"HCL Technologies Limited Q3 FY2017 Earning Conference Call"

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Moderator: Good Day, Ladies and Gentlemen and Welcome to the HCL Technologies Limited Q3 FY17 Earning 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. In case you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. C. Vijayakumar – President and CEO of HCL Technologies Limited. Thank you and over to you, sir.

C. Vijayakumar: Good Morning, Good Afternoon and Good Evening all of you and Welcome to our Third Quarter Fiscal '17 Earnings Call. I take a few minutes to provide an overall performance snapshot and it will be followed by my colleagues covering different aspects of our performance in the last quarter.

Looking at our performance from the last 12-months basis, we have had a good growth – (+10%) from a year-on-year perspective. It is also good to note that our employee growth is much lower than the revenue growth continuing a trajectory of driving non-linearity and business outcome-based Managed Services, contractual construct. Our EBIT growth in fact between December '15 and December '16 has grown faster than revenues. Net income about last three years have grown over 11%. This is a snapshot of the last three-year trend in terms of our revenues, headcount and profitability.

Just moving on, coming to the quarter in consideration, in the quarter ended December 31st, on a constant currency basis our revenues grew 3%, there was 170 bps impact due to currency, so the dollar revenue growth was at 1.3%.

In terms of Geographies, we had Europe leading the show at 6.8% on a quarter-on-quarter basis followed by Americas at 1.7%. LTM YoY growth for Americas is fairly healthy at 15% followed by Europe at 10.5%. ROW has been weak this quarter, even on year-on-year basis and it is primarily due to our reduced focus in the India business as one of the drivers for the softer performance in ROW.

What we are very happy and very encouraged is the broad-based growth in terms of our services. We are very happy to report 2% growth in Application Services, significant part of this is led by Digital programs. Infrastructure business grew 2.1%. You have to keep this in mind that the last two quarters prior to this Infrastructure grew at 17% and 4.4%. So, on the back of two very impressive quarters, Infrastructure grew 2.1%. Engineering Services has been soft for the past few quarters; this quarter has really been a stellar performance of 7.1% in the Engineering and R&D Services. Some of this is also contributed by the products and platform components. Even without that we have had a healthy growth in the Engineering and R&D Services. Our BPO business which has been soft for the last several quarters is showing some green shoots of growth; this quarter we grew 2.9% in our BPO business. This really gives a very balanced growth and if you also kind of break this down the Software Services which is your Application Services and Engineering R&D Services, has contributed substantially in terms of incremental revenues from the last quarter to the OND '16 quarter.

In terms of verticals, Financial Services 4.5% quarter-on-quarter growth; Manufacturing at 8.3% and our Public Services which is our Oil & Gas, Energy and Utilities and Travel, Transportation and Logistics and a little bit of Government has grown at 5.6%. Other Verticals have been soft from QoQ perspective like Life Sciences, Retail, CPG and Telecom; however, LTM YoY all of them are showing decent growth. In terms of Life Sciences and Healthcare this quarter the growth was soft because of one large program got completed and that caused some dip. Retail, CPG, seasonally OND are soft quarter because lot of programs are put on hold in the last quarter of the calendar year and that is the reason. Telecom was soft but overall on an LTM basis we have grown 9.7%.

Just moving on to the state of the market, I want to just leave with a few key themes, I am sure none of these are surprising but from our perspective, I wanted to simplify these messages to the following few: If you look at the overall IP spending, I have been telling you that it has either been flat or marginally growing, but recent Gartner's report talks about 4.2% Services spend in growth in calendar year 2017. So this is definitely an optimistic scenario in terms of worldwide IT Services spending. If I were to extrapolate that to our customer base and the conversations that we are having, I would say that most customers are either reporting a flat spend or marginal increase. That could be the view from what we see in our client base.

Now, what are the key drivers for spending? The entire world was at World Economic Forum in Davos that the biggest theme was Fourth Industrial Revolution is in the play and technology is really becoming the most disruptive element in transforming businesses and business models. We have been saying this for the last four years that technology is at the core of our 21st Century Enterprise. Building and evolving our strategies around this core theme and this was also the center theme in the World Economic Forum at Davos.

Now, if you have to simplify what this means? While customers have to continue to remain lean and agile, I think all enterprises are very sharply focused on becoming lean and agile and that is where they are leveraging significant amount of automation to significantly reduce the spend on Run-the-Business activity. They are substantially increasing their investments towards what we call as reimagining their businesses by three key themes:

One is connected experience which is really a connected consumer and the experiences that we get because of the connected end-to-end value chain.

Second is connected assets. The opportunity offered by sensors embedded in everything that you can conceivably imagine, it really provides a great opportunity at the connected asset and that will kind of throw open a lot of possibilities to reimagine businesses.

Third and very important from B2B perspective is the connected ecosystem, the ability to connect the supply chains across at least 10-11 layers or chains of ecosystem, also makes the numerous possibilities to reimagine business. Of course, all of this made possible through digital technologies and IoT and fundamentally enabled by cloud adoption and cyber security solutions.

So, in summary, customers are reallocating IT spends towards the discretionary spending, leveraging disruptive technologies. I want to be careful here it is discretionary spend using disruptive technologies and not traditional technologies while optimizing the non-discretionary spending to the extent possible.

Another important broad theme that we are seeing in the market is lot of Fortune 500 and Global 2000 companies are looking for alternative IT vendors. While this was a common theme in the ITO market, I do believe it is now becoming a fairly common theme in the ASM and ADM world where there is a lot more interest in doing Managed Services and outcome-based contracts compared to the traditional T&M and people-based contracting models which the industry was filled with over the last decade or so. This is what we are seeing in the market.

