanded by 40 bps from last quarter. The earnings per share at Rs.69 higher by 8% as compared to last quarter and 14% from same period last year. Our payout ratio in the last 12-months has been at 54% of the net income and 69% of the free cash flow before consulting any payment for IP related. So, it has been pretty good.

This is the summary of the financials. One more thing I would like to add is the increase in cash flow conversion has been good, the net income to operating cash flow has been at 102% while rupee cash flow to EBITDA conversion has been at 67%. So, the metrics have been doing good.

**C. Vijayakumar:** We are going to spend a little bit time on the Next-Gen Infrastructure. Kalyan Kumar who is our CTO for IT Services who also runs the infrastructure practice as a part of this portfolio. Over to you, Kalyan.

**Kalyan Kumar**: Thanks, Vijay. Good afternoon, good morning, good evening to all. I am going to spend some next five minutes running you through what we are really seeing and just to corroborate on top of our CVK mentioned about the bookings, the large deals, especially giving some examples of Nokia, what is really happening in the infrastructure market and what we have decided to capture the ship.

There are five real trends which we are seeing in this: The first one is about the customer spend in infrastructure is shifting, it is not going down, it is just shifting from one bucket to another bucket that they are trying to build infrastructure as a foundation called "Digital Enterprise" and also use it to modernize their infrastructure, they are coming on old kit, old infrastructure, running multiple data center footprint, they are trying to consolidate and bring them into a more hybrid model.

The second thing which companies have started to realize is that cloud is a means to drive innovation, new capability, drive modernization of applications, help, build more digital applications, it is not just you shift your virtual machine from one place to another or trying to move your workload but really use how to innovate and as a secondary band we can start to realize cost, which means customers are not really putting together a holistic software-defined hybrid strategy, that I want to modernize my data center using software-defined technologies, I want to use digital workplace as a lever to be able to drive significant employee experience and engagement, leverage all the new capabilities on AI, Cognitive, Cloud-Native, move lot of my productivity applications for SAP and that is where the big shift is happening.

The third is definition of infrastructure shifting from core infrastructure to application infrastructure platform and data infrastructure. That means I am going to really build new structure to support modernize applications in a hybrid way and able to handle this massive drive towards explosion of data is caused by the IoT, new social data linked to product mix public data with private data and create a hybrid data scenario. So, that is the big trends we are seeing in infrastructure is the customer mind pattern is continuing to focus on modernization and new capability and a lot of spend happening around employee experience at workplace and the last but not the least is seeing significant investments coming back into the network space. So, typically thought to be to just a carrier fees for industry seen capability around software-defined plans, software-defined networks and virtualizing lot of network confluence. So, what are we trying to do to enable this out? So, we started to release a new model, because the next generation infrastructure group is called digital transformation is being about 18-months in action. So, this is the new blueprint to help a customer, identify solution blueprint, reusable components and also pre-packet validated to time. So, we work with some of the new partnerships and systems for example, we are one of the three companies worldwide which are VVD 4.0 certified. We have got rebuild, reusable solution packs and build on pivotal cloud contrary they have open shift using modernized software-defined infrastructure, hyper converge platforms, building solutions around Microsoft 365, eSuite around the platform space. So, we started to create a new partnership with ecosystem around on this whole new infrastructure.

The third is we started to see significant shift in the way people consume infrastructure services and the commercial models around it. About a move from CAPEX models to infrastructure utility, ability to consume them in a more flexible up and down model, newer commercial models are being evolving around infrastructure space.

The fourth area which we are really focused on is how do we modernize ecosystem culture. So, apps, the world shifting towards the scale digital model, some of the principles and best practices are getting build up in the agile infrastructure, however making to the structure that is programmable, infrastructure is fold, how do I bring in some of the DevOps maintenance, really bring hyper integration between infrastructure and make it more agile to serve the digital needs of an enterprise.

The last but not the least most important is operating model is changing and as CVK pointed out before that we are using a lot of our DryICE products into the core operating structure services business, driving autonomics at the center, significant AI machine learning and those capabilities.

So, to sum it up, we are seeing a massive shift in the way customers are buying, that is newer evolution happening on infrastructure and we are rightly positioned and some of the examples of these like we announced quarters back like Procter & Gamble and Nokia are really driving this whole piece around using the blueprint.

