"HCL Technologies Limited Q1 FY17 Earnings Conference Call"

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Anant Gupta: Ladies and gentlemen, Good Day and Welcome to the HCL Technologies Limited Q1 FY17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Anant Gupta. Thank you and over to you, sir.

Anant Gupta: Good day to all of you and thank you for joining us for this Earnings Presentation.

We start fiscal 2017 quarter one with a robust performance. We grew sequentially by 6.5% and our EBIT grew by 5.7%. it pretty much reflects our strong foundation over the last many years in our transformation journey. So if you look at our revenue, our revenue has grown by a CAGR of about 11% over the last four years. Our LTM for this fiscal also was 10.7% in constant currency terms.

Interesting to note, you will see that our headcount has grown over the last four years at a 6% CAGR which is reflecting the non-linearity in the model and I will touch upon what we are doing in that specific area and what is contributing to some of that.

If you look at EBIT, EBIT has grown faster than our revenue. It has grown at a 17% CAGR and net income by 23%.

A key element for our growth really has been on our philosophy of relationships beyond the contract, something that we are extremely obsessed about, client relationships and this is simple slide which reflects this specific quarter as well. So if you look at our business – the repeat business, the percentage of revenue is coming from that from existing clients is at 96%, which is up from 92.9% a year earlier. If you look at each line item of client metrics, whether it is 50 million or whether it is 40 million or 30 million, we will see a significant growth both at the high-end of the value indicating the large scale, large engagements which are translating in to business as well as at the lower levels of 5 million and 10 million which is 26 clients and 22 clients over the years, reflecting the penetration of some of our transformational services in the new areas of modern apps BEYONDigital and IoT.

You would see that there is a movement, (-$100) million clients and this is largely due to as part of the contractual agreement on the offshoring, so the client was a little higher than $100 million dropping down to a little below $100 million, client continues to work with us.

Our philosophy on Managed Services continues to drive non-linearity growth. It further grew to 60.9%, up from 56.1% in the same quarter last year.

As far as our top clients are concerned – top five clients continue to grow. Well, they grew better than the Company average and the top 10 clients grew at the Company average.

Where are we seeing all this growth coming from? So if you really see the performance over the year as well as within the quarter has really been a broad based growth whether we look at it from a geographic perspective, Americas and Europe grew very well, both delivering double-digit growth on our LTM basis at 13.7% and 10.6% for Europe. If you look at the Service lines – Engineering, R&D, Infrastructure and BPO continue to also deliver double-digit growth with Infrastructure leading the pack at 18.18% on a YonY basis.

From a vertical standpoint – We continue to see kind of a significant growth in some of the emerging momentum markets and some of the commentary we have given over the last few quarters. If you look at Lifesciences & Healthcare on a YonY basis continue to grow at 21.5%, in this specific quarter a slight de-growth driven on a back of 10% growth in the previous quarter but overall on an LTM basis an extremely healthy growth driven by a lot of the M&A activity we are seeing in that specific sector.

Public Services which for us include Oil & Gas, Energy, Utilities, Travel, Transport, and Logistics continues to do very well. Given the pressures on the Energy sector, we continue to see the sector looking at newer ways in which they are looking at running their operations and increasing efficiency for a long-term. And given a differentiated industrialized way in delivering some of the Run-the-Business services, we are kind of getting pulled-in into that specific segment a lot more. Retail & CPG – Again growing very well at about 14.9% for the year. And likewise, Telecom & Media growing at 17.8%.

If you look at HCL's strategy – this is something which we have shared with you earlier about our definition of 21st Century Enterprise, and how do we see the characteristics of other organizations as they look to transform themselves into the 21st Century Enterprise and therefore how do our services kind of align with the objectives that we see for a 21st Century Enterprise? So the way we look at it is really the three buckets – the Operations IT, the Enterprise IT and the Business IT and largely the Operations IT and the Enterprise IT is something which we always clubbed in the traditional ITO business. Interestingly, you will see a fundamental shift. What we are saying from Discrete Application Services, Infrastructure Services, Businesses Services to more integrated next-gen ITO services. So we are seeing that trend for the last many quarters and the investments in various platforms such as DryICE which is our third generation platform, a hybrid cloud architecture and a Lean and Agile IT Enterprise continues to drive a differentiation in that specific area. And you would see a number of significant wins in there. Currently, DryICE is being used in over 200 engagements globally. It is a platform which consists of about (+40) different modules and different clients use one or more of the different components in that platform. And in that specific area, if you really look at it, Everest painted as the 'Service Provider for the Year for 2016' for overall IT Services and the Transmission and the value we are bringing to the customers in that specific area. And this of course is driven by way we really see the large scale deals and which continues to follow the trajectory of IMS into Run-the-Business and then into Operations IT in there.

On the other hand, the emerging areas which is really targeted at enhancing value for our customers which is around Business IT and our three areas – one of course the Engineering and R&D Services where we are leaders in that space continue to drive significant growth for our customers marginally around Platform Engineering and the two new areas around BEYONDigital and IoT works continue to help us to win and enter new doors in our customers' journey as they digitalize or as they enhance their penetration of Internet of Things within their offerings to the customers.

A notable acknowledgement by ISG is really about how we are trying to position the pain points of a 21st Century Enterprise and therefore how can customers overcome or achieve their objectives as they move on into the digitalization in that space.

From a customer wins' perspective – we again had a good quarter. We won over 13 deals in this specific space and we will touch upon that in a little bit more depth.

With that, I will give it to C. Vijayakumar who has recently been appointed as our Chief Operating Officer. And he will talk more in depth about Applications and Infrastructure and other services lines.

