"HCL Technologies Q3 FY'21 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to HCL Technologies Q3 FY'21 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sanjay Mendiratta – Head, IR. Thank you. And over to you, sir.

Sanjay Mendiratta: Thank you, Stanford. Good morning and good evening, everyone. A very warm welcome to HCL Tech Q3 Fiscal '21 Earnings Call. Trust you all are safe and healthy.

We have with us Mr. C. Vijayakumar – President & Chief Executive Officer, HCL Technologies; Mr. Prateek Aggarwal – Chief Financial Officer; Anand Birje – Senior Corporate Vice President, Digital & Analytics and Head of Application Services; and Darren Oberst – Corporate Vice President, HCL Software, along with the broader leadership team to discuss the performance of the company during the quarter, followed by Q&A.

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

Thank you. And over to you, CVK.

C. Vijayakumar: Thank you, Sanjay. Good morning, good afternoon, and good evening, everyone. I hope the year has started off on a great note for all of you, and all of you are doing well.

For HCLites, this year starts with a very significant milestone as you heard. In calendar year 2020, we crossed the $10 billion revenue milestone. This is an important milestone for us as a company. And it's a result of our vision, our employees' passion, and a very disciplined execution over the last many years, combined with the trust and confidence our clients place in us every day. We are very thankful to all our stakeholders for this support over the years.

While this is a great milestone, it does have a significant market relevance, especially if you look at the ISG service provider rankings; they rank companies starting from the booming 15, breakthrough 15, building 15, and the big 15. Obviously, this includes managed services market and as a service or the cloud providers. So, we will now be in the big 15 and it does definitely give us some advantage especially in markets and clients where we may not be present.

Having said that, I want to get into the next set of information, I want to share with you which is very specific to the quarter. At a high level, the strategic bets that we made in the last several years continue to deliver outstanding results as it is reflected in our sequential revenue growth of 3.5% in constant currency and 4.4% in US dollars. On a year-on-year basis, we delivered 1.1% constant currency (CC) revenue growth and 2.9%-dollar revenue growth. Our EBIT margins went up by 130 bps sequentially. It's a 22-quarter high, which is 22.9%, which is higher than the higher-end of our guidance, which was at 20% to 21%.

Our net income was Rs.3,982 crores, a 26.7% increase sequentially and 31.1% on a year-on-year basis. Higher net income is also due to lower tax provisions and a couple of other technicalities which we will cover subsequently.

Our attrition is at an all-time low; employee attrition on an LTM basis stands at 10.2%. So, this is a very healthy situation, even though we expected to inch up a little bit in the coming quarters, primarily due to the very strong demand environment.

From a booking perspective, we signed 13 transformational deals, all but one you can read in our Investor Release document. The TCV that we signed is a 13% increase year-on-year compared to the December quarter '19.

Our pipeline remains very strong. We are very confident of further acceleration of bookings in the coming quarters. Our strong performance was led by digital, cloud and products and platforms businesses, which reflects the success of the many strategic investments and bets we've made over the years, including strong and unique ecosystem partnerships and constructs that we have set up with hyperscalers. This happened a couple of years back, and each one of them are very mature, very cohesive operating units, which is working across the organization to drive and harness the momentum delivered through the year in partnership with the cloud hyperscalers.

The second important thing is the organic and inorganic investments we've made to build broad-based IP and products and platforms portfolio is a very important element. It's not just the inorganic investments that we made. But what we have done with those investments, the R&D investments that we've made to innovate and launch products, which are very relevant for our clients, is what is driving the success of our products business.

And the third very important reason for the strong performance is our digital transformation value proposition. It's truly differentiated, it's integrated, and it is resonating extremely well with our clients.

If you look at the growth drivers, I would like to talk about it on four broad reasons which is driving the growth. First is the overall buying temperature in the market is the demand environment is very strong. We are witnessing steady momentum in the market. Pent up demand in some of the most impacted sectors, like manufacturing and retail is slowly returning while the sectors that were least impacted or in fact benefiting from the pandemic like grocery and food distribution, life sciences and healthcare, the clients in these segments are making bolder bets and further evolving their business models and strengthening their business models using latest technologies. In this quarter, you saw a clear reflection of these trends as five of the seven verticals showed a positive momentum. Media and Telecom which posted 12% QoQ in constant currency. A substantial part of it is due to a one-time deal activity. So, do not extrapolate this into any major trend. Technology and services posted 6.8% sequentially in constant currency. Manufacturing has returned to a strong positive quarterly sequential growth of 5.6% in constant currency, which can be attributed to the new ramp ups that I talked about briefly earlier.

The second factor driving the demand, as I said, the Mode-2 businesses, particularly Digital and Cloud are growing very aggressively, as companies are modernizing their core processes for differentiation, speed to market, efficiency and scalability. Our results reflect the success of the strategic investments we've made over the years, including IP incubation in our cloud and digital service offerings, the integrated value propositions and unique ecosystem constructs with all hyper scalars. We were one of the first in the market to create dedicated business units for the large hyperscalers. We did these two years back and these are mature units in the HCL ecosystem.

Major part of the growth came from the performance of our Mode-2 businesses, which delivered a 10.9% sequential growth in constant currency, and 25% year-on-year growth in the constant currency.

We signed several large deals in Digital and Cloud businesses this quarter, like the one with the leading US financial services firm to build a customer-centric digital banking platform, leveraging the cloud technologies. Among other things, our solution here will enable the firm to offer a market-leading product portfolio delivered digitally by harnessing the most innovative low code, no code platforms, thus giving it a clear competitive advantage.