Over to Anand.

**Anand Birje**: Thanks, KK and good evening, good morning, good afternoon, everyone. I just wanted to give a few updates on our digital and analytics business globally which is the large part of our Mode-2 services. Kind of building on where CVK was talking about the growth that we have experienced in the last quarter and the last couple of quarters actually. Highlighting a little bit of the trends and catching up also from what we spoke about last quarter, which is enterprises are really moving away from proof-of-concept and small digital experimentations to embarking upon more continued digital journey. In those journeys, the enterprises especially Fortune 100, Fortune 500 customers are starting to rethink their applications in infrastructure topologies, their business processes, their value chains and value capabilities and actually in that journey also rethinking. One of the service providers they are working with and rationalizing service providers based on their digital capabilities and that translates roughly to the capabilities around process and user experience, transformation, their capabilities around modernize, application development and scale digital, scale agile approach to application delivery and also around data engineering, data operations and analytics. Some of our investments in these areas over the last two to three years are starting to really pay off, particularly our experience is that we have developed in working with some of the front running digital enterprises across the world and across industries that started adopting such scale digital and scale agile journeys, early in these last three years and our experience is in working with them in these operational model changes, in the process changes, and there of course their technology adoption changes are becoming really attractive to new customers as they adopt and start their journeys in these transitions, they see the experience as we have garnered as an important element of differentiation. Again, I do like to highlight that digital transformations are moving away from simply strategies and POCs to ongoing digital execution and digital engineering programs and that actually has reflected and the continued win momentum we are seeing in large scale digital deals where ongoing digital execution, digital engineering partners, the status is what clients are looking to essentially define for their multi-year engagements. This is happening across industry, this is happening across geographies over the last few quarters, it is only getting more and more validated.

We will be also sort of reformatting in how we are delivering and the format and design of our delivery centers that are ready for such scale digital deliveries. We established such centers in US across Frisco, Texas, in Europe across Amsterdam and then Den Haag in Europe and we are also bringing those same designs into the delivery centers that we have created in Noida, we recently leveraged and released actually a scale digital delivery center in Noida which has become a key hub for delivering large scale ongoing digital transformation programs and we are going to replicate that sort of design and that approach in our digital delivery centers across the country going forward. So, that is a quick update on where we are and what is causing the momentum shift and the growth in our Digital business.

With that, I am going to hand it over to Darren Oberst to give a quick update on our Mode-3 strategy specifically on products and platforms.

**Darren Oberst**: Perfect. Thank you, Anand. First to kick off, I think the CVK highlighted that this was a solid quarter for us in our products and platforms business. It was balanced along multiple dimensions. As CVK highlighted, all of the products that we are working on whether it is through IP partnerships, with a number of global partners, whether it is acquisitions, organically develop the IP, it is ultimately pointed in a direction of either #1, how do we enable and drive that automation in our Mode-1 business or play a key role in developing, innovating and transforming in a new offerings and conjunction with our Mode-2 service lines. So, all of our efforts are ultimately pointed in those directions.

A few of the key highlights in terms of this quarter: First, we did enter into an additional IP partnership with one of our large established partners in the area of digital experience platforms. We think there is tremendous capability both with the current technology as well as opportunities to modernize and innovate at over time, trying in with many of themes that Anand just reviewed. Second, we continue to make progress in terms of developing new innovations organically within HCL under our DryICE brand. We had several new successes with customers as well as new offerings, really just a component of 21 new patents and new technologies that we continue to develop in next-generation autonomics areas. Our IP partnerships continue to deliver better performance than our invested business cases.

I would like to take a couple of minutes and just highlight some of these case studies. I think one of the questions that we have gotten consistently from the analyst community to help understand at least qualitatively, what some of the work that HCL is doing, how is it unlocking value and how is it leading to better performance than the underlying business cases. So, I want to come to that and just jump into three specific case studies. The first of these case studies is a product, that is actually in a fast-growing market and it is one of the fastest growing market segments that we are in from a product and platform point of view, the market by most of the analyst's estimations were in 10-15%, I mean, those recent analyst report that I saw last week, it is 13% below projected this year. This was a product family that has been underperforming over the course of the last few years. It is actually prior to the IP partnership, it is actually declining double-digits to rapidly using market share in a market that required a lot of velocity, lot of investment and a lot of ongoing acceleration towards innovation. So, this is the product that we have been working with now for 18-months.