Now, how does this translate into our strategy? How are we really looking at our growth? This is what I call as the Mode-1, 2, 3 growth strategy. I have talked about this to most of you in various forums, but to put it simply Mode-1 is all about making an enterprise agile and lean and this is where our core services, Application Services, Infrastructure, Business Process Outsourcing and Engineering and R&D Services are really part of our core Mode-1 services and our biggest differentiator which we continue to invest and enhance is a DRYiCE Autonomics platform. We believe these are still underserviced markets. There is still 49% of G2000s who have not looked at outsourcing in any big way. There is a big rebid market which is existing. Vendor churn continues to be there in this market as I explained earlier. So all this is an opportunity and we truly believe this is an underserviced market and it has got legs to grow and we continue to participate and increase our win rates here.

Now, Mode-2 is all about business outcome-oriented conversations and experience centric services. Now, we have sharply defined four key service lines here. Each one is headed by a very senior leader at HCL. The first of business Beyond Digital, modern applications and business analytics service. IoT Works is the second one. Beyond Digital and IoT Works, both are helping customers to reimagine their businesses and enabled by cloud and cyber security as really the enabling foundational layers to achieve scale and leverage these technologies. These businesses are truly created at the inflection of all the disruptive forces in the industry, fairly high growth, high acceleration businesses with fragmented markets with not so clear leaders. We are focused on continuing to build strong organic as well as inorganic capabilities here.

Mode-3 is truly mechanism to future growth of our business where we are creatively building products and platform business. We have had good success in the product business where we continue to create innovative IP partnerships, I will talk about where are we on that in the subsequent conversations.

Here, our strategy is we want to create over a period of time a good product business with typical product business type margins and also finding ways and means to create growth in those products lines. We are also looking at platforms as an area to invest and build digital platforms either by partnering or carving out or building from scratch on some of the cloud providers.

Moving on, if you look at the performance in Mode-1 service lines, Engineering and R&D Services, as I said grew 7.1%, part of this revenue was driven by our Mode-3 product business, primarily the IBM partnership.

We also completed the Butler acquisition; however, there is no revenue for Butler in the quarter that has gone by. It is expected to kick in from 1st of January. Infrastructure Services fairly good growth; 2.1% on the back of two very good quarters.

We signed a couple of large deals – One of them is a large deal with the healthcare payer in the US. Here again, we are building the digital foundations and implementing DRYiCE Autonomics platform and also significant amount of work we are doing around service management and service acceleration.

We also won a contract with the US-based insurance provider for Integrated Services for Infrastructure and Applications Services. Our Applications business grew 2% quarter-on-quarter, this is also probably the highest growth in the last several quarters. It is primarily driven by Digital initiatives and some of it is also driven by some of the on-premise applications like SAP migration to Cloud. Earlier, we had called out that our SAP business is declining, but I think we are seeing some trends where we have been able to balance some of the declines with some sharp focus on a couple of areas where there is a lot of market traction and we are aligning all our energies to just go after that piece.

We won an engagement for SAP Transformation Program in Fortune 500 oil field services company very recently and the business is stabilized from a few quarters of soft growth, we have had close to 3% growth. These are many incremental businesses from existing clients and we also renewed a large engagement with one of our big clients based out of Europe.

Moving on Mode-2:

As I said, there are four broad categories of Mode-2 – Digital, Analytics, IoT Works, Cloud and Security. We have a separate session which will be done by Anand Birje for Digitals. I would not cover the highlights on the digital front. IoT Works, we have very-very unique position in the industry. All the industry analysts have ranked us as a leader in IoT Works. We are really ahead of the game. Some of the solution accelerators that we have created. Some of the early wins and the success of the implementation have really helped us get this position in IDP MarketScape for IoT, Consulting and SI Services. Everest Group in their IoT PEAK Matrix Report rated us as a leader and a couple of others as well have rated us as leaders. Probably we will be the only ones who has been rated as a leader in all four analyst assessment reports. We have had a couple of good wins in IoT Works as well.

In terms of Cloud, we continue to pursue Hybrid Cloud strategy. Some of the infrastructure is moving to Public Cloud and we are partnering with leading Public Cloud providers like AWS, Azure and Bluemix are some key solutions which are going into our overall outsourcing deals.

We have also launched an industry-leading software as a service platform and this is called “Service Engage” allowing all the service cataloguing aggregation and really creating a digital workplace for customers’ employees where they can really not only experience ordering of services through this digital platform, but it also connects to all the attended ecosystem and make the whole process much more smooth and amenable and the millennials are really happy about this platform. We won a couple of deals where we are migrating our client landscape into Hybrid Cloud environment and a healthcare provider we are migrating lot of their applications into Azure.

Cyber Security is again an important Mode-2 business. it is doing well. Primarily we are focused on information security, IT resilience and the governance risk and compliance solutions. In both the large wins that we have had, there was a significant component of security and digital rights management and risk and assurance, security, identity and access management was also another part of the parcel of work that we have got in these deals.

We will talk about Digital in a few minutes. Before that, I want to conclude my conversation with an update on our Mode-3 business which is the Products and Platform business. We continue to explore interesting, innovative IP-based partnerships. We had announced a partnership with IBM back in July and we had expanded it with another partnership with IBM in September. This quarter that got concluded. We extended the partnership for a few more products but most notable among them are application security product called “AppScan”. This is a product which is used for testing for vulnerabilities in the software code and given it is a very robust and very mature product with a huge amount of stickiness. This is one of the products which we are acquiring rights for.

The second is ITX. This is a product which is very useful in transforming some of the legacy landscapes. When you want to modernize them and make them digital, ready data in different formats across different applications is a challenge. This product is specifically used to address the challenge. So this really goes in very well with our digital strategy as well which Anand will talk about in a few minutes. So these are the two most important products. The rest of them are very small revenue components, but we want to really fill the gap in the rationale portfolio, we had already acquired because it is the same customers, lot of this goes in as bundle solutions so that is the reason we also have a few rationale products in this.

We have committed to invest $155 million in this partnership and we expect it to yield a revenue of $45-50 million in the first year. I will answer some questions on this later, but now I will hand this over to Anand Birje. Anand heads our Digital and Analytics Practice at HCL. Over to you, Anand.

