"HCL Technologies Limited Q4 & Annual FY'17 Results Conference Call"

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Moderator: Good Day, Ladies and Gentlemen and Welcome to the HCL Technologies Limited Q4 & Annual FY '17 Results 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 '*' and '0' on your touchtone telephone. 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 Evening and Good Morning, everyone and Welcome to HCL Earnings Call for the Fourth Quarter Fiscal '17 and the Commentary on the Full Year Fiscal '17. Today, I am joined by Anil and key members of the leadership team here.

This quarter, we are not making a presentation, we thought it will be more efficient to give you a commentary and then get into Q&A straightaway.

So getting to the next level of details, the common theme across both the quarterly results and the full year fiscal are two-fold -- One is industry-leading performance, industry leading by a fairly good margin and huge acceleration of our evolution into the next-generation technology services. I think these are the two broad themes.

I am sure you will agree with me that HCL Tech is emerging as one of the most reliable performers in the sector with a very consistent focus driven by our Mode 1-2-3 growth strategy which I had articulated three quarters back when we met for the 'Analyst Meet' in Mumbai in August 2016.

First, let me share the highlights for the Q4 and then I will share some highlights on FY'17. We had an industry-leading financial results for fourth quarter as well as for the full year. In Q4, we had a healthy sequential growth of 3.8% in revenues at an EBIT margin of 20% in constant currency terms.

We brought home eight transformational deals representing a well-balanced mix across service line, industry verticals and geographies. We saw a very healthy addition of clients in all revenue categories in this quarter. Five million client category went up by 13; Ten million clients went up by 9, 20 million clients increased by 10 and 40 million clients by 5. Number of 50 million clients also went up by 6. We delivered industry-leading revenue for employee metric of $60,000, marginal increase over the last year.

In terms of the full fiscal, we delivered a strong double-digit growth; constant currency revenue growth of 13.7% at an EBIT of 20.3 which comes in at the higher end of the guided range.

Our Mode-2 and 3 services which focuses on new growth areas like Digital, Cloud, Cyber Security and IoT as well as products and platform services registered a very impressive 30.9% growth in FY'17.

In August, we said that we are going to share the share of our revenues at the end of the fiscal. Today, we are very happy to report but our share of revenues in Mode-2 and Mode-3 services stands at 18.6% for fiscal '17 compared to 15.9% for 12-months period ended March '16.

From an industry sector perspective, FY '17 saw four of our key verticals deliver a double-digit growth -- Public Services grew by 31.3%; Retail CPG grew by 21.4%; Life Sciences and Healthcare 11.1% and Manufacturing by 17%. The remaining two verticals also recorded good growth. Telecom, Media and Entertainment grew 5.8% followed by Financial Services at 4.9%.

In terms of geographies, Americas recorded 15% YoY growth, Europe and rest of the world recorded 18% YoY growth.

In terms of service lines, Infrastructure grew by whopping 27.4%, Engineering Services grew by 11.7% and our Applications Services grew by close to 6%.

Over the year, we have also successfully established our client-partner program to deliver what we call as "One HCL to Top 150 Client Partner Accounts" This initiative is successful and we are seeing good traction in pipelines as well as bookings in the cross-sell opportunities. This year also saw us emerge as the fastest growing IT Services brand in the world as testified by Brand Finance Survey. Our brand value increased by 38% over last year.

Now, let me give you a commentary on our Mode-2 Services which is really the pivot of our growth strategy. Mode-2 which is really focused on new high growth opportunity like Digital and Analytics, IoT, Cloud Native Services and Cyber Security Services, had a great run both in Q4 and the full fiscal FY'17.

When I took off the role as a CEO, my prime focus was to focus and drive growth in our next-generation services, what I call as Mode-2 and 3 Services. As I see it, while the overall growth is something that we all need to track and deliver, I think we need a razor-sharp focus on the next-generation services so that we remain relevant in the market and really create a sustainable growth platform on the longer-term and that is exactly how we are looking at the agenda ahead. We have been able to measure our success of our Mode-2 by the fact that we have overall grown this portfolio by about 16.4% in FY'17 over FY'16. Most importantly, we have over 62% of our top 150 client partner accounts where we are delivering sizeable Mode-2 programs or doing pilot projects in Mode-2 for them. This means we have been accepted by some of our most important customers as the next-generation services partner… or actually they are willing to give us an opportunity in Mode-2 Services. More than half of our customers for the next-generation services are customers who have brought us in because they did not believe the traditional IOP partners or traditional large multinational vendors to deliver these next-generation services. We are really calling this as "Replace traditional application vendors' customer base." Many good examples of the client wins in these areas across different vertical sector. The other half of our next-generation customers are really enterprises who are adopting digital solutions and they really experimented using small boutique firms in the range of $200 to $400 million size in US and Europe who are very strong in capability but they lack the global scale that is required for these enterprises. We are really calling this the "Replace Boutique Digital Vendor Customer Base" and we are seeing good success there.