C. Vijayakumar: Thank you, Anant. Greetings everyone. I will start covering Infrastructure Services first.

We had a very good quarter on Infrastructure Services, 16.5% quarter-on-quarter growth, 18% on MTM YoY basis. This obviously includes a little bit of inorganic component. What is noteworthy is organic growth in Infrastructure business grew close to 10% quarter-on-quarter last quarter. This has not only helped us to get very high growths but it also helped us to maintain our EBIT at the Company levels from the last quarter.

In terms of business disruptions – the teams remain the same. Hybrid cloud adoption is something which we called out as a trend three, four years back, well ahead of everybody else in the market and we continue to invest in creating IPs around Hybrid Cloud Management and Orchestration so that is one trend.

The second is around Software Defined Infrastructure where we continue to build capabilities which help us to build private cloud solutions for some of our larger clients. And with the increased digital spending, more and more clients are looking at digital transformation, partners who really truly have the Next-Gen infrastructure capabilities.

In terms of performance drivers – we continue to gain momentum through integrated ITO proposition, Next-Gen propositions powered by DryICE, our Third Generation Autonomics and Orchestration Platform. We won several deals – a couple of notable ones this quarter includes the Next-Gen IT operations for the North American of a Global 2000 Japanese pharmaceutical major, and another Fortune 500 retailer.

We continue to be very successful in our renewals. Our renewal rates continue to be higher with 95%. Our several key renewals were due in the last quarter and we were very successful in renewing all of the Infrastructure Services business in the last quarter.

In terms of our differentiation – I think our key differentiation is all around our Next-Gen ITO integrated propositions which is primarily around hybrid cloud and the IP around MyCloud™ and other orchestration elements of the DryICE framework.

Automation and Artificial Intelligence continues to be a key theme under our DryICE framework and it has got significantly matured and it is now deployed and we see significant benefits across several client engagements.

Overall, Automation continues to be one of the biggest themes going forward where HCL will continue to invest. It is integral part of all our ITO offerings across Infrastructure and Application Services, we have over 200 clients who leverage one or more modules of DryICE. Last quarter we launched DryICE LUCY which is the Cognitive Services Desk agent which enables collaboration between service desk, analyst and end-users of our client organization.

We move forward to the Application Services – We had good growth in Application Services last quarter. We grew 1.9% quarter-on-quarter, on an LTM YoY basis 4.7%. The key trends here are – it is in line with the industry trends where we see reduced spending in the traditional ATM components and net new ERP implementations and those are declining, however, there is growth in newer areas, primarily an increased uptick of Digitalization, Analytics and Business Intelligence, Mobility, Cloud Migration, SaaS Enablement, all of that are significant business trends that we are seeing. As more and more digital adoption increases, demand for Agile delivery is increasing.

In terms of performance drivers – we have established a leading position in BEYONDigital and Modern Application space with numerous projects in existing and new clients. Though the deal sizes are small but they are very encouraging and very innovative and significantly helping our clients to re-imagine their businesses.

A few wins this quarter – A leading US based healthcare solution provider, we became the sole outsourcing partner for them for end-to-end management of their Healthcare provisioning platform for Application and Business Process Services. A Fortune 200 pharmaceutical company chose us for Delivering Application Services. Our differentiation here primarily stands from our strength in the BEYONDigital, primarily revolving around capabilities that we have built in Design Thinking and a couple of unique offerings like co-innovation labs and experienced labs are helping us to help our clients re-imagine their business processes.

Autonomics is again a very big theme, even in the application space. The DryICE which is our 3rd Generation Automatics and High Orchestration platform is leveraged across Infrastructure and Application Services. Several large application clients are leveraging some component or another of DryICE including test and build automation and test lifecycle management and things like that. Another differentiator for us is the software engineering expertise which is really a differentiator when you want to build digital and IoT platforms and our investments in DevOps and Agile capabilities is also a differentiator for us.

Moving forward, just giving a color on consumer and commercial industries, we had significant growth in Lifesciences & Healthcare and Public Services of 20%. The Consumer Services segment which is Retail & CPG and Telecom, Media, Publishing and Entertainment had upwards of 15% LTM YoY growth. Manufacturing was at 7.7%. In each of these verticals we see a significant trend playing out in terms of business disruptions. Emerging service and business model transformation seems to be a big theme in Consumer Services, primarily in Telecom and consumer products.

Oil & gas – the volatility in the industry and the pricing environment, that is challenging the current operating models which is again an opportunity for outsourcing providers like us. In Telecom we see a convergence of IT and OT as well as quicker adoption of digital technologies. Lifesciences again, IoT and digitalization, remote device management, drug efficacy tracking all of these are emerging trends.

Similarly, in Manufacturing, I think the biggest instruction that is happening is digitalization of the supply chain moving toward what we call a Supply Network Management, that is a key theme. All these verticals we grew quite well and it is primarily led by our wins in BEYONDigital and Modern Application space where we are growing in a very healthy manner. Some of the conventional ERP implementation and some ASM-ADM businesses, there is a decline but I think it is getting compensated by Modern Apps and BEYONDigital.

Our differentiations – I explained to you earlier, so it is quite similar to what we saw in the applications space. It is for domain verticals to process capabilities. Software Engineering leadership is another differentiator for us and in some of the industries where we are specializing or where we are focusing in front to back process digitalization using equipment centric approach is another differentiator for us. And BEYONDigital, we had explained earlier, experienced laps, one-two-three design which is really a design thinking solution and user persona libraries are some of the IPs that we have built which is helping us to be successful.