Anand Birje: Thank you, CVK and Good Morning, Good Evening everyone on the call. As CVK said, a significant portion of enterprises, technology services spend today is focused around their digital transformations. Gartner estimates that 19.5% of all technology services that enterprises are buying, have something to do with their own digital transformation. So they are driving their digital transformation agenda. So what I thought is I will put out here on Slide #11, if you are following the slides, if you look at the whole spectrum or the life cycle of digital transformation on the X-axis and where is the spend happening in terms of the volume of spend on the Y-axis. We think that HCL is uniquely positioned both due to some early investments we made as well as our fundamental DNA differentiation to participate in each of these zones or along the life cycle of spend. So, starting on the left hand side, CVK again mentioned this, the enterprises are spending significant amount of time in reimagining their businesses. One of the first things that they really embark upon is reimagining their business processes, using either the customer experience as axis for asset connectivity as an axis. We actually incubated about two years ago, a practice within HCL which became a cornerstone of our digital practice which was called “Beyond Digital” which was our in-house agency that helped with user experience, customer experience and design thinking-based business process we design. That has allowed us to participate in a lot of unique enterprise engagements around digital transformation in this first phase of enterprise transformation for digital which is business process we design using Beyond Digital as a capability. As you see, lot of that is the start point for large enterprise transformations which really happened in terms of application modernizations, modern application builds, digital platform engineering work, obviously also using data and analytics at the bottom. Some early investments we made in this area including our skill sets in using APIs and micro services and using modern applications stacks and actually our DNA in Product Engineering has helped us really participate in a lot of programs across the world where enterprises are looking at new generation and new skill sets in Application Modernization and Platform Engineering and we have been participating successfully in these programs. As you go down the lifecycle, digital applications and digital platforms have to be operated in a very new era of digital operations which we are using DevOps and Autonomics have been successfully able to transition into. Again, the underlying strength of our Infrastructure and Cloud business, has allowed us to participate in the third phase of digital operations.

So if you were to go to the next slide, what we are seeing in summary really is our ability to penetrate into enterprises where we were not an incumbent traditional application services provider and some of the examples we put out there a large global 100 financial services institutions in Europe that brought us in as their global partner for digital transformation and digital application services where they were not looking at their incumbents but they were looking for someone with strong digital technology skill sets and modern app skill sets in their execution journey for digital transformation. Similarly, a very large global marketing services company which is actually a part of one of the largest advertising firms in the world, brought us in for platform modernization and digitalization of their own business as they were transforming into a digital agency across the world.

We have been consistently rated as a leader in the Digital Services Quadrants by Everest Group more recently and Zennov in Retail. Few quarters ago, IDC had in their MarketScape for digital put HCL as a leader in the Digital Services Quadrants across the world.

So, that is a quick recap on where we are. I think we are seeing strong ability to penetrate into enterprises with our differentiation in digital transformation and modern app services.

With this, I will hand it over to Rahul Singh who is going to walk you through the performance in our Banking, Financial Services and Insurance vertical. Over to you, Rahul.

Rahul Singh: Thanks, Anand. I will quickly talk to you about financial services and what has been happening in the quarter, the trend that we are seeing in the industry and how we are reacting to that. So, Financial Services we had a good quarter-on-quarter growth of 4.5%, this is on top of a similar quarter growth that we had in the last quarter. So, we can see some momentum coming back in the Financial Services segment at HCL. To describe that to what is driving this growth, I would like to talk about three different segments in the presentation: One, what is happening in the industry? What is happening in the Financial Services sector? Second is what are our performance drivers? How we are remolding our services to address some of the needs of the Financial industry and what are our differentiators? So very quickly, in terms of the Financial Services disruption, we are seeing two specific trends taking place in the Financial Services market – one is the retail financial institutions, typically, retail, banks or retail insurance companies, they are obviously impacted a lot by the buying behavior of the millennials and therefore they are spending a lot of new dollars in terms of digitizing the way services are offered both in the Insurance and in the Banking world. So, that is one segment of the market which we may define as the retail segment.

The second segment is Financial Services which is the services essentially capital markets firms, capital markets firms tend to a tremendous impact of the low interest rates over the last couple of years …of course it may improve next year, but last couple of years they have been having impact of lower interest rate and also lot of impact on regulations. So as a result of which, capital markets firms have very high cost focus, we are seeing revenue-expense ratio is of high; 70s, 80s, in some cases even 90s and therefore capital markets firms tend to be under influence of cost and therefore of what service lines that we can put which enable them to get the cost under control. So, while this is what capital industry in terms of the digital and disruptive technology, we are seeing new customer acquisition channels emerging, there is a lot of focus on what is called “Micro Social Networks” where banks would be connecting to insurance customers connecting to that so they can sell services through that. So, capital markets firms are sitting on huge investments that are already happening in terms of technology, so there is a run-off which happens for that so therefore is need to cut cost in terms of technology debt. We are seeing tipping points happening in terms of cloud adoption. So, public cloud adoption in banks that always been something at the edge but now it is reaching tipping points so there are more POCs and there are more real cases happening of public cloud emerging.

Then if you look at long-term 3-5-year vision, there is a discussion around block chain and other technologies happening in Financial Services. As a result of all this, we are seeing a change of buying behavior in Financial industry; #1 is that I think there is a huge focus on vendor consolidation and simplification of landscape. Now, both vendor consolidation and simplification results in obviously more leaner and cost-effective technology state, but more importantly, we also make the organization more digitally ready. So therefore, that is the whole agenda around vendor consolidation driven by simplification which is happening. At the same time, we are seeing localization, influence of internalization, captives taking place, and there is a role which has been played by in-house captive organizations as well. There is a strong emergence of shadow IT. So the IT budgets, which typically spoke about the fact that budgets are remaining or the spend in IT is more or less essentially flat doing at 3-4%. So, while that is true in financial institutions as well; however, the spend in moving out of the CIO, CTO organization into digital organizations, business organizations, marketing organizations, we are seeing a definite emergence of shadow IT also taking place within our client landscape. So HCL is addressing that through specific thought process and strategy, I think the first is we are driving new account acquisition in a very specific manner. So, we tend to focus on large financial institutions. So therefore, it is not that we had multiple institutions every year, but we do aim to add about one or two large institutions every year to our portfolio.