In all the Mode-2 services, our balance portfolio is becoming extremely critical to really create and deliver the next-gen services. The fact that we have a very strong Engineering business, very strong Infrastructure business and then Apps business has helped us build a very-very relevant outcome-oriented propositions in areas of Digital, IoT, Cloud Services and these services need a level of depth in each of these areas and we have the depth to kind of build further on this. For example, in the Digital practice, what has really worked well and what is really resonating very well with our clients, we brought together three areas of capabilities that had existed in HCL in different pockets and we have been delivering these services over the past two years but were not really integrated. So they were coming across like really doing very specific tasks for the clients rather than really taking up digital programs. This included our Beyond Digital which is process and experience, design, academy which included our modern apps and the digital platforms and Big Data, Analytic Services. Any digital transformation and enterprise needs all these capabilities to come together in a manner that provider can take responsibility for an outcome and drive a program and that is where we have seen a good success.

Also, what has worked well for us is that, we have very little internal conflict or legacy to protect in the traditional applications business. So this is again coming in very handy and it is really becoming an advantage for us to take away aggressive positioning in our ability to even cannibalize some of our revenues in the existing customers to build a good digital footprint. So we are helping enterprises just processes through Design Thinking and also help them modernize their backend applications using API and Micro Services or build maybe Cloud Native applications or migrate applications to the Cloud. As we have mentioned earlier, Digital Media is where we maximum spend this and that is an area where we have fairly strong capabilities.

Going forward, I would really like to measure our success in how well we grow our Mode-2 and Mode-3 businesses and even more importantly, how well we are accepted as a next-generation services partner in our existing accounts, and of course, how we can replace traditional providers and scale the digital practice.

Even in propositions like IoT Works, I think we gained extremely good market recognitions and through this, very differentiated service; we have acquired six new logos this year which we would have found it very difficult to penetrate using our existing Mode-1 services due to the strong presence of incumbent relationships. So we really could get into these accounts purely by the differentiated proposition that are IoT practice has really created during the last may be 18-months.

In this quarter, we also folded in some run kind of services through our IoT business. It is spearheaded by IoT proposition and it really is significant remote operations kind of revenue stream. Some of the IoT Works deals also helped us tap into some of the new buyers, non-CTO and non-CIO kind of buyers like supply chain and operations, etc., which is again a very good differentiating strategy because we are able to address different set of buyers in our client organization.

In Cloud Native Services, we created a Unified Cloud Consulting Service bringing in all the capabilities that existed in this space across our various businesses. This quarter we also launched what we call as Elastic Cops. This is the world's best application intelligence for our Cloud Native operations platform. This platform has been acknowledged by some of the leading public cloud service providers and it is really a preferred platform for Managed Services, for the workloads that are being moved to the Cloud.

A Quick Update on Mode-3. Under Mode-3, as you would know, this is about creating an IP-led business. We concentrate our efforts in two critical dimensions -- One was on IP partnerships as we had announced an IP partnership with the strategic partner. That had in a scope about dozen different software products. The overall business plan is working pretty much in line with our expectations and we are happy to report that it is really progressing well.

The second dimension which we have put some more focus on in the last couple of quarters is we continue to invest and enhance our DryICE platform. While different components of DryICE have been sold as a product for IPO proposition, we do believe several components of DryICE really have an independent product characteristics and they can create a growth engine by itself. So this is the second effort that is really underway in our Mode-3.

Just moving on to some of the other topics like Employees and Community. Our differentiated employee engagement practices underlined by focus on the next-generation learning and development helped us reduce our attrition by about 100 basis points QoQ and 40 basis points on YoY basis. Our attrition in IT Services stood at 16.9% significantly lower than what it was in the last year.

With many technological disruptions shaping the future of the IT Services space, we continue to invest in reskilling, training and capability building of our employees to be future-ready. We had trained 23,500 unique employees. Out of which 13,000 employees were trained on future skills. So really enabled them to take up some of our Mode-2 and Mode-3 kind of work.

Value Portal, which is a lead platform where our employees generate ideas for our customers, saw 11,868 ideas generated last year which delivered over $530 million worth of value to our clients. This portal since its inception has engaged about 30,000 unique contributors who created value and delivered cumulative value to our clients of $2.1 billion.