Similarly, a Europe based Life Sciences and Healthcare company selected HCL as its preferred digital transformation partner for bottom-up transformation. Later in this call, Anand Birje, who leads our digital & analytics business will provide more examples and highlights of the type of work that we are doing, what is differentiating us, and the business outcomes that we are delivering for our clients. And Darren, who heads our HCL Software business, will also weigh in on the HCL Software business, which really brings me to the third dimension of the growth driver, which is the products and platforms business, which grew by 9.3% in constant currency year-on-year, which is a very strong growth. It continues to validate our strategy. We have a very strong business model and an impeccable execution rigor in this business, which is delivering some outstanding results.

In this quarter, we had very high TCV booking, almost triple-digit increase in the TCV compared to the OND quarter in 2019. And Darren will talk about some more details about how we are seeing this business and our performance in the last quarter.

The last growth driver is the most important thing. This is the trust and depth of our client relationships. We signed a lot of renewals and many renewals had new scopes with our existing clients in this quarter. In the increased uncertainty mix created by COVID, our clients benefited significantly from the flexibility, trust and support we offered, driven by our relationship beyond the contract philosophy, which has further motivated them to make bigger bets on us. A leading Europe-based global manufacturing company, for example, significantly expanded its partnership with HCL in Q3. In almost a decade of relationship with the client, we have helped them in managing and transforming their IT infrastructure landscape. Now, they have asked us to help them with the multi cloud transformation program. Similarly, a large pharma company and a large bank both in the US, they have decided to bring this on for completely new services.

So, in summary, our strong pipeline and good order book keeps me very optimistic about our growth trajectory moving forward. I strongly believe we have uniquely differentiated value proposition on the market through our combination of solutions and services, and strong client relationships and the digital thought leadership and the entrepreneurial DNA. All of this will help us gain significantly from the increased market activity and the momentum that we are seeing.

With that, I will hand it over to Prateek to provide more financial details and commentary. Over to you, Prateek.

Prateek Aggarwal: Thanks, CVK. Good evening, everybody, good morning to the ones in the US. Happy New Year and I hope all of you are keeping safe and doing well.

So, to catch up on some of the financial highlights, the biggest highlight of course for the quarter and for the year is the $10 billion milestone, which we have achieved in the last 12-months in calendar year 2020.

Moving on to the quarter itself, the quarterly revenue came in at $2.6 billion, which was a growth of 4.4% on a sequential basis, and 2.9% year-on-year in dollar terms. In constant currency, it was at 3.5% sequentially and 1.1% on a year-on-year basis. As far as pre-COVID peaks are concerned, two out of three segments, which is IT and Business Services, as well as Products and Platforms are already above peak that we hit in the March quarter of 2020. ERS is the one which is little behind and hopefully we would catch up soon.

In the P&L accounts, EBITDA for the quarter in IND AS terms, stand at 29.1%, which is up 157 bps sequentially, and that close to 360 bps year-on-year. The reason I call out EBITDA is because that as you know is the closest in terms of cash profit, and reflects more the cash generating ability of the business.

Moving on to the EBIT, per US GAAP EBIT came in at 22.9% this quarter, which was up by about 130 bps QoQ and about 265 bps on a year-on-year basis.

To give you a quick margin walk on a quarter-on-quarter basis, we had the wage hike impact of about 50 bps in this quarter. So, the increase of 130 bps was actually 180 bps at a gross level. And some of the factors capturing or the source where that came from is, first of all the SG&A leverage, we also had some reversals in the provisions for bad debts because we could actually go and collect some of the things that we had to provide for in the earlier quarters. So, SG&A

leverage as a total gave us close to 80 bps. And part of that was offset by the higher depreciation and amortization, giving a net benefit of 50 bps.

We were also helped by work moving more offshore and offshore margins being higher than onsite margins, which gave us about 50 bps on top. At the same time, there have been some revenue catch up, particularly in the Mode-2 services and also in the ERS segment which flew down to margin basically coming from previous quarters, and at the same time in the last quarter there was higher bonus payouts and provisions made in the last quarter. So, that is kind of playing up the difference between the two quarters: September versus December. So, that's the quick walk on the margin side.

I will move on to the profit after tax, the net income close to $540 million, in rupee terms, it is close to Rs.4,000 crores which is I believe the highest profit we have had in any quarter. And it is helped by obviously the solid growth that we have delivered 3.5%, as well as the margins of 22.9% but also helped by a couple of decisions that came our way, it has been a very productive quarter from a tax team point of view, where the tax expense of the quarter is kind of half of what it would have been otherwise but for these two factors. And the first factor is reversal of a provision for an uncertain tax position, which had been set up in the prior years. And now because of a certain judgment, we could reverse that provision and it is kind of confirmed at a higher court level.

The second factor is more lasting kind of a benefit, which will sustain into future years as well. And that is giving us a reduction in the tax liability due to very basic change in the method of calculating tax exemption or tax deduction that we are eligible for, which is also the result of some recent judicial rulings that came our way.

So, like I said, the second part is expected to sustain and going forward in Q4, our (ETR) effective tax rate will not be the usual 24% which we were running in the first half of the year, it will be sub-22, maybe 21.5% to 22% kind of a range. And therefore, for the full financial year '21 the ETR would be about 20%. So, that is what has given us a solid leg up in terms of the profit after tax or net income for the quarter.

Moving on then to the more cash flow and balance sheet kind of metrics, we are happy to have brought down the (DSO) day sales outstanding now down to 78-days, including unbilled revenue which is one day lower than the 79-days that we achieved in the last quarter, which as you might remember was already a significant reduction of seven days from the 86-days that we had at the end of March and June quarter. So, compared to March and June quarters, 86, we are now down to 78 days, which is a solid reduction of eight days. And this is despite some headwinds from the Forex fluctuations, which actually increased the DSOs on a standalone ceteris paribus basis.