What we still start to hear is if I lay out a few steps that we are taking or some of the themes that have really been a part of the flavor we build towards these IP partnerships. First thing that we did is that we invested and expanded the engineering team and really cleared a backlog of a quest from existing customers became major focus on the needs of those customers to really energize some of the core installed base, some of them are passionate users of the product. Let me put in very carefully that we made sure that we were building features and functional enhancements that were aligned to the real need that they had in the product. That is typically the first step in any of these IP partnerships which is helping to energize and activate the existing installed base.

Second, we brought in a lot of new capabilities to drive this product set towards greater modernization and innovation. We brought in the product management, we invested in product-related services to help with implementation, upgrades, training as well as client advocacy, signing an engineer from the team to a large customer to build a good technical dialogue and to make sure that the engineering team stayed in touch with customers and vice versa. We continue to invest in a SaaS-based offering. We also innovated and pioneered the first machine learning capability in this technology set. Net-net, the results of it over the course of the last 18-months is the product has now been growing double digits for the last year and a half and in the past quarter has exactly surpassed that market growth rate. I think a key punch line, and you will hear this on each of these case studies is also we have released in the last quarter an HCL brand inversion of this product and it is now available to be integrated in with our Mode-1 and Mode-2 service offerings, so we can bring that automation and better solution value to our customers.

The second case study is a little bit different. This was a product in a market that also has growth, although a little bit slower, the product has been little bit more trend line, it had some strengths and it had some weaknesses over the preceding couple of years. But, it is the time of the IP partnership which was the year ago is it really been suffering and began to languish in the market. The brand of the product had begun to diminish many existing customers who are no longer seeing as a core part of their future. This product again many of the themes gains that I went through in the first case study. We invested in engineering capacity, we invested in clearing the backlog of customer request, and we invested in the velocity of fix and future packs and within this quarter in June sort of culminated a one-year cycle since the time of the partnership. We have released a major new release of the product. So, we believe we are still in early stage on the journey of this product. But what you can see is the stabilization of the revenue curve and our expectation is over the course of the next 12-18 months to begin to move back to and to surpass the market growth rate. Again, as I highlighted in the previous case study, I think the next quarter we will be releasing an HCL brand inversion of this product again to supplement our managed service and outsourcing offerings to customers.

That leads to the final case study. Here is a product family that has more challenges to it. This is a product set in a market that was growing in single digits. It is matured, faced a lot of competition from open source technologies as well as newer vendors. It is going through a lot of transformation in the way the customer consumes these types of tools. This was actually part of the first major IP partnership that we completed over two years ago. So, we have had a good history of working with this product family. Many of the same elements that I have highlighted in the previous two case studies. This was a product family that was declining. 15, 20% and look rapidly on its way to obsolescence. It has stabilized today, but it is still at a climbing product set. We have had some quarters of growth, there are some products in this family that are growing, but still in the aggregate it is still hovering in single digit negative territory. Some of the steps that we have taken, we have had over 50 releases across the family over the course of the last two years, we have signed lab advocates to work with many of these large customers and we have really focused on finding this pocket of innovation within these products and energy scenarios. I think what you are going to see again in an ongoing journey with these products is some really exciting things happening over the course of the next six to 12-months excluding next generation versions of these products available and we are able to bring them to market.

What has also been exciting about this product family is this is one of the first products that we released through the HCL channel to be made available to bring into integrated software plus services deals to bring these solutions to our customers. We had several pilot names in the last quarter and I think over the course of the next few quarters there is going to be a lot of major wins and major deployments that we will be able to feature as case studies.

So, hopefully this is helpful to give come context behind some of the headline numbers and trend, gives you view some of the work that we have been doing around these IP partnerships and how we continue to create value and surpass or get these cases at the time of making investments.

So, with that, I will conclude and pass it back to CVK.

**C. Vijayakumar:** Thank you, Darren. I want to just conclude the product pre-performance strength that Darren said, for this product line we are still doing better than the business is. That is the highlight of this.