We also enhanced our diversity and inclusion practices. There was a Woman Advancement Program where we launched two new programs this year -- One of it is Red Letter Initiative which is an exclusive gender inclusion program for women leaders within HCL and in our client organizations currently being launched in a few chosen departments.

Also, we are very happy to report and very heartening highlight of the year was the passionate effort HCLite invested in giving back to local communities, whether it is the "HCL Samuday Program", "Power of One", "Princess First Get Started With The Technology Program", several local and regional programs in virtually every country of our presence or the humanitarian relief work our employees devoted close to 100,000 hours towards community service this year.

That kind of overall provides the summary of the quarter and the year. I will now hand it over to Anil to share "Financial Metrics."

Anil Chanana: Thank you, Vijay. Good Evening, Good Morning, everyone. So if you look at the performance which has been a very good performance both for the quarter as well as the year, just maybe emphasize certain aspects, So in constant currency terms, revenue grew by 3.8% QoQ while the net income grew by 14.3%, partially held by some of this as a lease which came in the tax with the conclusion of the tax assessment in a foreign jurisdiction. Overall, for the year, we grew by 13.7% YoY, so we are just shy of 7 billion. The net income came at 18.1%. So the margin at EBIT level was better than it was last year from 20.1% to 20.3%.

If you look at the cash conversion, the net income to operating cash flow was at 112% for the quarter, it was good, and in terms of EBITDA to free cash flow conversion that also very good at 79%, up from 67% last year.

Our layered hedging program has been working well and it continues to deliver the satisfactory results. This year we had about 28 million of hedge gain and our hedge position is about 1.4 billion with the average book rate being close to Rs.70. The further details are in the account which you can see on our website.

From a tax angle, this year we were at 21.7% if I normalize and do not take the benefit of the reversal which were.

There have been certain questions which we got during the day and I thought I must actually address those questions. One of the questions was with reference to the IndAS account, the revenues and margins of IndAS accounts versus the US GAAP account. If you find in the IndAS account, the revenues and margins are higher. This is because of the primarily the geometric transaction we are following the scheme and the GAAP. The revenues have been recognized from the appointed date which was 1st of April 2016; however, under US GAAP we follow much more stringent criteria. It is only one month of revenue which has got recognized. We had some other differences between the IndAS and US GAAP which are reflected in the margins. On the whole, the IndAS account has reflected much better picture than what the US GAAP account reflect and we have been following US GAAP consistently and therefore and all the results which we have declared are also based on thereon.

Another question I got during the day was certain amortization which is of license IPR which is being treated as a reduction from the revenue. So these are the license IPR where the amortization is happening in proportion to the expected revenue over the estimated life of the assets or the arrangements whichever is lower. A portion of that amortization as it relates to the contractual relationship is recorded as a reduction in revenue. A significant portion is coming there as a reduction in revenue and some portion also has the amortization together with the amortization of other intangibles is getting recorded. So, just wanted to highlight that because you will see this line in the account, so you should be aware of that.

Before I move on, I would also like to emphasize the guidance which we have given for FY'18. Our revenue in FY'18 are expected to grow between 10.5% to 12.5% using the average exchange rate for FY'17 last year; however, if I take the exchange rate as was prevailing on 31st of March 2017, the guidance will translate to 9.9% to 11.9% in dollar terms.

With respect to operating margin, you remember last year our guidance was from 19.5% to 20.5%. For the last year FY'17, the average USD/INR exchange rate came to be 67. We delivered 20.3% which was higher 5.3 bps as compared to the previous year which was FY'16. This year we are maintaining that range while lowering the assumption regarding USD/INR. I have been asked the question as to why we have chosen 65.50. This is the exchange rate which we have used internally for budgeting purposes. So this is not a magical number, but just we took a number, we had to use a number, we thought this could be a number, so I have not gone by any guidance of any sort of provided by any of the bankers, it is just our own belief, that is the number we have used for the purpose of our own internal budgeting.

So, with this, I will hand over 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 Yogesh Agarwal from HSBC. Please go ahead.

Yogesh Agarwal: CVK, on the full year guidance, you had a very strong year FY'17 almost industry leading growth. But if I look at the constant currency organic guidance for next year it is showing a bit of deacceleration versus the last year, it is probably 6% to 8% whereas for most of the other companies they are actually guiding for an acceleration because of their assumption for better macro environment. So two parts to it – Firstly, are you being a little conservative in the next year guidance? Secondly, what do you assume in terms of macro…do you also expect pick up in overall banking and overall spend from the US particularly?