Moving on, I want to also talk about strategic partnership that we established in the last quarter. We entered into a strategic partnership with a global technology major. This is primarily to invest and grow in two key technology areas, one is workload automation, the second one is DevOps. Workload automation, if you know traditionally has been used to move workloads across legacy and modern environments within large complex heterogeneous IT environments. With the emergence of hybrid cloud, there is workloads residing in Enterprise, on-prim and workloads in public cloud. And the virtualized workloads and dynamics workloads are really, it is quite a complex piece to manage workload across hybrid environments. So there is a need to modernize the workload automation solutions available in the industry to the modern hybrid cloud environment.

And the second theme is around DevOps and service virtualization. Again in the DevOps world, there are number of opportunities around testing automation, service virtualization, all of that becomes extremely important. So, we are investing in these two key themes around workload Autonomics and DevOps and service virtualization areas. We will accelerate the innovation on these products and extend it to the hybrid cloud. These two solutions will also significantly enhance our capabilities in DryICE Autonomics and Orchestration platform.

This is a continuation of our long-term strategy around IP partnerships, which we have been pursuing for over 10 years with several leading technology companies around the world, we are pretty excited about this arrangement. This involves licensing of certain software IPs and transfer of associated employees. And as a part of this partnership, HCL will be responsible for accelerating the product development, cloud enablement and support and provision of professional services.

We will also leverage the existing sales channels of the partner and also build our own channels over a period of time. It is a long-term partnership, at least for 15 years, involving licensing of certain software IPs and transfer of employees. Some of the financial aspects of this strategic partnership, Anil will cover in his commentary.

With that, I will hand over to Rahul Singh to cover the Financial Services overview.

Rahul Singh: Thanks, CVK. I will quickly cover Financial Services performance for the last quarter. So we had a muted growth in the last quarter, roughly about flattish over the previous quarter. And there is a specific reason for that, one of our clients has in-sourced component of the BPO activities that we were doing for the customer. If I were to exclude that in-sourcing that the customer bit, Financial Services has grown quarter-on-quarter by about 3%.

I would like to also mention that the client continues to be a customer of HCL and we have continued to grow in other service lines we are offering to the customers. So, it is a very specific BPO in-sourcing that happened which has caused quarter-on-quarter growth be muted.

In terms of disruptions that we are seeing in the Financial Services business, from a client's perspective, in retail banks and in insurance companies we are seeing digital innovators disrupting the business model. And in the wholesale banks and capital markets areas, we are seeing regulatory pressure continue and customers are also under tremendous margin pressure. As a result of that, from an outsourcing perspective, digital is taking center stage. So we found customer's need for digital is increasing both from the end customer perspective as well as for a connected workforce.

We are also seeing as a result of the margin pressure as I mentioned earlier in capital markets and wholesale banks, we are seeing a lot of our customers, especially in North America and Europe, looking at the consolidation of their existing vendors, looking at flattening of the costs, so that they can release the money for investment in digital. So that is a key trend that we are seeing in the business side.

We are also seeing the whole India based outsourcing firm, financial services firms move from transaction based outsourcing to more strategic partnership-oriented outsourcing. So, customers are moving out from T&M based models to more strategically outsourcing. And on the micro vertical side, we are seeing traditional payments, wealth insurance offerings that are undergoing change. We are also seeing the emergence of new technologies, more or less in pilot forms not still to industrial scale, but in pilots on the business side.

From an HCL perspective, from our annual performance perspective – we have been participating in several customers' need for new vendor enrollment. As I mentioned earlier, customers are looking for consolidating vendors. So the new vendors that customers are looking for are basically ones who demonstrate what you may call as Gen 2/3 outsourcing characteristics. With all-round ability to provide incremental value which are around being able to provide technology services in Next Generation frameworks such as Agile, DevOps, lot of managed services where you can take volumes of business and then perform on a long-term basis. Also, we have seen the front to back IT Simplification and we are participating in client RFQs in that as well. We are also seeing a certain amount of interests in our offerings in terms of legacy modernization and strengthening of fintech's participation in our large clients where we are participating with customers to provide high level of services.

HCL differentiator continue to be similar what CVK talked about, largely on the one side we are using the DryICE IT framework to provide more integrated services straight through and so on and so forth. In addition to that, on the digital side we have created co-innovation concept with several of our large financial services firms who co-invest and co-participate in creating digital assets. That has been pretty successful differentiator for us.

We are also investing continuously in terms of three or four specific areas; we have invested in new client relationship. As I mentioned earlier, since clients in North America and Europe are undergoing consolidation, while it does throw a challenge from our existing customer's perspective, it also provides an opportunity for us to therefore participate in new accounts as they consolidate their current vendors. So we have won three or four large new clients both in North America and Europe based on Gen-2, Gen-3 outsourcing reach of our customers and therefore providing high value. So that will be strategic investment that we made in the new accounts.

We have also invested in an IT led JV called Celerity Fintech and we have also invested in near-shore centers in Europe and in Mexico. So these initiatives are providing us differentiation and while we had muted growth this quarter, we are looking forward to average company growth rates during the course of this year.

With that, I would like to hand over to Anil.