With that we are pretty much done with our commentary. We are happy to take questions.

**Moderator**: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

**Sandeep Agarwal:** CVK, just a couple of things. We have consistently been seeing last, four five months significant amount of traction in the industry coming back whether it is BFSI vertical, whether it is Energy, lot of data is coming from different central European companies and even Indian IT providers who are clearly suggesting that there is a good traction in demand and we have seen similar situation in fact today's press release from your company where the number of new deals which have got signed is around 27, that is probably a very-very good number, but just a couple of things I am little curious about, one, what stops us from upgrading our guidance – do you think that the old business is still killing our good work from the new business or the new deals which we are signing or you just think that the lag effect would not allow you to increase guidance just immediately? Second, what is your sense on the digital side? You very nicely explained but just wanted to have a little bit more idea, are you seeing the digital deals coming in from more number of clients or you are seeing the clients scaling up significantly gaining scale in that sense? Finally, if Anil could give out some number on how much of the current quarter's growth contributed by inorganic if that is possible?

**C. Vijayakumar**: Thank you, Sandeep. Let me start with a guidance question. As we indicated, we are very encouraged, I feel upbeat about what has happened in Q1 especially on the bookings front; however, for the bookings to translate into revenues, we need to do transitions, some transformation, like for example, Nokia, the revenue side expect to materialize only in the OND quarter. So, while we remain very positive, we continue to see a pretty good demand environment, not just in infrastructure services, but digital and significant amount of on Mode-2 offerings and also in our engineering services from a core organic perspective we are seeing good traction, I feel pretty positive, more positive than what I was in the last quarter, still only one quarter done, and we have three more quarters to go. This would be number of things which could come into play, there will be some plans specific issues or whatever, we are not prepared to increase the guidance, we feel good, we will deliver within our guided range and if there is any change obviously we will come back to you next quarter. But at this point I feel good, bookings are good which really translates to a good longer-term growth rate rather than immediate quarter-on-quarter growth rates. Having said that we will develop an incrementally better quarter-on-quarter growth from here on, that is really my expectation. On the digital front, I will ask Anand to respond.

**Anand Birje**: Thanks CVK. So, I think on the digital front we are seeing really a fairly even upsurge in the market across industries firstly, so if we look at a year ago or couple of years ago, mostly consumer facing industries either it was retail, CPG, healthcare, what at the forefront of digital spend, but really in the recent one or two years every industry whether it is a B2B like manufacturing, energy and utilities, oil and gas, pharma as well as B2Cs continue to invest heavily on their technology dollars for digital transformations and really because it is not just about consumer engagement, but it has also got business operation transformation, operational efficiency gains and so many other aspects of digital outcomes that customers are seeking. So, that is on an industry front we are seeing a fairly even industry spend across industries. Now when it comes to net new customers versus existing, we are seeing a huge amount of opportunities in net new customers where as I said earlier, customers who are rethinking on their vendor portfolio, we are seeing opportunities where we were brought in as a net new vendor to replace some of their traditional IoT vendors or traditional application services vendors because they were seeking next-generation technology delivery as well as next-generation process delivery which is the scale agile delivery of application development and application build to deliver digital programs or digital execution. At the same time in existing customers, we see huge opportunities specifically in customers where we were largely present on the infrastructure side of the business or on the ERS side of the business, customers bringing us into new digital transformation opportunities through those vendor consolidations. So, we are seeing a fairly balanced win rate both in existing accounts and net new accounts where there is replacement of vendors happening.

**Anil Chanana:** With reference to your question on the organic versus inorganic, so C3i which we consummated in the early April is included here and which gave addition of about 2% to the revenue this quarter.

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

**Ankur Rudra:** Just first question is on growth. It seemed a bit concentrated this time, in fact, on a sequential basis, almost every vertical except technology services, public services and life sciences saw a bit of a decline and also if I look at two of your bigger service lines, there were either flat QoQ, barely 2-3% YoY basis, so if I look at the balance of business, if you can give me a sense of when do you see the balance of revenue decline from renewals on these applications for contracts turning more favorable from the new deals you are seeing?