In line with that, I would like to talk a little about recent win that we had which was in the digital space, I think Anand just spoke about that. So, this is a large retail bank in Europe. They have come up with an agenda for digitally transforming themselves, they have identified close to almost a quarter of a billion dollars of spend over the next 3-5-years to digitally reorganize the way they are dealing with customers and obviously to bring in new digital technology as well. So, they have brought HCL in as a new digital partner. There are of course few other partners in that mix as well. But we are the new entrant there and we have displaced existing partners there which were there. The reason why I think we were able to do that is because they were looking for technology providers which bring in technical skills more than domain skills. So, people who can actually make the process more agile, people who can actually do the APIzation and open up architectures, who can connect with what we are calling as a micro social networking and so on and so forth, they were looking for a technical partner to come in and that enabled us to get into the new account in a certain manner. So, while that was on the Digital side.

We continue to see wins on the Mode 1. So, we spoke about Mode 1, propositions which are more around costs. So, we had an insurance win in the US which was apps and infrastructure combined win. So, clients looking at multi-stack as a buying behavior. We also had an empanelment in the US last quarter, which we announced last quarter, the large firm empaneled HCL has a critical Mode 1 participant. So, we had a couple of Mode 1 wins and we had a couple of Mode 2 wins in Financial Services.

I think we spoke about the focus on Digital, I do not want to repeat that, but I just want to mention here that being able to bring outside experiences of how digitally oriented companies are performing into the Financial Services segment is seen as a differentiator for HCL at this point of time.

If I look at the differentiators beyond the Digital, as we spoke about DRYiCE earlier, I think our engagement models, we are obviously as a firm having a higher share of managed services contracts, which are more outcome-based, I think that helps us. We are also now focusing in terms of operating models which have full stack. I gave an example earlier of an Apps in Insurance space, but full stack operating model versus conventional outsourcing is also good for us, and we have invested in Financial Services in acquisition of new insurance centers which we set up. So as we are getting more aligned towards the client stage, digitally, as I spoke about earlier, it is important to have the right centers in right places. So we are investing in a couple of near shore centers customers developing as well. On an overall basis, HCL does have stronger strength in the capital markets and now emerging in the Digital area as well. So I think these are the couple of differentiators that we are leveraging on Financial Services.

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

Karan Puri: Hi, Good Evening and Good Morning. I will talk about the verticals outside of Financial Services, primarily focused verticals being Manufacturing, Life Sciences and Healthcare, Public Services and that to the point CVK mentioned covered a lot of other verticals supporting like Logistics, Utilities and Energy, Retail, CPG and finally Telecom and Media. As you can see, the performance obviously has been on LTM basis, pretty robust I think between 10% to 24% on 12-month LTM basis. Recent quarters, we have seen some softening largely in verticals, there were a lot of investments on the consumer space, which typically does not get deployed in the last quarter being the holiday season and the buying season for retailers, CPG companies and consumer-facing industry. But essentially the performance has been pretty robust. We believe this is going to continue in the same order. Essentially going forward, what I do want to focus on our components that have helped has become consistent in performance over the years and showcasing the growth that we have. I think the big differentiator that I want to put out here from a vertical standpoint and industry standpoint, HCL has been for some time investing in what we call "Micro Verticals", essentially putting a fair amount of investment in domain and in solutions that tend to align and resonate with business stakeholders, more so than the IT stakeholders. Quite frankly, primarily maybe six quarters where we have seen this investment paying off substantially, where a lot of change that is now coming through business ask is now being deployed through technology and IT. This conversation is really where disruptions help us have face-to-face conversations with business stakeholders.

If you look on the left side, the disruption that we are seeing, whether it is in the media or the broadcasting industry, Gaming, Entertainment, Life Sciences, Healthcare, Manufacturing and Oil and Gas are largely driven by this understanding of the domain that you bring to the table. I think the big component that has helped us also is the fact that we are focused on making sure that the consumer-facing verticals which are largely Media, Telecom, Gaming, Life Sciences, where there is a fair amount of focus on connected experience and connected ecosystems. I think that has become a very interesting confluence point where a lot of these domain technologies and domain understanding is becoming fungible. You can use some experience on one and transpose that to other industry or similar industry. On Manufacturing, which has seen substantial growth in the recent quarters. Oil and Gas Utilities sector typically had been lagging in the past, we have seen a lot more change happening on their side, where the focus has been more on connected assets and connected ecosystems, fundamentally where the confluence of assets and what will be considered as an extended enterprise is where a lot of changed products have come through. I think the understanding of domain is now beginning to pay off. It is also going to pay off more so on the projects that are coming in the Mode-2 side of the house. I think that is fundamentally where we have also seen a spur of new activity in helping us do IoT Works, whether it is enabling a large-scale enterprise which we call the digital to scale, essentially platform that allow enterprise to play substantial scale, not only on the UI side, but largely within the enterprise itself. I think that is fundamentally enabling both the asset-focused industries as well as consumer-facing industries, substantial transformation, and that is where we have seen work as you can see on the performance driver, there is very diverse set of work coming in across multiple industries and the nature of work is also becoming pretty thought leading in some way. The proof of the pudding has been for us just getting acknowledgments. I think if you look at the differentiated outcomes that we are seeing, the way the industry is beginning to rate the solutions that we are demonstrating out there and standing out as the vendors or leaders clearly across the board, whether it is in life sciences, obviously, Energy, Utilities and the kind of award that we announce beginning to get on these areas, I think clearly has positioned HCL into a very domain-centered, vertically-aligned industry understanding company and that is where I think a lot more energy is going in the coming quarters as well. So that is the outlook for our vertical industries for both consumer and commercial.

C. Vijayakumar: With that, we will have Subbu do present "Financial Analysis." Anil is not here; he had to be away due to personal bereavement in the family. So Subbu is standing in for him; Subbu is the Senior Executive in our Finance team. Over to you, Subbu.