Anil Chanana: Thank you, Rahul. Good evening, good morning, everyone. Thank you for being on the call today. So I will just give a view of the numbers. As you have already seen, our revenues this quarter grew by 6.5%. We were, of course, helped by the currency in this quarter by 50 basis points. So the constant currency growth has been 6%, and the net income growth has been 7.1%. If you look from an EBIT margin perspective, we were almost at the same, we dropped from 20.7% to 20.6%, so basically helped by here the increased off-shoring and the increased adoption of DryICE platform, which has helped us to take out the cost from the EBITDA. So from a EPS perspective, from our annualized EPS, it is at Rs. 58. Quarter-on-quarter there is a 6.3% increase and on a year-on-year basis it is higher by 14.8%.

Just to clarify, there are no internal costs relating to software which have been capitalized by us which you will find as part of the software. So I will sort of a dwell upon it slightly more, but since we are on the P&L, I just wanted to sort of clarify this aspect.

Going further on the guidance, I think the industry is evolving and at various times, various lead indicators have been used. We believe that in this period it will be good to, sort of, state what exactly is our revenue guidance. And so we have stated our revenue guidance from 12% to 14% in constant currency terms, this is based on the FY16 average exchange rate. If you use the June 2016 exchange rate, by when particularly the GBP and other, a lot of currencies had depreciated against the US dollar, it comes to 11.2% to 13.2% for the full year, which is April 2016 to March 2017.

We are also sort of putting a guidance range on the operating margins which we expect to range from 19.5% to 20.5%. Vijay talked about the IP partnership, IP partnership is where investment of $350 million is envisaged and this investment is to be paid over a period of two years, part of that has got paid within this quarter, which you will find in the cash flow statement. And so this software will get amortized, this cost over the period of the arrangement. There is a revenue stream which is associated with this IP partnership, however, it is still in transition and we believe that it could provide us from $30 million to $40 million in revenues in this financial year as we complete the transition.

Since we are talking about revenues, I would also like to highlight that we have not included any revenues flowing from Geometric acquisition. We have received the approval of the Competition Commission very recently and we will be moving the court for the approval. I mean, as we get more certainty on when these approvals will be through, we will be able to sort of inform you and while at the same time Geometric will continue to be a listed company, it will continue to report its number separately. Another thing, since we are on this IP partnership, I would also like to add that so far as the EBIT is concerned, as with any other IP partnership which we have entered into, which we have been doing over last many, many years and in various forms and shapes, I mean, we have generally seen EBIT to be accretive in these arrangements and we do believe that this will also be EBIT accretive.

Moving on, in terms of cash conversion. The EBITDA to free cash flow is at 56%, at the same level as it was last year, while net income to operating cash flow is at 96%. If you look at the hedge position, almost at the same level, slightly ahead by $70-odd million as compared to last quarter. So the booked rate average is at 67.99. There is a mix of forwards and options and most of these are in USD-INR, and while we also have on GBP-INR and EUR-INR and a lot of other currencies. While we are on currencies, I would just like to highlight one more thing that the GBP revenues as a percentage of the overall revenue in our books is 8%, 8.1% to be more accurate.

Moving on in terms of FOREX gain, so we did record $9.9 million of FOREX gains this quarter and the OCI position is positive at $7.1 million. For the next quarter, we estimated FOREX impact, impact meaning a positive impact of $2.72 million. This was the exchange rate which was there as of June 30, 2016.

With the respect to tax, we anticipate the tax charge to be about 21% and last quarter and this quarter it has been 21% the effective tax rate.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Sandeep Muthangi from IIFL. Please go ahead.

Sandeep Muthangi: I had a couple of questions, especially with respect to the partnership. Anil, first of thanks for giving that clarity on the revenue and the sort of EBIT impact of the deal. You said that it is EBIT accretive, I wanted to ask is it EBIT margin accretive. And the guidance of 19.5% to 20.5% EBIT margin guidance that you have given, does it include the impact of this deal? The second question in the same vein is, could you clarify a bit more on the other items that will get impacted, you are saying there are employees that are getting transferred, when will those costs hit? And even the sort of depreciation for the software that you are booking, when will those hit the P&L?

Anil Chanana: So first of all, the EBIT, deliberately I am stating EBIT because it after taking into account the depreciation and amortization. So, it will be EBIT positive. And this is factored in so far as our guidance of Rs. 19.5 billion to Rs. 20.5 billion is concerned. However, as I said, it is in transition and in this year we are anticipating between $30 million to $40 million in terms of revenues going from this. So far as the people transfer is concerned, I mean, it will be happening, it is in transition and it is still work in progress. I think it will take maybe a couple of months to get completed.

C. Vijayakumar: I just want to clarify, Anil mentioned it is EBIT positive, it is actually EBIT accretive.

Sandeep Muthangi: And just one more question on the Volvo deal. It has been completed, you have started booking the revenues also, but still I see a small item around employee obligations not being yet recognized in the balance sheet. Just a quick clarification on what is the update on that and would you be recognizing the employee obligations from next quarter onwards or what is happening over there?

Rahul Singh: That is with respect to the balance sheet opening liabilities and does not have any P&L implications

Anil Chanana: So my colleague Bansal will be clarifying this. So, I think the answer is that it is a more of a balance sheet item and not a P&L item, correct?

Prahlad Rai Bansal: Yes, we have to take over the employee related liabilities like the leave due to the employees and other long-term benefits for which it will be separately paid for by Volvo and there is no additional implications there.

Anil Chanana: So there is no cost implications as far as HCL is concerned, it will be paid for fully by the customer.

Moderator: Thank you. Our next question is from the line of Anantha Narayan from Credit Suisse. Please go ahead.

Anantha Narayan: My first set of questions was just around engineering services and the BPO business. On engineering services, you have been sounding fairly positive for quite some time, although the recent quarter numbers have not been very strong. So can you maybe just give us some color on what is happening there and when things change? And on the BPO business, is the client specific issue now behind the Company or should we expect some more ramp down of revenue over the next one or two quarters?