**C. Vijayakumar:** Thanks for the question. As we had indicated, there is certain dynamics around renewals and some contracts for the annual cycle, so that had a step reduction, so that is one element. The second one is there were certain renewals which were renewed, but the effective dates were starting this quarter. So, some of them are for what is causing reductions in manufacturing and financial services. Public Services growth has been very good, all of that is organic. Life Sciences is largely enabled by C3i, but the organic growth in Life Sciences is also pretty good probably comparable or even higher than public services. In terms of the way forward, I see higher growth, incremental organic growth is what we are continuing to improve in our application and infrastructure services as well as our engineering services, that is going to reflect across multiple verticals. So, I am pretty confident of acceleration in our quarter-on-quarter organic growth from here on. And if you see all these metrics, LTM YoY numbers are very healthy including financial services which has grown 9% LTM YoY and similarly, Retail, CPG has grown 7%, Life Sciences has grown 10% and Telecom is something where we have had some excellent bookings in a couple of deals and we see a good pipeline in telecom, so I see that also picking up moving forward.

**Ankur Rudra:** Can you share some color on the IP business? Now that you have launched 6 to 8 IPs under the HCL branding. What horizon should we have to see significant or at least material customer migration to your branded IPs, the impact on economics and what kind of investments do you need to drive that?

**C. Vijayakumar:** Darren, do you want to take a shot at that?

**Darren Oberst:** I will take the second part first in terms of the investment. This is work that is underway. So, in terms of many of the investments that we discussed that is baked in the case so to speak. So, I do not anticipate incremental investments relative on the margin profile, revenue curve, many of that you have seen. Coming to the first part in terms of when we will begin to see in a significant customer deployment. I would expect to see that quarter-after-quarter-after-quarter, growth and momentum as we begin to embed these IPs within some of our larger customer accounts and outsourcing deals, so I would expect that within FY'19, I would say from a proof point and case study point of view, we will have case studies to report. Third question you are asking is when we will begin to see maturity of uplift from the financial point of you, that will certainly take number of quarters before that revenue stream becomes significant.

**Ankur Rudra:** Just a last question on margins. I saw the segmental margins is kind of a bit different trend on infrastructure versus app despite similar growth and also surprise to see BPO margins were not really impacted much by the acquisition, if you could just elaborate on that point?

**Anil Chanana:** There are two ways, Ankur to look at the margins, one is of course the way you described and probably I think the better way will be to look at from Mode-1, Mode-2 and Mode-3 which we are reporting for the first time. If you look at the margins, Mode-1 is very much in line with the company level margins, in Mode-2 basically the investment is happening which is slightly below the company level margins and the Mode-3 at the higher end, significantly higher than the company level margin. I think that is the trajectory. Other than that, it can be a variation on quarter-on-quarter basis with the numbers, sometimes like in the infrastructure space, with the transition phase, we are moving into the steady state so there is a lot of investment taking place, similarly in the applications space some of the digital deals need investment, so it gets reflected in a different manner, but I think this is giving a clearer picture.

**C. Vijayakumar:** And just to add a point on BPO, the organic business margins also saw some uptick and the inorganic margin was somewhat comparable to the BPO margins that we had, so that is why materially impact that.

**Moderator:** Thank you. We will take the next question from the line of Pankaj Kapoor from JM Financial. Please go ahead.

**Pankaj Kapoor:** My first question is on the Mode-3 business. Is it possible to get a sense how much of this is constituted by the licensed IP and how much of this could be from the organic IPs?

**C. Vijayakumar:** At this point, I think we do not want to call to organic IP and rest of the business, but what will be more relevant will be the split that I called out right, 60% of business is in mature products and the 40% is in high growth, very new significant growth opportunities, that could be the mix. Even the IP partnerships has a decent mix of mature and high growth products.

**Pankaj Kapoor:** CVK, if I look at the split that you spoke of 60% you. Being basically enabler of Mode-1 services, where the growth is still very weak. I am presuming that the investments that we are making and what Darren referred to is going to probably accelerate the growth here. So, do you think we can really get to Mode-1 services which are relatively mature again growing at double-digit with these investments and if so when you think can that happen?