G Subramanian: Thank you, CVK and Karan. Good Morning and Good Evening to everyone. We had a very good quarter, closing the revenue at $1745 million. Quarter-on-quarter showed a growth of around 3% in constant currency terms and 13.8% on year-on-year basis. Revenue growth at around 11.4% year-on-year and EBIT is at 13.4% which is also showing the growth. EBIT margin at 20.4% has shown growth both on quarter-on-quarter basis and on year-on-year basis.

So just touching upon the guidance, we had guided around 12-14% on average exchange rate of FY16 and we expect to be in the middle of the range and this excludes the acquisitions and the IP-led partnerships which have been before 30th September, and this additionally would be contributing around 0.6% to 1% in revenue depending upon how Geometric deal would take shape from what it would be. From EBIT perspective, we have been riding 19.5-20%, this includes the consummation of acquisitions which was above mentioned. From JFM, we expect the quarterly margin to be in the similar range. So, we have been continuing to do good cash conversion and it continues to stay above, OCF to Net Income has been above 100% and we are continuing that good scale.

From hedges perspective, we have total hedges of around 1.4 billion and cash flow hedges of around 1.2 billion and the balance been the balance sheet hedges and an average book rate is around 68.9%. So, on the FOREX gain side, so this quarter we had around 6.4 million and when you look at it from OCI perspective, as of December, it was around 34.7 million before the tax benefit and when you see the FX hedges, the 7.93 million will be the FOREX impact assuming the December closing rate continues. Moving on to the Tax Provision: At this time, this quarter had 21.5% and we expect to be in the range of around 21%.

Back to the operator.

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 Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: First question is on the guidance. You have chosen to provide a single number this time for the fourth quarter as opposed to a range. I was wondering if there was any thought to why a single number, is this because you have a range already in your implicit guidance for the acquisitions?

C. Vijayakumar: Ankur, we have said it is going to be in the middle of the range and that is in relation to the 12-14%. So it is not an exact number, it would mean that it could be a little bit plus/minus the middle of the range, that is really what it means.

Ankur Rudra: Secondly, CVK, if you could highlight a bit more color on the IBM IP acquisitions you have currently invested, I think close to $555 million across the three sets of IP. We understand these are sticky revenues and high margins; however, some color in terms of where you see medium to long-term growth in a business of this nature, long-term value accretion synergy strategic fit that will really help?

C. Vijayakumar: Ankur, that is really a very good question and it helps me to kind of articulate our strategy around Mode-3 business. As I said, we are focused on two broad revenue streams in our Mode-3 business. We want to create a product revenue stream in the long run. We do believe as a company we have very strong credentials in building products and enhancing products; however, we have not created and sold products under HCL. We have been enabling our customers to build products. So we have strong capability. A lot of our Engineering and R&D Services is all around that. So, based on the strength and also our understanding of the enterprise landscape and the CIO requirements, we believe there is a good way to leverage Engineering and R&D capability and understanding of the enterprise market and our product business fits perfectly within that description. So we have options of creating products from scratch, I think some of that will mean a lot of investments and it will also involve certain risks, whether the product will be successful. So, we strategized and we believe it is a good mechanism to take over the IPs of some of the existing products which are struggling for investments but they also have a huge traction in the market in terms of the need and the stickiness of the need. So whatever qualifies within this and it is also synergistic with what we are doing, I think that is really the qualifying criteria for these products. These products have good very large customer base and they also have potential to grow because once we modernize the product, some of the adoption opportunities also increase, like earlier we had said workload automation we wanted to enable them as a cloud workload automation solution which is becoming very relevant in a hybrid cloud where workload transfers happen between on-premise and off-premise. Like in the current round of investments, security is one of the big focus areas for us as a part of our Mode-2 strategy and this one really perfectly fits and creates a wedge into getting into application security. We are very strong in Infrastructure Security but we do not have much of presence in the Application Security Services market and even the product market and this is a perfect way to get access to that space. The whole data extended, data transformation, it is a tool which is used for lot of digital transformation programs. As Anand explained, if you take the biggest opportunity, it is not the UI and the Design Thinking, that is one element which is really the beach head, but bulk of the spend is in how are you able to modernize and digital enable legacy landscape. That is really the fundamental business problem we are solving and a product like ITX helps in that. Whether it is the only product? Answer is no. It is just one more product which enables this whole process. The couple of others I would say are not necessarily strategic fits like we have long analyzer, test automation and mainframe management tools. They just give us a little bit benefit because we have lot of mainframe customers, we want to expand in the mainframe. May not be a great strategic fit but gives us a little bit tactically it helps us in growing revenues and kind of getting more from the clients. So each one has the rationale but largely direction it should strategically make sense. Of course, it has to go through a very stringent financial criteria that we use for evaluating this. We are really happy that we have been able to build this strong partnership with IBM and we have been able to scale this, it is a unique opportunity and we are continuing to look for such opportunities with other technology providers as well. So over a period of time, you will see us creating a very healthy revenue stream which is relevant to our business, which is strategic for our business and also growing. Similarly, there is a strategic underway for platforms. Here again, we do not want to build platforms from scratch. We are working with the mature enterprises and banks and different types of industries where they have a mature platform they are looking at carving them out and creating some kind of platform where we can invest and modernize them and neutralize them and have them utilized by multiple customers. Probably a long answer because the investment is also big.

Ankur Rudra: You are trending at the upper end of your margin range now. My question on previous quarter, how do you decide between the choice of growth and margin over the next few years?

C. Vijayakumar: Ankur, ahead of us the market opportunity is big. I do believe we have to invest, we will really go after capturing the market opportunity and that is why we said we have given a guided range. Anything for the next year, I think we will be in a better position to answer probably in the next call because we would have done a planning…it is not that everything that we are going to generate above 20.5 will go into investments, we will have investment plan based on which we will make our decision and provide a guidance in the next quarter.

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

Anantha Narayan: Also, just sort of carrying on from Ankur's question on the IBM sort of tie-up, can you maybe just share some of your thoughts on what your internal IRR or return on investments would be that you would seek from such partnerships?