Anant Gupta: So, I will let Rahul answer the BPO question and let me just first address the engineering and R&D. So, engineering and R&D continues to be strong, we have ultimately delivered a 10.4% growth on a YonY basis. I think some of the negative numbers you are seeing is largely on account of some of the very large contracts which we had done and as per the contractual nature of its off-shoring and right-shoring, the revenue stream is obviously moving from an onsite centric to a more offshore centric. Besides that, we continue to see good wins in that area, both IoT led as well as non-IoT led.

Rahul Singh: Yes, Anant, I will take the question on BPO, the client in-sourcing. That activity is over, so that has fully been taken into account in this quarter.

Anantha Narayan: And just one final clarification again on this IP deal, Anil. So you mentioned that the $350 million will be amortized over the period of the arrangement, so what is the period of this arrangement? That is question number one. And secondly, is this in the form of an acquisition of the IP from the global major?

Anil Chanana: So the amortization for this arrangement is for a minimum period of 15 years, so the amortization therefore will happen over the period of the arrangement, number one. Number two is, it is in the form of the IP and that's exactly the IP partnership. And so there is the IP and there is the people and then we will sort of transition it and…

Management: I mean, I would say it is not an acquisition of an IP, it is really an IP sharing arrangement where this IP will be with HCL where we have the ability to develop and create more innovations on top of it and the incremental innovations will be part of HCL's IP. And we have an unlimited ability to reuse this IP to develop and sell and things like that.

Anantha Narayan: Sorry, just one final thing, is it specific to one customer or can you use it across customers?

Management: Yes, it is across, it is a very widely used solution which will find a lot more adoption as the hybrid cloud adoption increases. In assets, there is a significant increase in dynamic and virtualized workloads and in this environment it can be used across many, many customers. All the large enterprises, all Global 2000 are very good customers for these products.

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

Pankaj Kapoor: Just a couple of questions, sir. So the guidance that we have instituted from this quarter onwards, so is this now institutionalized, i.e. we are going to come with a revenue and margin outlook each quarter? So, just a clarification on that.

Anant Gupta: So Pankaj, that is the idea, we will be giving the guidance every quarter.

Pankaj Kapoor: And sir, the second question is on the Volvo transaction. So, how should we look at it? I mean, is this transaction which is acquisition plus the deal, is it similar to the large deals that we have won in the past where margins typically are low in the initial phase, but obviously expand in the later years as the deal matures. So, does the margin profile of this transaction will follow similar nature or you think that given the contours of the deal, it could be more linear in nature.

Anant Gupta: It would be very typical of some of the large deals that we have won in the past, because the deal nature is exactly the same, same set of services, only thing is it is a little larger in size. So, I would see that it will follow the same trajectory of margin improvement as other deals.

Pankaj Kapoor: Sir, the question essentially came because I do not think that we are transitioning from any existing vendor here. So, does that changes the profile of the margin?

Anant Gupta: See, I mean, even in the current business mix, probably about 30% of accounts are first time outsources and 70% is where we transition from an incumbent. So I think the nature of work and nature of transformation that we will do and operational model transformation, all of that remains largely similar in both the cases. Only, there is a little bit more risk in transition itself when there is an incumbent involved, that is not there, we are through with the transition. So from now on it would be like any other deal.

Management: Just to add, maybe similar levers of right-shoring, similar levers of being able to use DryICEin autonomics to reduce workloads, and similar levers of third party cost reductions in the Telecommunications spend and datacenter and other such areas are applicable here as well. Of course, given the size it is complex, the duration it will take will be a little longer than our typical traditional outsourcing engagement.

Pankaj Kapoor: And lastly, just on this partnership. So the money that is coming-in in the balance sheet today, that essentially is the amount that we have paid for licensing of these IP from the technology major, is that right?

Anant Gupta: Yes, correct.

Anil Chanana: Money is yet to be paid fully, so partially it has been paid. The payment will happen over a period of two years.

Pankaj Kapoor: And we will be not involved in the sale of the IP, that will be taken care by the partner, we will be looking at the development and the back end part of it?

Anil Chanana: So well established go-to-market channels, they will continue to sell this. HCL also has the provision to sell this, if we can in any of our ITO deals or any other engagements we can also sell this as a part of our services or as a standalone product as well, both opportunities exist.

Pankaj Kapoor: And just finally, Anil, the cost of the transfer of employees, is that included in this $350 million-odd or is that over and above this amount?

Anil Chanana: It is part of that.

Pankaj Kapoor: So there is no incremental cost that will come and impact us going forward?

Anil Chanana: That is correct.

Moderator: Thank you. Our next question is from the line of Viju George from JPMorgan. Please go ahead.

Viju George: I just, again had a question on the deal, that IP partnership, what might be the expected revenue payoff that you would be having over the coming couple of years or something like that?

C. Vijayakumar: As Anil mentioned, the revenue expected in this fiscal is $30 million to $40 million.

Viju George: And over the slightly medium-term to longer-term, you have any targets which you can share?

Anant Gupta: Actually, this is just the initial revenues as we ramp up and as we sell, create more innovations on this product, I think that is an upside. It is very difficult to quantify it at this point in time. I think what we are comfortable is the $30 million to $40 million which we have assumed in our projections at this point.

Viju George: **A**nd this has got the life for 15 years?

Anant Gupta: Minimum of 15 years, potentially it could be much longer.

Viju George: And does this arrangement preclude the other partner from licensing the same IP to anyone else?