During the quarter, we generated operating cash flow (OCF) of $684 million, and a free cash flow (FCF) of $621 million, both being 127% and 115% respectively of net income, numbers to be proud of I believe. And over the last 12-months of calendar year 2020, our OCF continues to be at a level of $2.7 billion and FCF at $2.4 billion. So, these are the same level that we achieved in the last quarter on a LTM basis. And we are happy to be sustaining that for one more quarter at virtually the same levels, and $2.7 billion is 150% of net income over the last 12-months and FCF of $2.4 billion is 135% of the net income.

As a result of all those cash flows coming in, and outflows including the payment of $850 million to IBM over June and July, and also the dividends that we pay during the quarters, net cash is now at $2.2 billion, which is double of the same quarter last year which was at $1.1 billion and after paying off all those items that I mentioned. And even on a quarter-on-quarter basis, that's a solid increase of $375 million. That results in our last 12-months EPS at a level of Rs.48.7, which is up by 26% on a year-on-year basis calendar year '20 versus calendar year '19. And cash EPS on a last 12-month basis is now at Rs.62.2 which is also up by a factor of 28%.

The board has declared a dividend of Rs.4 per share. This is as per what we had mentioned in the last quarter as well. So, we are continuing with that.

And the guidance for the coming quarter is revenue is expected to grow at about 2% to 3% in constant currency for Q4, which includes the DWS contribution and some expected seasonal downturn in the Products and Platforms segment. And EBIT which we had earlier given the guidance of 20% to 21%, that has been now increased, the 21% which was earlier at the higher end of the guidance is now the lower end of the guidance, and the range now expected to be for the financial year is from 21% to 21.5%.

I will stop there and hand over to Anand for his commentary on the Mode-2 and Digital businesses. Over to you, Anand.

Anand Birje: Thanks, Prateek. Good morning, good afternoon, good evening, everyone, and a very happy new year and wish you a healthy new year ahead.

As CVK mentioned, we continue to see strong growth in our Mode-2 services due to differentiated capabilities that we've invested in and scaled out over the last several years, specifically around digital consulting, helping enterprises reimagine their digital programs and then to find the digital programs and prioritize and execute their digital programs through our consulting capabilities.

Application modernization both as enterprises deliver these new digital programs and adopt cloud journeys. Application modernization plays a significant role in our participation and differentiation in the market. Data and analytics transformation, along with key ecosystem partnerships, both with the hyperscalers and also leading SaaS MarTech data platform, analytics leaders, etc., which all come together in conceptualizing, strategizing and then executing these programs. Enterprises across industries B2B and B2C have been investing in digital transformation over the years. But what we've definitely seen is a massive acceleration in their investments and rebalancing of the portfolio spend on what we would consider traditional business as usual IT versus digital transformation spend in the post-COVID world. Enterprises have accelerated almost multifold bringing in these programs to the core to rapidly even reinvent and survive and thrive in the net new normal. Value chains, such as CX, which includes customer engagement, partner engagement, employee engagement, omni-channel transformation, both online and offline commerce, supply chains including planning, logistics, last mile delivery, new products and ability to launch into products in new markets faster. And many other aspects of value chains that are industry-specific, are getting reimagined and transformed rapidly across the world and across industries. Our experiences in translating these transformation programs from strategy into more programmatic journeys and executable journeys that are delivered in virtual agile program planning to delivery. And really having participated in such programs over the years and learn from those participations has really helped us win some of these new engagements and the growth that we see across markets. Customers are really putting premium on partners like us who have the ability to translate programs into prioritized roadmaps and execute these programs that bring together technology, design, process and domain consulting skills to execute rapidly with business and IT partnerships.

We have also created, over the years, what we call Day-0 and Day-1 teams globally, which are really made up of digital strategy and technology transformation principles, or architects that include application modernization, integration, data analytics and cloud capable highly skilled teams that are focused and embedded into some of our largest and key customers. And also hence bring domain knowledge, customer relevance in both conceptualizing and executing on these programs with our customers. At the same time, they are embedded into all the net new journeys with new customers, right from solutioning into execution.

I will provide a little bit of color to the kind of programs we are seeing and the kind of transformations we are seeing. And I will put in the dimension of both value chains and verticals. Obviously, as I said, some of the value chains are cross-vertical. So, if you take CX as a value chain, which is the most commonly occurring across multiple verticals.

CVK mentioned one of the largest banking partnerships we did earlier this year, actually earlier in the quarter, which is a retail bank in North America where they are really rethinking their entire value journeys in delivering their retail products and services to their customers, including core banking, as well as home loans, auto loans, and so on so forth and really rethinking their platforms on which they deliver their services. Modernizing these platforms using SaaS and Cloud Native capabilities, building API's to integrate with ecosystem partners that will bring new products and services, and delivering these at a time to market so that they can onboard members at 40% reduced time. And also, cross-sell products and services increased by 30% across their member bureaus. They're also acquiring rapidly across North America, and so their ability to integrate the acquired banks is going to be an important factor for the platforms that have been built and delivered.

Similarly, one of the largest utility companies in Europe chose us as a partner to help them reimagine and transform their customer engagement, customer service and billing platforms, which are being really harmonized for content management, leveraging cloud, both for CRM as well as other aspects of functionality in the platform. Using latest data integration, as well as data analytics technologies, increasing customer communication, customer satisfaction and customer experience overall, this company is actually expanding rapidly and expects to go from 3 million to 30 million retail and B2B users over the next three years, as the platform is expected to onboard almost 300,000 new customers on to this over the next few quarters, rapidly increasing the usage and scalability of their business.