C. Vijayakumar: We use a rigorous financial model and we have expectations just like how you would do any investment or M&A, those are the metrics which we are used. I would not be able to share specifics because there are too many variables because the products are different, the longevity is different, growth rates are different. So there are multiple dimensions which is playing into it, but definitely we are very happy with these investments and we believe they will be a game changer for us in the long run.

Anantha Narayan: If I could just attempt to ask in a different way, will the financial parameters for such an alliance would be different from what it is for an acquisition?

C. Vijayakumar: It would be similar and in fact our approach will be in a little conservative in how we are estimating the revenues and how are we estimating the growth. I think we have been conservative and I do believe there are upsides but they have to be playing out based on how much emphasis we give in modernizing this and selling them in the marketplace.

Anantha Narayan: One data point of how much of that $555 million has already been paid out, and what is going to be the schedule going forward for the remainder?

G Subramanian: Around 60% of that is already paid out and the balance 40% will be spread over this calendar year by close of this calendar year will be paid out.

Moderator: Thank you. The next question is from the line of Prashant Kothari from Pictet. Please go ahead.

Prashant Kothari: Two things I needed your thoughts upon; one is how do you think what elasticity of IT budgets as we go through business cycle and especially when business kind of goes up for your clients, how much elasticity do you see in terms of their spend on IT Services? Second question was on are you seeing any hesitation on part of clients to kind of close deals because of this uncertainty, are you seeing that impacting closure of deals that you have done?

C. Vijayakumar: To your first question, I think they get little more open to do new things and experiment some new solutions, I think that is what we see. But I think this will be very-very client specific, I do not think I can generalize an answer, but largely the theme is the spend is more or less constant and maybe marginally growing in some industries and clients are focused on optimizing and then reinvesting in new areas. On the second question, you talked about are you seeing any behaviorally different patterns because of some of the current political environment. While intuitively you believe that should behave differently but we have not seen anything. All our customers, whatever closures we expected, they are more or less happened as planned and of course there is lots of conversations that customers are having with us about how much visas dependent are we and how much local resources do we have compared to H1B visas and things like that. These are just kind of questions and dispreparedness and kind of we are trying to look at what is the situation and what mitigations we have. As a company, we have been fairly comfortable because our H1B visa dependencies have been substantially lower and we have built significant onshore presence like in US we have six delivery centers and two of them are significant scale and we are continuing to leverage them, we are continuing to increase our local hiring, we are also putting a thrust on fresher and entry level hires in the US. All of this is to help when we have growth, we have a better capability to fulfill locally rather than depending on visas.

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

Sandeep Agarwal: CVK, just a couple of more questions on, one will be extension of the previous question and another one on the business side. So first coming to the business side, there has been a lot of noise on the cannibalization impact of Cloud showing up in some of the reported company's ADM part or maintenance part or in some cases even the IMS part. How are you seeing this, are you really seeing a big impact of this on a systematic basis going forward? Question #2, we are still not seeing a big positive impact of digital on any particular vertical or services. So are we missing something there? Finally, on the H1B and the new rumors of border tax and all, what is your view... in which direction will things go from the perspective of cost and is there option of passing on some of these costs or clients if you can throw some light?

C. Vijayakumar: I will start with your first question about cannibalization of our revenues due to cloud adoption. I have stated high level view point clearly earlier. I do not think there is a lock, stock and barrel movement to cloud especially in the client base that we are engaged with which is Fortune 500 and large enterprises. There is a merit in a certain part of the infrastructure landscape moving to cloud. I said 10% to 30% I think broadly it seems to be in that range, some of them are higher, some of them are lower but on an average I think 10% to 30% is a good metric. So I do not see it is significantly impacting revenues. There will be some impact wherever it moves to cloud, we will lose some revenues but there will be some additional revenues which will come in as well. I think my position remains the same. What we are seeing in our customers, I have done a few test cases to make sure my assessment is right on the level of movement and the reduction in service revenues and they are pretty much in the similar range. Moving to Digital, I think so far we have largely focused on the beach head of the digital revenues like Beyond Digital, Design Thinking, UI, UX kind of work and now we are able to connect the dots and we are able to scale these programs to drive much larger programs. The example that Karan talked about and a couple of examples that Rahul talked about, both of them have pretty big downstream revenues. I think now we are very clear; participating in Digital to get just the beach head is really not going to be lucrative in the long run. We should be able to play the game end-to-end and I think that is where we are gearing up. I think as a strategy we have got it right, it is resonating very well with all the analysts and advisors, our customers are buying into it. I think this is the starting point for digital at scale.

That is what I would think. On H1B whether we can pass on the cost to the customers? I do not think so. I think it is a very competitive market and it is a level playing field and it will be difficult but in new deals obviously we will look at any fundamental cost structure changes and see we need to do any change in our pricing mechanisms. But at this point, in the near term I do not see any price increase possibility due to this.

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

Ashish Chopra: CVK, you briefly touched upon some change in trend as far as the growth within SAP or Enterprise Systems Integration is concerned. Could you throw some more light on that in terms of whether you would expect going forward the outlook to be much more rosier than what it has been in the past few quarters?

C. Vijayakumar: My commentary earlier was some of the on-premise large implementations are dwindling down and that was one of our strengths and that component was going down, revenues were also going down which is still happening. However, I think we have put a very concerted effort to focus on a few opportunities that were visible and we have kind of aligned our capability and all that around those opportunities. Those are looking positive and we have had some good initial wins. So I get a sense that we would be able to arrest the decline in our SAP kind of businesses in the coming quarters. It may happen in the next quarter or it may just happen one quarter later, but I feel pretty confident directionally we are changing, refilling our teams and also some of our customers who have had a lot of significant on-premise implementation of SAP, large accounts, they are also adopting cloud. So that way that is also giving us some confidence on this business.

Ashish Chopra: Secondly, in terms of the expenses, you spoke about building capabilities or modernization of the partnership with IBM in those products. So could you just throw some light on what would be the effort expended towards that in terms of the cost structure and would there be a certain number of people who would be deployed towards purely working on that end, does it move the needle on the cost in anyway?