Anant Gupta: Yes.

Viju George: So, it is exclusive?

Anant Gupta: Yes.

Moderator: Thank you. Our next question is from the line of Yogesh Aggarwal from HSBC. Please go ahead.

Yogesh Aggarwal: Just two questions. Firstly, Anil, the rest of the payments for the IP, are they dependent on some targets or are they related to the employee transition?

Anil Chanana: I think we will be making the payments over a period of two years, I mean, there will be certain milestone, but I think that is the commitment and that is how the capitalization has been done.

Yogesh Aggarwal: And secondly on the enterprise Application Services, pretty decent quarter. And CVK, you mentioned that the core enterprise market is still weak, but there are other fringe markets which are doing well, can you just elaborate a little bit on the kind of deals and the sustainability of this business line?

C. Vijayakumar: So there are some of the traditional components in the Application Services space are ASM which is the support kind of work, and the second one is large roll out of ERP implementations. So these two areas, I would say, is a little bit weak, more specifically the large-scale enterprise implementation projects are not too many. However, the spend on digital and modern application and business analytics and business intelligence, these are the areas where our clients are spending, and we have fairly good propositions around this space and we are seeing seen good wins. However, the deal sizes in this are small, but there is a number of deals across our existing clients as well as new clients.

Yogesh Aggarwal: So growth could be volatile, quarterly?

Anant Gupta: Yes, I mean, so if you look at ASM as we have talked about it in previous quarters as well, ASM is roughly growing at the industry average. The ERP, of course, is much, much lower, in fact in certain cases there has been a de-growth like we have shared because there is really no large deals. We continue to look at whether S/4HANA and some of these triggers could kind of trigger large scale implementations. While we see a lot of conversations, we do not expect any one of them to materially realizes in this calendar year for sure. The way to look at the areas which are on growth, which is on these three or four new areas, which is whether it is modern apps or digital, the way to look at it is these deals are small in size, ranging $2 million to $10 million. But given that these are long-term journeys, three to five year journeys with the customer, they will continue to there will be like pieces of statements or work which will come on execution depending on the outcomes of the initial SOWs would really be the movement to the next phases. So, it will not be like a large engagement in one shot.

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

Kawaljeet Saluja: Anil, my question is that, can you quantify what your organic revenue growth guidance would be for FY 2017?

The second question which I have is that, can you quantify the amount already paid for the IP deal, the amount that is yet to be paid, and the annual revenues that you have from the deal and not the $30 million to $40 million that you have quantified?

And the third question is that, can you provide a detailed margin walk, your margin performance is quite impressive and congrats for that. Given that you had multiple headwinds including 60 basis points from BPO, you had Visa headwinds, and Volvo deal related headwinds as well. So if you can just provide a detail margin walk, that would be helpful.

Anil Chanana: So, first of all, I will address your question on the margin guidance. So 12% to 14%, as I said, does not factor in the Geometric acquisition because it is all dependent upon when the deal gets the final approval from the courts, it is subject to the court approval.

Kawaljeet Saluja: I think, Anil, let me just interrupt. See, basically there is a Volvo acquisition and you have done I think five to six acquisitions in the last six to nine months. So what I am asking for is more the organic growth guidance number. I mean, I understand that Geometric is not a part of the guidance.

Anil Chanana: Sure. I think at this moment I have basically two, I mean, the others would have sort of not very significant which has happened, I do not have the numbers right away with me at the moment. But so far as the Volvo is concerned, as we further stated today that this quarter we have contributed $40 million in revenues, that is one, you can annualize it and take that.

And second element which we talked about is the IP partnership where we said it is $30 million to $40 million of revenues which could accrue this year depending upon the timing when we are able to complete the transition. So, this is all so far as the inorganic part is concerned.

I think, your next question was with reference to…?

Kawaljeet Saluja: The IP payment, how much has been paid and how much is yet to be paid?

Anil Chanana: So (+$130) million has been paid, I do not have the numbers in front of me, the exact number, and the balance will spread over a period of two years. So in terms of margin walk, I think there are very small components which are there, so I have not created a walk. But I think we did not have any significant impact on account of Visa because we are not highly Visa dependent company, less than 50% of people in the US are on Visa, that is one. And we did get a lot of efficiency gains through the off-shoring which is happening with deals as they are maturing and the off-shoring which is happening. Some of it also must talk with the reference to one of the engineering clients where we are moving the work offshore, so which pushes up our margin percentage and also the use of DryICE Automation Platform which also helped us in enhancing our margin.

So far as the utilization factors are concerned, these have a very, very marginal impact I would call it. So on the whole, it has been I would say efficiency led sort of a gain, which could certainly absorb the large deals including Volvo, which got sort of kicked in, in this particular quarter. So if you look at the Infrastructure Services, as Vijay explained, even organically grew in excess of 10% this quarter, quarter-on-quarter.

I think your next question was with reference to the partnership deal. Again, on the annualized revenue, I think as we move forward we will have better visibility and we will be sharing it because as I said we are just in the midst of a transition and so for this year we have just factored in between $30 million to $40 million, but if we will have more visibility, we will certainly share that number.

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

Ankur Rudhra: On the IP partnership, perhaps if you could elaborate a bit more on what is the strategic rationale of going in for something like this? And what is the synergies you expect from this? I understand the financials that you have highlighted, but if you could elaborate on the first two parts a bit more.

And secondly, related to the same thing. If you could highlight some qualitative factors about this IP in terms of, is this a mature IP where the main play is extension of life and getting good profitability, or is it a bit more of a newer IP where you are doing incremental new work along with this IP partner? Thanks.