**C. Vijayakumar:** I think while IP partnerships and the products definitely are embedded into our outsourcing deals. We do not see that as a driver for some differentiated growth because the numbers are very-very different, but our regular mode-1 business, both infrastructure business and the engineering business we see lot of opportunities to re-innovate and we differentiated and create growth opportunities and in our application services most of the business is really transforming into digital business, there again I think we have the solid proposition, whenever there is a large engagement where five or six traditional vendors are there for applications services and they are looking at a new-age partner, we are definitely being invited among the top two. So, I think all of this augurs well for the long-term growth in our traditional businesses. I would not comment on whether it is going to be double digit or anything like that. We see good growth momentum, growth opportunities and we are also feeling extremely confident of our differentiation and our ability to win.

**Pankaj Kapoor:** Lastly, CVK, will it be possible to quantify the deal booking that you had in the quarter, so we can better understand the scale and how it can play out in the coming years?

**C. Vijayakumar:** Pankaj, we are not calling out the total value of the deals, 27 transformational deals, it is significantly higher than the quarter that we had highest bookings earlier, which is the OND quarter of last year and whatever this coming is generally baked into our guidance, so I would encourage you to use the guidance as the real number and if and when we feel we can do better than the guidance, we will be very happy to let you know.

**Moderator:** The next question is from the line of Divya Nagarajan from UBS. Please go ahead.

**Divya Nagarajan**: We are clearly seeing deal momentum pick up and thanks for providing the details on the IP side as well. What should we look at as a timeframe for an inflection point on your organic revenue momentum from these activities? Second is you spoke about why your Mode-2 services have lower margins right now because of the investments. What is the timeframe that you are looking at for those investments to normalize?

**C. Vijayakumar:** On the organic business, as we have said, this was the strongest booking quarter and if the same trend continues for a couple of quarters that will only be a big inflection point for the organic growth, and the pipeline is good, we feel there is an opportunity for us to clock in similar or comparable levels of booking in the coming quarters; however, at this point I am not able to really provide a perspective on where we will land in the next two quarters in terms of booking. But if the continued booking performance repeats, it will definitely be inflection point for organic growth. Mode-2 has multiple services like each one is at a different scale, like public cloud adoption is a big theme, but there are three large solutions, so each one we need to build capability, partnerships, so the number of areas where we invest, even in digital and analytics, there are at least 10 different areas, everything has got different dimensions like our whole UI/UX significantly has been built on organic investments, so that is an area we will still how to invest and that is the capability we need to make it much more global in nature, right now it is focused on US… and even in US it is a new in a couple of locations and one location in Europe, so we need to kind of expand on that. IoT works is in a very-very early stage of big market opportunity and we have created a big impact in terms of good case studies, analyst recognitions. Security is again an area where we have to invest. So, I am not in a hurry to really optimize the margins in Mode-2, this is the time for us to see what all we need to do correctly to enable the momentum in this business because a lot of our future in the traditional IT space is dependent on this. So, I think it is a long-term trend, but you will still see some incremental uptick in margins as you go forward, but that will be small.

**Moderator:** The next question is from the line of Sandeep Shah from CIMB. Please go ahead.

**Sandeep Shah**: Just on the infrastructure management side, if I look at the YoY EBIT margin as well, on absolute basis EBIT has declined. So, what could be the reason – is it largely the renewal and do you believe CVK this time the renewal pressure is higher than the earlier years?

**C. Vijayakumar:** I think we had renewals and structure reductions which happened in the beginning of this year. Some of that will take some time to optimize, sometimes the optimization is leading the reductions that we plan, in some other cases the reductions are little earlier and the optimization is lagging behind. I think that is really the reason. Some of our investments in cloud and security that would also be in the infrastructure segmental earnings, but if we really segregate Mode-1, 2, 3 that gives you a good perspective. I think our core business and infrastructure margins are fairly stable. They probably vary between (+/-1%) or something like that and there are lot of deals in transition, some of that is going to also cause some bulges in the cost.

**Sandeep Shah**: If I look at the revenue breakups, you said within Mode-3, 40% of the revenue are new technology, so that works out to be close to 4.4% and Mode-2 being 15.6. Is it fair to say 20% is a pure, pure model on new digital technology as a percentage to your revenues versus for peers it is anywhere between 25, 30%?