C. Vijayakumar: I think each of these business cases have a built-in assumption of how much investments we will do year-on-year. So that is a part of the business case. I think it will be difficult for me to share what is the level of investments, but they are all built into the business cases and each of these products and revenue streams would give us margins which are better than our current margins as we had indicated earlier and that includes the potential investments that we have to make.

Ashish Chopra: Should we expect more such investments in platforms and/or products of similar quantum going forward? If you could just throw some light on what would be the criteria or the identified areas for those investments?

C. Vijayakumar: As I said, this is a strategic initiative to build products and platform business. There are several criteria, I had explained some of that to my first response to Ankur's question. Largely we need to look at strategically fitting into some of our areas of engagement because if you see there are two key drivers why are we doing this – one is we want to leverage our product engineering capability and legacy there and second is our understanding of the CIO and the IT landscape in large enterprises. So if it is relevant to this and we are able to do something to these products which helps us to modernize them or kind of solve some new business challenges for our customers, those are the considerations for large part of the investments. There could be some pieces which are bundled together, which could be just a tactical financially prudent decision rather than a financially and strategically prudent decision.

Moderator: Thank you. The next question is from the line of Akshen Thakkar from Fidelity. Please go ahead.

Akshen Thakkar: My question was a little bit around capital allocation. I am not saying in the next quarter or next year but just directionally in the next three to five years, how do you see capital allocation shaping up for the company?

C. Vijayakumar: I think it is really a long-range question. First is I do not think I have an answer on how capital allocation is going to happen for the next five years but I think directionally we do believe all incremental cash that is generated are potentially available for investments. That is the way we see this. How will it vary from year-to-year and all that? I do not have an answer now. We can definitely share this maybe as a part of an analyst meet or as a part of our annual planning exercise, some directional trends on how this will happen.

Akshen Thakkar: Let me attempt to sort of reframe the question that we have seen payout ratios being stable for you and this question is coming from that in the last one year we have seen HCL using cash flows towards IP investments, etc., Is what we have seen this year more representative? I know as a strategy we would still look at IP sort of sets but it is a quantum as a percentage of either cash flows or cash you would like to slice it, is the quantum something that we should keep expecting from HCL or are you seeing as more tactical, you will go as the opportunities present itself?

C. Vijayakumar: It will be dependent on the opportunity and given the landscape and the visibility of opportunities and potential market opportunity, this could be quite representative of the future as well.

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

Sandeep Shah: CVK, now three deals with IBM and based on what we said the revenue potential turns out to be $160-165 million. Just want to understand what is the method of arriving at this numbers …it is based on the established existing client base or based on the projected revenue based on potential?

C. Vijayakumar: I think we said the first year revenue; the first year revenue is largely based on the existing revenue base. Of course, there will be some growth but that is not something which we have factored in at this point. We would probably do that as a part of our annual planning and then share that. Right now, for these products I think you are absolutely right, $160 million is a good estimate of revenues based on the three investments on a full year basis.

Sandeep Shah: So that number is fairly visible for us as of now?

C. Vijayakumar: Yes.

Sandeep Shah: Secondly, in terms of Digital, I think the comments indicate that in terms of the adoption curve, now the clients are moving away from testing to more scalable operations and may lead to a larger deal sizes. So can you throw some light, is it more in terms of integrating the front-end with the back-end how the deal size are increasing and is it sporadic instances of such deals are coming or there are more deals coming across clients, across verticals?

Anand Birje: Actually two things are happening, right – one is if you looked at the last three years, lot of enterprise, CTO, CEOs were doing sprints of digital. So they were doing small programmatic efforts in adopting digital transformation either in one component of the front end, interactions with their customers or with their partners and taking process-by process digital transformation, right. What is now happening is really across the industry especially in large Fortune 500s and Fortune 100s, there is more long range strategic effort in defining roadmaps for digital. So that is firstly creating more define spend and not a project based individual sprint but roadmap based spend. That is #1. #2 is I think in the general commentary you heard that it is moving away from small pilot programs to now looking at the entire technology landscape and applications landscape and looking at how do they modernize the landscape either through creation of engineering new platforms or really modernizing the existing landscape using APIs and Micro Services and new technology stacks. Those are creating again large programs. In these two areas, there are more programmatic spends that are happening and not tactical spends are happening. That is what we are seeing as a pattern and it is not a one-off pattern. I think our ability to engage in these kind of programs across the industry, even our model of engagement now with not to engage for projects but trying and participating in the program structuring, using reference architectures to help clients define more long range architectures and then embarking upon execution of these programs, that is what we are seeing.

Management: To add to what Anand just mentioned, there is another driver which is there. If you look at Financial Services, is under competitive pressure from the nonconventional financial institutions, right, so Paypals of the world, the fintech emergence, etc., I feel that the pace of digitalization in Financial Services will also be picking up as a result of the external differences that are coming, for example, no bank can afford not to have a great payment network, right. So therefore, there is an urgency which is also driving the digital spend to happen. The scale is also being driven because of the urgency and therefore lots of work has to be done in a shorter period of time.

Sandeep Shah: In terms of the IMS, if we look at the growth in this quarter it has been close to 2% and the implied growth guidance for the coming quarter also looks like close to around 1.5% kind of growth if we assume that most of the growth next quarter is largely coming through Software Services and the Engineering R&D. So anything to read, CVK, you still believe IMS will continue to remain growth driver for a foreseeable future or you may have to do deals like Volvo IT to get into that service horizontal much more aggressively versus the history of growing highly on organic basis?

C. Vijayakumar: Our strategy would be to grow the core business organically because we are highly differentiated, our win rates are high and our market capability all of that is highly respected. So largely we will grow organically. Of course, the law of large numbers are catching up and that is going to post some challenges, so growth rates would moderate itself a little bit. I do not see any fundamental concerns because if I look at the pipeline today, it is comparable to what it was last year for IMS, for other businesses it could be higher. So I think as I always said before do not look at IMS business or any of our businesses on quarter-on-quarter basis, just look at it from year-on-year and that would be the right way to look at it and there we continue to remain positive about the growth trajectory of our IMS business.