C. Vijayakumar: So as I explained earlier, if you want to give a little more qualitative perspective around this IP, it is broadly in two areas. One is in the area of workload automation. So workload automation, the strategic rationale is we have been focused on autonomics which is what our DryICE Autonomics platform is all about. And in the hybrid cloud world, workload automation becomes a very, very important component in a number of large enterprises. You have some workload on-premise and some workloads on public cloud, there could be DR situations where there is workload automation kicks in between on premise infrastructure or on premise applications to public cloud. So, it is a very dynamic and virtualized workload, it becomes very, very relevant. It is unique, but we think it is strategically very, very important in the future scheme of things, especially in the hybrid cloud world.

Similar rationale differentiated approach to DevOps and service virtualization is possible, we believe there are opportunities to create service offerings around these IPs like workload, I mean, service virtualization as a service, DevOps as a service and things like that. So it is really fitting into lot of new things that can happen. To answer your question around whether these products are mature or new? Actually, these are very mature products, but there needs to be certain innovations to make them relevant for the modern world. And that is really the opportunity that is there with us as a part of this IP partnership. I hope that was explaining the question that you had?

Ankur Rudhra: Yes, that was relatively helpful. Is it possible to share the scope of this beyond the IP partnership? Will you have something over and above what's been highlighted here in terms of future scope of work in terms of services perspective?

Anil Chanana: I think we have shared it, I mean, as we have explained it is already shared in the presentation and the scope of what it involves, there is really nothing more that we can share at this point.

Moderator: Thank you. Our next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: Anil and Anant, I have a question which you might answer very simply but it is a little long question, so please bear with me. If you see your revenue guidance, and if you chip apart the Volvo numbers and the $30 million, $40 million which you are saying you are building in from the IP side. And if you see your revenue concentration on the portfolio side, you have good presence in IMS and R&D on one side, and even if you see the industrial part, you have good presence in Manufacturing, retail and healthcare and these are actually growing at a much faster pace than others. Now, in our case, if you see R&D has not been firing that much, but in spite as, so the only segment which is firing is IMS. So don't you think when R&D comes, the organic guidance, which is the implied number based on our calculation we are separating $167 million or $200 million from Volvo, approximately $200 million from your guidance at the lower end. Doesn't it mean that just when IMS is growing you are giving this guidance and you are probably very conservative in building the part which can give you a kick from the R&D side, because that is not is still growing at the pace at which it should. So can you throw some light, what actually is you thought process in issuing this guidance?

Anil Chanana: I think first, if you just look at the portfolio, I think the rational for some of that really stems from really a lot of confusion in the environment, whether the IT services sector is reeling under pressure. So from the lens that we are seeing, obviously we are basing that based on our; A) order book, B) our pipeline and; C) our execution and some of the core differentiations around DryICE, BEYONDigital, and IoT WoRKS. So obviously when we are looking at the guidance, it bakes into that.

Now, engineering services has done well and we have seen spurts of it grow and we have seen some very, very large deals. And then like we have shared earlier, those large deals will follow a trajectory where they will get into their balanced margin operating model, which means it may further get right-shore and so on and so forth where the revenue may decrease and the margin may go up. So we will continue to see some of that. But I think in the last three or four quarters, we have not seen large engagements, such as the ones we did announce in the year prior to that, some very, very large engagements where we talked about three and four. So we continue to see momentum in the engineering space, but we do not see an inflection point like when we said around infrastructure that we have started to see every month or at every quarter, number of very large engagements.

So I think that market we are continuing to watch, we are looking at it. Obviously, different sectors in there are behaving in a different way, I mean, and we have shared this before that we focus around four different sectors, so high-tech sector, the industrial goods, medical devices and the aerospace industry. So I think in two of these industries we have seen some fantastic growth, in medical devices we are seen some great growth. So when you look at healthcare and our growth coming in, it is not just coming in from infrastructure, it is also coming from infrastructure applications as well as engineering services. Likewise, around high-tech and Manufacturing, some of the growth rates and strong growth rates you are seeing is coming in there.

Sandeep Agarwal: So will it be fair to say that the backfilling kind of time period which we saw in IMS for a few quarters, we are probably undergoing that period in the R&D and there would be an inflection point after which there should be high growth?

C. Vijayakumar: Well, like I said we are waiting. When we kind of see some of that happening, we will definitely provide you with a guidance and our view on that. But at this point, we are not seeing it anywhere in the near-term.

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

Mukul Garg: Anil, first just wanted to clarify on the Volvo revenues which came in this quarter. You mentioned $40 million in the quarter, is that the number from the external clients of Volvo or does that also include the big internal deal which you guys won there, that also came in during this quarter and is included in part of this number? And second, given that you mentioned $190 million when this deal happened for their full year revenues, so does that mean there is a seasonality in this business and you will see a different number in the second quarter?

Mukul Garg: So just to clarify, that $40 million is what we have acquired as an inorganic deal, but what is the organic part of the deal is part of the organic revenues. So that is one. Second is that $190 million in terms of revenues is translating for us at $40 million this quarter. Typically, this business has project revenue which can come in any year and go in the next year, which also happens within our own business. So currently, I mean, that is the run rate at which we are certainly working on growing the business, but I think, I mean, at the moment you can assume at the current level.

Mukul Garg: And is this all under the infra business or is there some applications which also fall under this external clients?

Anil Chanana: All of this revenue falls under the category of Infrastructure Services.