Similarly, one of the world's largest wealth management and financial services firm is partnering with us in modernizing their wealth management platform as they see the demographics of their customers shift rapidly from U.S. and Europe based predominantly to across Asia, Middle East, etc. And so they are trying to harmonies their platforms for user experience that is consistent across geographies. At the same time, build composability so that they can have countries-specific and culture specific needs tailored for advisory services, localized investments and investment plans. And also broaden the customer base, both by geography and by net worth, increasing their overall revenue and EBIT 3x over the next three years.

If I move to another sort of value chain that we are seeing, really getting transformed across industries, is omni-channel commerce, both in retail but also increasingly in B2B industries like CPG, Manufacturing, Life Sciences, we are seeing commerce modernization, especially in the post-COVID world happening quite rapidly.

One of the largest industrial tools manufacturing firms in the world partnered with us. And one of the journeys that we are embarked on with them is modernizing their B2B and B2C commerce value chains across the world, across their brands, as they are increasingly seeing direct-to-consumer business increased by almost 26% in this year alone, and they see that trend only increasing. So, modernizing their B2C, at the same time harmonizing across brands their B2B platforms, leveraging UX and CX to increase commonality of experience, leveraging cloud for scalability and also leveraging API and micro services for modernizing these platforms to increase overall adoption and the customer experience they want to deliver to direct-to-consumers commerce growth that is happening in their business.

If I kind of go to core retail, across the world retailers are adopting to the new normal. One of the largest retailers in Asia Pacific partnered with us, as they are in the post-pandemic seeing a surge, both in online business as well as very different demand patterns and delivery and fulfilment patterns. And so the commerce modernization, omni-channel modernization as well as delivery modernization, and what they call servitization is where they are launching their digital programs. And we are helping them with improving the overall time to market as well as customer experience, especially in the highly impacted customers that include elderly and customers impacted by COVID, creating features like on call waiting, online, as well as creating urgent deliveries similar to Prime deliveries, for customers in need, etc., across the markets that they deliver to.

I think supply chain is the third sort of value chain across industries that was already going through a big metamorph over the last years and has accelerated, including planning, warehouse management, logistics, last mile deliveries, transportation, all of the aspects of supply chains are getting rethought of, because both the demand patterns in how the customers are buying as well as the supplier patterns and the logistics and routing patterns are changing quite rapidly. For one of the largest CPG firms in North America, we have partnered to help them rethink their entire supply chain, specifically reducing their transportation cost by over 18% in the next year alone, as their last mile deliveries because of direct-to-consumer increase in their business, needs for them to change their fulfilment planning, their transportation logistics, their timetabling for their resources, as well as trying to meet market demands for zero cost deliveries and so on so forth, is driving their digital programs.

There are many other sorts of aspects of transformation, that include the increased risk and fraud protection because of adoption of digital. As I said, one of the largest banks in Europe partnered with us and we are continuing to modernize their KYC or know your customer platforms, as they see increase in both digital customer base and digital banking across the world, they are trying to harmonize fraud detection using advanced analytics, using visual analytics, as well as low-code no-code platforms to fast roll out to necessary regulatory compliances within countries, essentially trying to meet all the compliance demands within the next 12 months as they see increase in the digital channels of banking.

So, those are some of the examples. As I said, we see this only increasing in acceleration over the next few quarters. We think we are very well positioned, both due to our capabilities, and most importantly, the experiences that we bring to the table and have helped customers succeed in these journeys.

With that, I will hand this over back to CVK. Thank you, everyone.

C. Vijayakumar: Thank you, Anand. Maybe Darren, if you could provide an overview of the HCL Software business, and then we will go into question and answers.

Darren Oberst: Thank you, CVK. And good morning, and good evening, everyone. As CVK and Prateek highlighted, the third quarter was a strong quarter for the Products & Platform segment. For all of you who have been following this business over a number of quarters, you may recall that it was six quarters ago that we closed on the significant divestiture transaction with IBM. So very notably the last two quarters, our third quarter and our second quarter really were the first two wraparound quarters where we really started to have an operating baseline and the baseline for comparison in terms of the growth rate of this business. I think it's very heartening. And I think, in particular, the third quarter was really a key milestone on the journey that we have been on with this business.

So, in terms of constant currency, it was 9.3% year-on-year growth in Q3. And when you look at that six-month period, these first two wraparound quarters, the growth rate was in the 12% to 13% range year-on-year. In terms of how we have been performing against the business case, we continue to track favorably, especially in terms of the profit contribution that we expected. The business has proven to be a little bit more profitable than we thought it would be. And this is especially heartening in light of the environment that we have been working in, in terms of the pandemic.

When we really think about the commentary of what have been the key drivers for these results, there are really three key items that I would call out. The first is just good, consistent execution against the strategy that we have articulated. And quarter after quarter, step after step, customer after customer we have been delivering against. When we announced the divestiture, we laid out a very ambitious roadmap in terms of modernizing and investing in innovation in each of these products, we have delivered on that. And as we have seen each of those new deliveries, it's had a direct impact on customer commitments to grow and invest in these products, on new customers and the competitiveness of these products in the market. And it's also led to things like very high and consistently improving net promoter scores, so our customers appreciate and value the investments that we have made in the products.

We have also focused on building out a global sales organization. And quite frankly, that takes time. And so, again, quarter after quarter after quarter, the leadership, the management process, the pipeline build has continued to improve. And then finally, from a strategy point of view, we have really tried to get the little things right. And sometimes those are the things that aren't as visible. But they are the kind of things of listening to customers, focusing on customer's success, building a winning culture, and making sure that, again, customer by customer you win that trust, and you create that value. So, that's probably the first thing underpinning I think the strong results that we have had this quarter. We have had a good strategy; we have executed on it pretty well. And this is just a paying dividend from that strategy.