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

Mukul Garg: CVK, first, I wanted to just clarify on the IBM partnership. So you have done one deal each in last three quarters. So how does this work…do you approach IBM based on availability from their end or the criteria is more on you do own partnership, you see the success rate and then you look at more areas where you can do this partnership with IBM or any other company. Secondly, you mentioned that the margins would be little bit higher on from the services side of the business. So are these risks also more aligned to no risk usually seen with the software development project which are usually front-ended?

C. Vijayakumar: We enjoy a good relationship with IBM. So lot of this are jointly discussed as a part of some strategy workshops and if we find a good strategic fit and we feel confident about what we can do to the product and how it can help us use some of our existing capabilities and create a growth curve, I think that is what we do. Then lots of such opportunities but we have been selective. So that is all I can tell you about that at this point. It is not like a software development project where you develop and then there were risks of timelines and things like that. This is all existing products which have huge installed base in fairly large Financial Services, Healthcare companies in a highly embedded manner. But the effort that goes in is you may want to modernize products, you may want to make them cloud-enabled. So some of these will need some investments but of course, these investments are less risky because you are always making the investments based on what you see are the client requirements and if customers have some feature enhancement or certain new modules to be added on to this, they are going to prioritize them over a generic product roadmap which is going to be more aligned to client requirements.

Mukul Garg: Second question was on Mode 2 and Mode 3 services. So when do you see them reaching scale when you can probably break them out? Secondly, so how does this Mode 1, Mode 2, Mode 3 work inside the company -- are they independent units or are they part of the same units within Mode 1?

C. Vijayakumar: I had explained this earlier, Mode 1 is largely our go-to-market organization, and it has a delivery arm to execute to it. Mode 2 is if you really see the different services in Mode 2, they cut across multiple service lines. So that is the reason we have created dedicated teams for Mode 2 which really overlay teams, they ride on the back of go-to-market teams, but they are very focused on creating capabilities, proposition and differentiation, analysts recognition and all of that and very, very closely work on the client pursuits along with the go-to-market teams. This is Mode 1 and Mode 2. Mode 3 is we are creating a separate organization to drive the Mode 3 business, especially on the products side. When we start doing some platform type of work, I think it will have to coexist with our vertical teams as well. So, we have to pay the construct which will be optimal once we have a big ticket platform thing in place.

Mukul Garg: Then just one clarification on the SG&A side, for the last two quarters, SG&A spend has been slightly on the lower end. So, do you think this is sustainable or how do you see this going forward?

C. Vijayakumar: Typically, we have been in the range of 12%, but 10, 20 bps up and down there are many factors which play into it, the currency also plays into this, I do not see it significantly changing. I think we will be in ballpark in the similar range.

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

Ravi Menon: Just wanted to clarify, CVK, if I understood you correctly, I think IBM deal, you talked about how this even helps with the whole digital transformation, the landscape simplification kind of deals. So, is that correct?

C. Vijayakumar: Yes, one of the products that we have acquired this time which is data extended ITX, I think that plays into the topic that you are talking about.

Ravi Menon: Even the other ones before that you acquired, would not that also work well with run the business kind of spend, trying to compress the business?

C. Vijayakumar: Yes, that is right.

Ravi Menon: So then would it be fair to say that you are looking at this not just from a purely IRR kind of point of view, but you are evaluating this as to be differentiated to help you win Application Services deals as well?

C. Vijayakumar: I do not believe they will really help us win new ITO deals as such, but since we are in the market, we are playing to the same customers, we are servicing them, I think it will just help us to understand and modernize these products and even sell to some of our customers. Of course, it will go into some of our ITO deals as well, but it will be a smaller component because ITO deals are very large deals and there are millions of many software components which goes into it, and some of this would also be form part of it.

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

Ashwin Mehta: I had one question on Engineering Services. So possibly there was a significant contribution from IP deals in it this quarter. So what are you seeing x of that, is there a pickup in growth any sign of the larger $100 million kind of engagement that you won earlier being seen at this point in time?

C. Vijayakumar: Ashwin, outside of the IP contribution also, the ERS business has grown well, I do not have the exact number, but it is a decent growth. However, it is not because of a contribution from $100 million type of large deals, there are a number of small deals and some of the existing customers are also enhancing some of the spend. So many small such things have driven and pretty healthy growth outside the IP revenues as well.

Ashwin Mehta: So just as a follow-up, wanted to check in terms of outlook or in terms of what you are seeing in the market, are you starting to see the return of the larger deals or the deals will be more in the ballpark of $30, $40 million kind of deals that you have historically seen here in the Engineering Services space?

C. Vijayakumar: I think the numbers that you mention would be representative.

Moderator: Thank you. The next question is from the line of Jay Doshi of Kotak Securities. Please go ahead.

Jay Doshi: Just one more question on IBM deals. I was trying to understand how are these deals different from acquisitions -- is there a competitive bidding process, are there incentives and all now it is in place to sort of ensure that the deal that you acquire or maybe IBM stays interested in? Just also curious to know what are the quantum and nature of investments that would be required given the fact that you mentioned that perhaps IBM does not have budget to make those investments and that is primary reason why they are sort of letting go on some of these IPs?

C. Vijayakumar: I explained that considerations, I would not be able to really comment on the competitive landscape, obviously, when there is a business opportunity, there will be multiple players who will be interested in. But some of these are fairly complex transactions, right? It needs a significant amount of engineering skills, it needs even the deal structuring, all of that is a little bit complex. So I think given that we have a successful track record and we flawlessly kind of did the first transaction, obviously, we have a preferential access and knowledge of what is coming and what we can do about these products, it is like any other good relationship, if we are in the relationship, there will always be some benefits.

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

C. Vijayakumar: Thank you. I really enjoyed your well thought out and nice questions. You have been nice to me I am sure. Thank you for that.

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.