Mukul Garg: And my second question on SG&A part. So, can you help us understand how this spend will look under SG&A, you had quite low number this quarter. So how should we look at it on an ongoing basis? And specifically, do you see a requirement for additional spend due to the pickup in cloud and digital, as CVK was mentioning, so on training or on hiring of specific sales guys, do you see any requirement there?

Anant Gupta: Obviously, we have a fiscal budget and whatever is needed for delivering the growth, both at revenue and margin, is obviously baked into our plan. So, obviously can't tell you whether every quarter it's going to go up or down, but as required to deliver to the market, for achieving whatever is the objective, we will do what is required in terms of sales, in there. But having said that, what we have done over a period of time and this is what you should look at, given that we are seeing a lot more integration in the global markets in terms of what is the buying behavior, if you look at the way deals are getting constructed, so yes we continue to invest in new talent like in BEYONDigital, like in IoT WoRKS and like in some of Next-Gen apps. But in the same time, obviously the areas which are not necessarily seeing a trend in the market from a buying perspective, we are obviously optimizing that. So we are either training people, retraining people to be able to cater to some of the new ones, and where we see a gap we, obviously, acquire the talent. And this is something like we did, if you notice, about four quarters back when we kind of stepped up our investments in BEYONDigital quite significantly, I think is something that we will keep watching depending on how our BEYONDigital business is growing and the demand for that service. And if it requires it to be adjusted, we will adjust it.

Mukul Garg: Just one final clarification and then I will get back into the queue. You mentioned GBP exposure at 8%, is that the same exposure for UK business also or is it higher in UK? Thank you.

Anant Gupta: Sorry, please could you repeat, we couldn't catch your question.

Mukul Garg: So, you mentioned GBP exposure at 8% of revenues, is that the same exposure for UK also?

Anant Gupta: Broadly it is similar, I mean, broadly it reflects. One of the whole issue of Brexit, I mean, obviously it is early to say what could be the impact. In fact, the way we look at it is, with every incident such as this, significant incidence such as this, one can look at it as an opportunity and that is the way we are looking at it. We believe that it will open up the market a little further. Yes, there are some concerns around the currency and that is the reason why Anil did mention the fact that 8% of our revenues, largely driven from the UK market, is in GBP.

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

Ashwin Mehta: I had one question on banking and financial services. Now that has been a segment which has been sluggish for us, we have highlighted issues like in-sourcing and vendor consolidations in the past as reasons. So do you think this vertical stay sluggish for some time, which you had earlier indicated, or we are starting to see better participation in terms of vendor consolidations for us to start to see better growth going forward?

Rahul Singh: So obviously, the vendor consolidation has got a double-edge kind of a story. So on one hand our existing clients going for vendor consolidation and that results in some sluggish growth rates for us. On the other hand, because the banks and financial institutions in Europe and North America are seeing that as a part of the vendor consolidation, they bring in new vendors which are more aligned to their thought processes. We are also seeing wins happening in vendor consolidation for new accounts. So, the new accounts, however, the ramp is required, right, so you get into a big accounts and some of these are really the large financial services firms which have now got us as new vendors, but ramps of that will happen organically and that is the reason why the growth will start coming back in future quarters.

So to answer your question, we have been brought in as new vendor by new clients and these are large clients, these are all top, let's say, 20 financial service firms in the world. And that is great for us because these are places where headroom for growth could be high.

Ashwin Mehta: But you had last quarter indicated two quarters of sluggishness here before things start to look up, does that still stay?

Rahul Singh: If you look at this quarter, if I were to look at the impact of the one of our client on in-sourcing in BPO, we had grown financial services at about 3%.

Anant Gupta: We do not anticipate any change in this calendar year, any significant change in this calendar year. So, I do not think customers will start, the large firms will start doing sourcing strategy towards the last months of the year. So, I think to whatever Rahul just mentioned, I think large firms especially are looking at, on one side how can autonomics help them on the core operations and, of course, technology being a key part of that, how could that get them significant savings. So, in the future one would expect engagements which can take our cost very significantly and drive the investments for some of the transformation to be kind of jointly baked in one engagement, I mean, that is what we anticipate.

Moderator: Thank you. We take the last question from the line of Ashish Chopra from Motilal Oswal. Please go ahead.

Ashish Chopra: Just one question from my side on the IP deal. So, the remainder or the remnant portion that remains to be paid, just wanted to understand would there be any kind of a conditionality sitting into it, or if you could just enumerate, because it is a fairly substantial amount, how would you be looking at mitigating the risks that may arise in terms of the way the revenue pans out going forward?

C. Vijayakumar: So as Anil mentioned earlier, the rest of the payments will happen in the next little over two years, and they are related to certain timelines in the program. And, so as we make progress in terms of achieving those milestones and progress, the payments will get paid.

Ashish Chopra: But the quantum remains pretty much that, the quantum will not be subject to…?

C. Vijayakumar: That is right.

Moderator: Thank you. Ladies and Gentlemen, that was the last question for today. I would now like to hand over the floor back to Mr. Anant Gupta for his closing comments. Over to you, sir.

Anant Gupta: So, thank you very much for joining us for the quarter one earnings presentation. As we highlighted, we have a strong order book, we have a strong lead in various sectors, strong performance, strong sequential growth. We continue to look forward to a good year from the length we are sitting in. Obviously, we will anticipate, we are looking at our performance, we are obviously evaluating it from a YonY perspective or full year perspective. So, we will continue to focus on what is right for the business giving the market scenario that we are in and really just focus on execution and strong client satisfaction. So, with that, thank you very much and look forward to seeing you next quarter.

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.