I think the second thing then to call out is this was a very strong quarter for us in terms of new license bookings. What we have seen over the course of the last three quarters through the COVID era, throughout FY21 is consistent and steady growth in our new license pipeline. And we reaped a lot of the benefits of that in the December quarter. We would expect that it is a seasonally strong quarter, but even when you compare it year-on-year, as CVK mentioned, we had over triple-digit year-on-year growth in new licensed bookings. We booked $91 million of new licensed booking TCV which actually represents over 250% year-on-year growth.

To share a couple of other key metrics and highlights in terms of the bookings for the quarter. We completed over 6,000 individual sales transactions that consists of both new license and renewals. A key metric that we track operationally are our new footprint wins. When a customer purchases a new product for the first time, we see that as a very important validation. We had 350 new footprint wins in the quarter, which is the most that we have had so far.

Another key dimension in terms of bookings were just customer growth synergies that we have seen. And we have highlighted these anecdotally over the course of a number of calls. But we have seen it, I think, coming in multi-dimensions. The first we have seen customers growing their existing software deployments, buying and committing to more of the product that they already have. We have also seen a significant amount of upsell and cross-sell, where customers expand the relationship then to work with us in other product categories.

And then finally, and I think an area that we are really just scratching the surface is starting to find that synergy where a customer that has one of our products starts to give us proprietary access and competitive advantage to really deliver very unique managed service offerings around it. We had one very important win in this quarter with a European customer, where we had a large significant expansion from them on the software side, but it also led to a multi-year managed service partnership on the services side as well. Again, these are anecdotes, but we believe that this is just the beginning of a trend where we will continue to find more growth synergy from our customers.

The third key driver for this quarter, I think, really does speak to the mission critical nature of these products, the underlying resilience of this business through the pandemic. While certainly we have seen headwinds like every other business in the world, we have also seen for many of our customers a counter, which is they see these products as more critical than ever in the types of digital journeys that Anand had just walked through. And so we believe, again, this is a great validation of the underlying business model, mission critical products, high diversification in terms of major enterprises across all industries and across all geographies. We think it’s a great underpinning of the fundamental hypothesis that we have had for this business.

So, those are really what we see in terms of the three-key growth drivers for this quarter. I did want to offer perhaps by way of a closing comment, just how do we contextualize this performance. And a couple of the things we would say are, I think this is a good step in the journey, but I think it’s important to realize that it is a journey. And this is a long-term commitment from HCL to really build a long-term growing, very meaningful strategic software business. And we have just completed two wraparound quarters. So, it’s still very early days.

As Prateek mentioned, there is seasonality in this business. And we would expect that to continue. So, almost every year we are going to see a pretty strong cycle from the fiscal second quarter to third quarter, and then seasonally weaker in the March quarter. That’s just as many customers with December year ends, deplete their CAPEX budgets, and then correspondingly have less budget for new CAPEX in the March quarter. So, we would expect that seasonality to continue. Also, while we have completed most of the transition associated with the divestiture, there are still transition going on. And we would expect there to continue to be some one-time effects, both positive and negative in any given quarter. And so one of the things we would encourage what we look at is the most important metric to track this business, is that year-on-year our growth trajectory of the business as measured over a number of quarters.

One final point that I do want to mention, it’s a positive is that, actually our new licensed pipeline today is actually larger than it was in the past quarter. So, growth and momentum in the pipeline continued to grow. We see a lot of opportunity. So, we are continuing to invest in SG&A, continuing to hire our sales team in areas where we see more opportunity. As a result, though, we may expect a slightly lower margins for this business over the course of the next few quarters, as we are ramping up that sales team and as we are building pipeline.

So, with that, I will close my comments and turn it back to CVK.

C. Vijayakumar: Thank you, Darren. With this, operator, please open it up for questions.

Moderator: Sure. Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Pankaj Kapoor from CLSA. Please go ahead.

Pankaj Kapoor: I have two questions. My first question is on the Product business. So, as a portfolio, that seems to be doing very well. I was just curious if all of them are going at a similar pace, or is there a difference in their trajectory? If you can give some color on that, that will be useful. And also, if you can correlate that with the investments, we made in upgrading each of them? That is what I am looking for. Thank you.

C. Vijayakumar: Darren, do you want to respond to that?

Darren Oberst: Sure. Thank you. So, we have not at this point broken out or given specific guidance at a product level. I think in the future, again, as we start to have more consistent operational baselines, I think we will be in a much better position to do that. I think right now, if we gave too much commentary, it might be based on a very limited number of data points. But what I would offer is that the investment that we have made was in every product that was in that acquired portfolio from IBM. And so far we have seen good results across the board. Again, in any given quarter, like the quarter we just finished, certainly there were a couple of products that performed better than others. But I think across the board, right now, we are seeing positive uplift and positive dynamics as a result of the investments that we have made in them.

C. Vijayakumar: I also want to add, while we have not done a very precise analysis of correlation to the investments to the growth, but we see a numerous anecdotal evidence of features and functionalities which we have invested in, being adopted and accepted by customers. And that is creating some increased interest and momentum. See, we see a number of anecdotal examples, but it's too early to kind of really create a trend and communicate it.

Pankaj Kapoor: Understood. My second question is for Prateek. Prateek, were there any one-offs in the margin performance as you enter that? And if so, can you please quantify that? That is all from my side. Thank you.