**C. Vijayakumar:** I think there is a tag Sandeep, because lot of our modernization work like software-defined infrastructure, all of that is sitting in Mode-1 because I personally do not see Mode-1 as something old and which has no opportunity to grow. So, I think we have decided to classify this in a manner which provides a right focus on some of the market trends. Even the 60% which are there in the Mode-3, which are in the mature products, there are a lot of opportunities to innovate and classify and modernize. So, I think that is the fundamental criteria for us to choose a product is there an opportunity for us to modernize and transform and create a growth trajectory. So, actually if you really compare an industry in like-to-like perspective, some of the revenues in modernization in Mode-1 is also a part of the overall new technology and service revenues. Cloud again there is a significant amount of private cloud and utility services which the industry tends to classify them as Mode-2 or digital and things like that, whereas our Mode-2 has what I call as cloud native services, which is all public cloud of stars, there is all the private cloud work is happening in the infrastructure numbers. I am not going to spend more time trying to classify whether an infrastructure and utility and private cloud and things like that. So, we have defined certain categories and we are very clear as to how these are defined and there are strong criteria to classify something as Mode-2 and 3. And Mode-3 has some services, but all the services in Mode-3 are built on top of an IP which sets you modes. So, that is the real criteria for services, a little bit of services that comes in Mode-3.

**Sandeep Shah**: Last time we said 130 bps of the guidance is built through acquisitions. So, there are two acquisitions; one is the last German acquisition and this quarter there is additional investment of IP. So, do you believe these two are enough in terms of compensating that 130 bps inorganic growth which we have planned? Second is gross margin in this quarter has gone down by 60 basis points. So, what are the various reasons for the same?

**Anil Chanana:** Sure, Sandeep, thanks for this question. I am taking the second question first with the reference to the gross margin decline, I think the C3i acquisition which we said is a low-single digit EBIT margin deal had impact on the gross margin, and as we just talked about some of the deals ramping up and those investments taking up as well as some of the anniversary sort of reduction which took place. So, these all impact us in terms of gross margin, but we do believe that we will meet our guidance in terms of 19.5-20.5%, we are very confident of that. Second to answer your question with reference to the guidance we had given, I think we are reaching there, we are yet to close the H&D transaction and then we should be depending upon that closure to happen. I think next quarter when we talk to you, will have better fix on the number.

**C. Vijayakumar:** And the new IP deal is also under transition, so once it is done, we will get a better grip, so maybe we will wait for a quarter, but I think a good part of that number is potentially being covered if these two transactions happen as planned.

**Moderator**: Thank you. The next question is from the line of Kawaljeet Taluja from Kotak. Please go ahead.

**Kawaljeet Taluja**: Just a couple of questions to Anil. Anil, first in your financial statements, there is a line item called contract assets of $73.5 million. Can you please detail out as to what that relates to? Second, if you can just quantify the amount invested in the latest IP deal? Finally, your tax rate is 20.5% for the quarter which was lower in your guided range. Does that change your tax rate assumption for FY2019 as such?

**Anil Chanana:** Let me start with the last one and then you have to remind me about the other question. So, in terms of the tax, I guess we guided between 22 to 23%, I do believe we may be at the lower end rather than the upper end. There are variations that will always happen depending upon the assessments getting completed in the various sort of jurisdictions in which we operate. So, basically that sort of impact will be there. So, that is, so far as the tax charge is concerned. But overall for the financial year at the moment, we can assume 22% as a guidance. The other question was with reference to IP deal investment. The net-net investment is 177 million, the numbers you will see in the financial statements and if you look in detail. the numbers may look lower which is about 125 million. I think there is a currency impact which has come this quarter, more because of the sharp depreciation of the rupee this quarter. So, that was the second question. To your first question, it is basically that the implementation of AS 606 and where we are required to now classify the unbilled receivables into two parts, one is with the reference to the fixed price contract. The part relating to the fixed price contract, part of the contract assets, together with some of the deferred cost which will also fall there. So, it is more of reclassification in line with the new accounting standard.

**Moderator**: Thank you. The next question is from the line of Surendra Goel from Citi Group. Please go ahead.

**Surendra Goel**: CVK, your earlier strongest quarter on deal wins which was a couple of quarters back has not really resulted in much of an acceleration so far and if I kind of look at the transcript at that point the expectation was we would see an acceleration in the first half of this year. So, why has that not really resulted in an acceleration so far and why do you expect the outcome of another large deal win quarter to be different this time?