Prateek Aggarwal: Yes. So, Pankaj, like I mentioned during my commentary, there was some degree of revenue catch up in the Mode 2 segments. That was roughly around 40 bps. So, I believe that is what you are looking for.

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

Sandip Agarwal: Wishing you a very Happy New Year and stay healthy and stay safe. I would also like to congratulate the team for the excellent execution and robust results. So, CVK, I have just one strategic question. If you compare the last five years for Indian tech industry and HCL in particular, how do you see the next five years? I am not asking for any quantitative data, but qualitative side. Do you think that there were much better reset, or the times will be much better as you see today?

And a related question to that is that, if that is true then if you go back a little bit in history and you see last year at FY 2020, we ended at 10.7% constant currency growth for the full year. So, we were already at low double-digit trajectory before the pandemic. So, will this pandemic in that case push up those numbers quite significantly? And I am not looking for any quantitative number, I am just looking at some qualitative comment around that.

C. Vijayakumar: The simple answer is, yes, Sandeep. Several months back I did mention in one of the analyst conferences that the next five years will be seeing better growth for the industry than the past five years. And there is no reason why that's not true for HCL. And your observations about having a low, I mean, high single-digit growth over the last four or five years and the subsequent next few years will definitely see a better momentum. So, you are absolutely right.

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

Kawaljeet Saluja: Congrats on excellent margin performance. I have a couple of questions. The first question is on large deals and in consequent correlation with growth. Now CVK, the last time you grew in double-digit on organic basis, it was helped by a significant number of mega deals wins. Just wanted to know that if that mega deal win is a precondition for you to return to a double-digit growth or whatever you are targeting, as we are moving towards FY2022. And a related question to where it is the fact that the market seems to be quiet right for fairly large transformational deals and competition is also quite active. But HCL has been unusually quiet. Just wanted to get your thoughts on this as well.

C. Vijayakumar: I think, see, I mean, we have won 13 transformational deals, and we can only announce what our clients accept or allow us to announce. So, that's one restriction that we have, Kawaljeet. And we are very strongly participating in a lot of large deals. The pipeline, at least 60% of the pipeline is filled with large opportunities, which are in a very, very well qualified and in an advanced stage. So, I cannot really say anything more than that. Demand pipeline is good, our booking will only accelerate.

Now, the first question whether mega deals are a prerequisite for a double-digit growth. See, when we have mega deals, it does push up the growth by 2% or 3%. But I don't think that's a prerequisite, there are many years where we have grown well without a billion dollar deal, for example. So, I do feel positive about multiple $200 million, $300 million deals, which are in the pipeline and which we continue to win, they will give us the good basis for strong growth in the coming years.

Kawaljeet Saluja: Thank you, CVK. My second question is on ERS. Now, I think while for IT services COVID has been a big accelerator for digital transformation. And consequently, hope of acceleration in spending. The trend for engineering services post-COVID is not clear. Just wanted a high-level views on how would ERS change post-COVID, let's say, over the next three to five years or how does the market ERS surface change?

C. Vijayakumar: Yes, I will provide a high-level view and request GH to kind of elaborate a little bit. I mean, as Kawal, you know, we have two components, assets-like industries and assets-heavy, and some of the challenges that we are seeing is in the asset-heavy industries. But the overall engineering now can be classified into traditional engineering and digital engineering, which is around IT, IoT technologies and 5G and servitization and some of these trends is what is going to drive the growth in engineering services. Maybe GH, if you could elaborate that a little bit more.

GH Rao: Sure. So, if we see engineering service, first of all, from a growth perspective, it has been growing very well. One reason why you may not see same result in the top line is because the growth has been mostly offshore driven. So, the reason why you see better bottom-line improvements in our segment, maybe a little bit lower in the top line. So, the growth has been fairly well. Secondly, as CVK mentioned, engineering is going through a transformation that is more towards digital engineering, which is primarily led by various factors like software, aviation, 5G, or analytics or as a service model of similar products. This transformation is definitely giving impact to the growth engineering services. At this point of time, there is a lot of growth in software engineering-led areas are telecom networking, semiconductor, which are the industries which have not been impacted by COVID that much, but if you take other industries, there are still active bounce back, the industries especially in some of the manufacturing on aerospace and once they start coming back, we expect the growth to be even better, so overall we are doing well. We expect to do even better as the COVID impact needs to be taken care.

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

Ankur Rudra: CVK, you referred reference to the few times that your ecosystem partnership with hyperscalers is unique, could you just elaborate on how you are unique and how that is helping you in this acceleration to digital transformation and cloud migration?

C. Vijayakumar: Good question Ankur. First is, we were first of the bat to build the ecosystem specific business units and for each of the ecosystems, we play in all the key layers because lot of this cloud and hyperscaler ecosystem while cloud migration is an important component, but there is a lot more value that can be created by leveraging the various functionalities of the cloud providers and early in the game, we have been investing in certain accelerators and certain tools which help in quicker migration, create quicker value from the cloud migration journeys and also very strong capability around financial operations once the clients move to significantly cloud enabled environment. So, these are some examples and with most cloud providers we also have a very strong 360-degree partnership where we sell to them, we sell with them, so I think it is the strength of the partnership, the IPs and accelerators that we have and the early leads that we have with the ecosystem partners that truly differentiates us.

Ankur Rudra: Sir, can I get a quick follow-up on the P&P business, thanks for the color again, I was just wondering if you could elaborate on the synergies, of the extent of synergies you are beginning to get now, when you think this could become material on the services side, also given the very strong new License revenue, could you suggest if once we cover complete 2 years, what level of organic growth one should expect from this business?

C. Vijayakumar: Ankur, in terms of synergies, I think we can still only talk about it in an anecdotal manner. As Darren said, there are 2 broad areas trying to sell more products to the very large client base that we have. We are already seeing a significant synergy in that dimension. The second dimension would be trying to synergize between the software and services. In one of the large accounts that we signed in the December quarter, we signed $30 million TCV services deal for supporting and build continuing to build on the software platform that we sold to the client, so that is a great example. It continues to be a little bit patchy, but I expect to see that focus of cross-selling between services and software increase as we go forward.

Ankur Rudra: The related question also CVK was on, what kind of organic growth level should we expect after we complete 2 years, is it like mid-single digits, high-single digits, what are you targeting there?

C. Vijayakumar: Ankur, it is still early days, we don’t want to commit to growth rate, but we will continue to give you lot of leading indicators like, we gave you a commentary on the booking this quarter. We will continue to provide all the metrics which are very typical for software companies. I think we should wait for at least the second year to be completed, so that we can really create a trend and extrapolation of this, but I am very confident that it is a growth business, it is not going to deplete. The fundamentals of this business are very strong, the client interest is very strong, customers are loving what we are doing, the mission critical nature of these products are going to keep it very sticky, especially commerce, security, low-code, no-code platform and many other innovation that we brought. I would leave it there as a qualitative commentary Ankur at this point.

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

Prashant Kothari: I have the questions on large deals again, we are seeing that many of the companies which are probably not doing so at the large deal front, have organized themselves differently now and are able to often better there, I just wanted to understand how you have organized internally and if there are any more work to be done on that front for us to have kind of better wins in the future and may be kind of a related question is that with many of our competitors kind of fixing all these issues around growth, around margin over kind of last 3 years, how do you see the competitive landscape out there? Would it be much more difficult going ahead to be kind of outperforming the industry in terms of growth rates?

C. Vijayakumar: Prashant, in terms of large deals, there is no change in our operating structure, we have go-to-market teams which is either verticalized in the US and Financial Services is global and then geographic in Europe and Asia Pac. In each of these teams, there is a hunting team, the team which is focused on large deals and our overall rhythm around large deals is very mature, the finance and various teams come together extremely well to play a large deal pursuits, so we don’t see a need to do any changes. Actually, we are very good in large deals and that momentum, I am pretty confident in the current structures it will continue, I don't plan to change anything there. Sorry, I missed your second question.

Prashant Kothari: Yes, the second question was, I mean we are seeing that lot of your competitors are able to fix their issues, yes, some had issues with winning large deals those kinds of issues, but in general we are seeing that these players have improved a lot versus what they were and while HCL has been outperforming industry growth rate for a while now, do you think it will become much more difficult now because the competition is all kind of caught up?

C. Vijayakumar: I mean I really cannot comment on that, I think a lot of it is dependent on the nature of deals, I mean if you do upfront rebadging of large number of people, you have different dynamics. If you transition in a logical way and build up your offshore capability, then it translates to different revenue mechanisms. I think what you need to keep in mind is of the 6600 net additions, 90% of these additions have been in the offshore. So, usually it is 80-20 or 75-25, so that also creates different dynamics from a growth perspective. So, lot of these factors play into it. It is just not about winning large deals, it does not necessarily directly translate to the revenue, but they are really long-term value creating opportunities.

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

Sandeep Shah: Just a question on products & platform, if we say that the new license TCV booking at $91 million which has grown at 250% year over year, is it fair to say the earlier base being as low of $26 million out of the total revenue size of give and take 630-650, it was just 4% of the revenue, if you assume the tenure being just 12 months as a whole? Is it the right way and is it fair to say that the license renewal business has been improving under the HCL Tech brand versus what it used to be earlier?

C. Vijayakumar: I think first is these are net new licenses, what we talked about. It is not renewals. Renewals, we have not even called out and these are quarterly numbers. So, your number calculation is right. These are quarterly net new license wins. So, your numbers are right.

Sandeep Shah: And just a question to Prateek, if I look at the full year EBIT margin guidance and arrived at the implied EBIT margin guidance for the fourth quarter, we are guiding for 19-21% EBIT margin versus our Q3 run rate being as big as 23%. So, even at the upper end, we are looking at 200 bps QoQ margin dip despite there would be a savings through lower amortization as guided in the US GAAP financials as well. Is it conservative or are there some investments which are planned in the fourth quarter?

Prateek Aggarwal: Sandeep, as I replied to Pankaj a little while back, there is a degree of catch up that we had in this quarter and you had asked for the quantification which I gave as 40 bps. So, in that sense, the 23% or 22.9% to be more precise comes down a little bit and we are also conscious that we have salary increments coming up next quarter, part of it took place this quarter which I quantified as 50 bps. Next quarter is expected to be 80 to 90 bps. So, that clearly practically brings it down to the higher end of the range that you rightly calculated. So, that is where the guidance is and we will wait to see what the quarter brings. We are just in the first 15% of the quarter, 85% still to go and that is the realistic estimate of the quarter both from a topline and bottomline perspective that we have given in our guidance.

Sandeep Shah: And just a clarification what is this 40 bps which you catch up, I did not get it correctly.

Prateek Aggarwal: There was some revenue which we could not recognized for various set of reasons in the previous quarter results and that got recognized in this quarter and flows down to the bottomline.

Moderator: Thank you. The next question is from the line of Sudheer Guntupalli from ICICI Securities. Please go ahead.