**C. Vijayakumar:** In OND quarter, we said it was the highest booking quarter and it had one large consumer products deal as a part of that. If you take an example that deal has actually gone live only early this month. So, some of the transitions were planned in a manner that they were taking time, because they were global transitions, transitioning from incumbents, so it has taken time and we see that kicking in, in this quarter and also a couple of deals there were cloud migration and transformation deals. Some of the cloud migration and transformation deals are taking a little longer than what we anticipated. I see that coming into this quarter that we are now running. I think probably booking in one quarter is going to transmit into revenues probably four months after that, I think that is what I see as the only outliers was in Q4 of December quarter, the large deal actually was six month transition and two cloud opportunities, which are also sizable bookings, that is taking time, it is really a implementation delay and it is due to the complexity of what we are doing and lot of things are being done for the first time there, that is what is driving it. And I gave you a good indication of the booking this quarter, some of that bookings last quarter which is again significantly higher than what he had in OND. Nokia billing will get into revenue in OND and may be subsequent quarters. I think there is a lag, but apart from little bit of pressure due to renewals and some of the reductions that is happening in a structured way, I do not see any other dynamics, we feel pretty good that two quarters in the last four quarters having significantly higher booking rates. It is going to help us accelerate our-organic growth from a quarter-on-quarter perspective in the next three quarters.

**Surendra Goel**: To be very clear on that, so what you are suggesting is it is due to delays or say taking more time in ramp ups rather than because the business getting wet off because there is pressure on the older part of the business. Is that understanding right?

**C. Vijayakumar:** Yes, there are certain reductions which are planned like for example Volvo starting April had a reduction and India business we planned a reduction of 12 million, so there are some plan reductions, beyond that some of them are planned in a manner of longer transitions and couple of them are really due to execution delays which is I am not surprised, it is a lot of learning, most of these programs across the industry is being done for the first time, moving some significant landscape with very-very complex integrations into AWS and things like that. So, that is really an execution delay which will convert into revenues in the coming quarters.

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

**Ashish Chopra**: CVK, you mentioned that you would look to see if there is good amount of conversion of the pipeline in the following quarters as well to get that inflection for organic growth. So, I just want to understand as to whether it is really a function of the win rates this quarter which is driving the confidence or as compared to maybe last quarter that you mentioned that probably the guidance of organic and inorganic split half and half, is the confidence coming because the pipeline is also now much more improved versus what you were seeing before?

**C. Vijayakumar:** Pipeline I would say incrementally better, not really significantly better. I think one change from last quarter commentary and now is, I think last quarter I said large deal momentum is not there, number of deal sizes are small, but now I am seeing at least three or four large opportunities where we think we have a good shot at. So, it is either zero or one situation. The pipeline may be incrementally better, but it is three, four big deals which can make our break, that is the way we are in.

**Ashish Chopra**: So, when do you expect to see the decline in the India SI business - should it last for the course of this year as well or are we nearing the end of it?

**C. Vijayakumar:** It has now come down to half a percent of our revenues, it is probably going to become a quarter percent of our revenue next quarter. So, after that I think I do not expect it will have an impact.

**Moderator**: Thank you very much. Ladies and gentlemen, this was last question for today. I now hand the conference over to Mr. C. Vijayakumar for his closing comments. Over to you, sir.

**C. Vijayakumar:** Thank you everyone for joining this call. It is probably getting late and I really appreciate all the insights and the questions that you asked. So, overall it has been a good quarter as per plan and the momentum that we are seeing and the win rates and pipeline all of that continues to give us the optimism to deliver to the guidance that we have provided. I think our overall strategy of focusing on Mode-2 and 3 with very-very dedicated leadership and pretty creative thought process around deal constructs and how we believe that some of the investments are really creating more annuity streams rather than more projects in fluctuating streams. I think this really augurs well for long-term stability and growth of us for our business as an overall portfolio. With that I sign off and look forward to meeting some of you next week and probably talking to you during the next quarter. Thank you, everyone.

**Moderator**: Thank you very much, sir. Ladies and gentlemen, on behalf of HCL Technologies Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.