Sudheer Guntupalli: The broader investor understanding at this juncture is that as and when travel and office resume, some of the onetime cost savings that HCL or industry in general has seen in FY21 may unwind, be it travel or offshore etc., but at least part of these savings can be extrapolated over the medium term. In that context, CVK, your Press Meet outlook of 20-21% EBIT margins in steady state, it is a little perplexing because it essentially indicates that will go back to pre-COVID margin adjusted a little bit for product acquisitions. Would be glad to know your thoughts. What are the puts and takes in a steady state completely understanding that some of the timelines are still fluid and not in our hands?

C. Vijayakumar: Sudheer, see, I do not think we have done a very precise estimation of the margin dynamics in a post COVID world. Of course, there are many variables, so I do want to just leave my commentary on margins in the longer term or even midterm in a little more qualitative manner as you called out some of the travel and other costs will come back. Typically, one would assume there is a 2.5% benefit that we would have got due to reduction in some of these costs. I think about half of that would come back in a steady operating environment. The second important dynamics is the offshoring component is going to gradually increase. In fact in the last year, basically OND 19 to OND 20 our offshore percentage mix has increased by 2.5%. So, that will drive some improvements, but we are also in a market which is seeing tremendous momentum in various geographies across the world. So, there will be a need to invest a little bit ahead of time for some of the deals and that may create a little bit of headwind to margins. So, these are the qualitative factors from a pricing perspective. Nothing unusual, it is pretty much similar dynamics as well in the past. So, these are the qualitative factors, but we have not got into a very precise estimation. Possibly as we plan for the next year, we will get a better understanding. So, our commentary of 20-21 was a very directional high-level view that we shared.

Moderator: Thank you. The next question is from the line of Girish Pai from Nirmal Bang. Please go ahead.

Girish Pai: CVK, you mentioned that the next 5 years is going to look stronger in terms of growth versus the last 5 years. Do you see this growth frontloaded in this 5 years and specifically I want to ask about this digital infrastructure part that the digital foundation part that you have been talking about. Do you see this that the demand for this compressed say the next 12-24 months and then after that kind of wait, that is question number one?

C. Vijayakumar: So, I would not say that it is frontloaded, especially the digital foundation led transformations. Even if you look at the hyperscalers, lot of their booking does not translate into revenues quickly because there is a lead time in the whole migration process which includes significant amount of planning, lot of associated infrastructure component modernization like network, security and things like that. And some of the process improvements that needs to be put in place. So, while large deals and large bookings happened, I think the translation of that into revenues would be gradual. So, I would not say that it would be frontloaded at least from a digital foundation perspective; however, there could be lot of cost transformation deals where you take over a lot of legacy landscape including people transfer and some asset transfers where you may find a little more traction due to the economic environment that we are seeing, that could create a little bit of an uptake. But what we are largely focused on is the long-term value creation and digital transformation programs and that is going to be somewhat uniform in my view will scale up gradually over the years.

Girish Pai: One last question, this is regarding margins. Do you think structurally you would be seeing higher margins say by 100-150 bps from here on after what we have seen in FY21?

C. Vijayakumar: I just answered this in the context of the question that Sudheer asked. We have not done a very precise estimation of what the post COVID margin scenario will be, but there are many qualitative factors which will continue to be tailwinds from a margin perspective, the higher offshore content and definitely half of the savings due to all the travel restrictions would come back. So, these are the two positive aspects. But there is also such a great momentum in the market. This is also the time that we need to invest in the right areas and especially if you want to look at our products and platform business, it is seeing so much traction, the pipeline is good. So, we will continue to look at it and invest in the sales and marketing efforts to really capture the market. So, these are the few variables that are on our plate. We don't have a precise estimation; may be in the future quarters we will try and quantify this for you.

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

Ashwin Mehta: CVK, two questions, one is on the asset heavy side of R&D where we are seeing some challenges, so are there opportunities here in terms of either captive carve outs or some parts of the business being outsourced which are now becoming say noncore for customers, so some of these cost saving opportunities accelerating in this part and how are we looking at that opportunity?

C. Vijayakumar: Yes, Ashwin, there are numerous opportunities for captive carve outs, either India-based captives or even global captives and we are participating in these programs. Some of that is in the asset heavy industries as well, also not very different from the rest of the industries and as

GH said, we are already seeing the pickup in most segments, however, the pickup is a little bit more offshore centric, so that would have its own revenue dynamics.

Ashwin Mehta: The second question was in terms of the product business, so while we are selling to our 14,000 customers our own products, is there an opportunity to also sell products to some of the other vendors, so may be partners like Temenos, as deal are more opportunities out there and can this be a big opportunity over the next 3 to 5 years?

C. Vijayakumar: Darren, would you want to take that?

Darren Oberst: Yes. In short, I think there is a lot of opportunities to in a leveraging ecosystem in a work with other software companies and other service providers that are in complementary in our areas and absolutely that is something that will perceive, but the question is specifically around product resell business of third-party products, I think I could give a clear answer now, that is not really an opportunity.

Ashwin Mehta: And just one last small point from Prateek, what would be the expected tax rate for FY22?

Prateek Aggarwal: Ashwin, again like the rest of the commentary whether it is topline, bottom line, same goes for tax rate, I don't have a very precise number for you, but it would potentially be going up on a year-on-year basis simply because more of the tax-exempt units would go, some more would go from 100% to 50% exemption and from 50% would go from 50% to 0%. So, potentially, it would be around roughly about 23.5% give or take a percentage points, so may be a range of 22.5 to 24.5 whereabouts.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. C. Vijayakumar for closing comments.

C. Vijayakumar: Overall, we continue to feel very positive about the market momentum and differentiation, our ability to win and execute is outstanding and I personally feel very confident about harnessing this momentum and delivering value for all stakeholders. So, thank you for joining the call and look forward to speaking to you in the coming interactions. Thank you everyone.

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