C. Vijayakumar: Hi, Yogesh. Thank you for the question. If you really follow the overall commentary that I have been sharing in the last three quarters, while macro environment definitely has an impact into how we are looking at the projections and of course the guidance. The guiding factor for us has been what do we see in our customers, what has been our pipeline and what is the kind of approximate dates in which we expect these programs to close and how much of that will really get converted into order book. I really do not want to comment on your estimation on what the organic revenue growth is because it is a very complex math and once we have integrated an entity we absolutely have no way of tracking what service is being sold to which client and which component of the service is organic, inorganic, lot of decisions are made by client partners, they are also driven by certain overall margin performance consideration. So there are several elements which plays into it. In the interest of transparency, every time when we made an investment or when we made an acquisition we have shared what the investments were and what was the 12-months revenue that we could expect from that entity at that point in time. I am sure you will appreciate the fact that that revenue profile once it is integrated into HCL for change due to various reasons the customer could be strategic, there could be non-strategic customers, we may not see growth potential in an account, the margin profile may not be something which we will be able to live with for long-term. So all these considerations come into play. So I would say we are quite comfortable with the 10.5 to 12.5 guided range. It factors in everything that we know at this point in time. Long answer but that is what it is, Yogesh.

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

Anantha Narayan: I had a couple of questions: The first, CVK, to look at your service wise split up. On the apps there seems to be some initial size of improvement over the last couple of quarters. So for FY'18, do you think that segment can actually accelerate significantly from FY'17? What are some of the sort of pluses and minuses in terms of drivers in that business?

C. Vijayakumar: Hi, Anantha. The way we see this is as we move forward, right, it is going to become difficult to really segregate apps and infra and some of the other service lines because there is a blurring of the boundaries between several services and especially when we get into Mode-2, if you have Cloud, Consulting and Migration program, there is Cloud Migration program with the infrastructure team could deliver and then there is an application refactoring program which could be delivered by the apps team. Now, when you look at application refactoring, there are several elements of refactoring which are completely technical in nature which could be delivered by an infrastructure team. So this is just one example. But as we kind of get into the new technology areas, the divide between apps and infra will blur in especially the Mode-2 services. Yes, we have definitely done well in the Application Services. We are delivering a certain level of consistency in the last three quarters and I do expect this trend to continue. What is driving this trend is definitely our success in Digital and Analytics space. However, if you just follow my earlier commentary, there is also a little bit of cannibalization of the traditional ASM and ADM revenues which we are doing proactively to drive and really position ourselves well as a "Digital Partner of Choice." I think that element is more important. Moving forward while overall revenues, all of that is very important, we will really razor sharp focus on how are we really enhancing our Mode-2 and Mode-3 revenues. Because that will really determine the long-term success for us in the business. I know it is a little difficult to just ignore an overall number and provide focus on a certain dimension, but I think that is what we are disciplining ourselves to really look at as we move forward.

Anantha Narayan: My second question was to Anil. Just to clarify on this amortization expense for the IP-related revenue, so is this understanding right that hypothetically if you have an annual revenue from IP of say 100 million and the amortization expenses are about 20 million, so you are recognizing only 80 million of revenue, is that the right way to look at it?

Anil Chanana: That is correct, partially it goes into the amortization line, but it is in line, but significantly goes into the revenue line as a reduction from revenue, gets recorded because of the contractual relationship with the party from whom the intellectual property has been acquired is following the US GAAP.

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

Ankur Rudra: CVK, you mentioned that we should measure you on Mode-2 and 3 growth going forward and clearly that is thinking in the right direction. But I believe FY'17 did have some contribution from your IBM IPR acquisitions. So if you could give us a sense of what was the effective underlying organic growth in FY'17 stripping out those acquisitions that really help? The second question was around SG&A jumped quite a bit this quarter. Was this because of the acquisitions or was this because of any kind of acceleration in your spending?

C. Vijayakumar: Again, Ankur, there is just one challenge, right. When we acquire IPs and when we acquire products and we kind of modernize those products, you have certain assumptions of what is the current install base and what is the revenues from these products. Also, there are certain assumptions as to what we can sell to our existing client base. So it is a little difficult to provide segregation. But if you really want to make a very critical analysis, you could take the revenues that we had associated with each of the investments and have calculated. But I do believe we would have a very-very strong organic growth in Mode-2 services where it is again there is virtually no inorganic piece in the Mode-2 where we have grown some 17%. Mode-3 has got multiple components. One of them includes the IBM partnership; it includes a lot of our DryICE and other products. Most of that is being sold as a part of our ITO deals but there are also some standalone sale of these organic products that we have closed. I think there was a growth even higher than what we have grown on the Mode-2 revenues.

Ankur Rudra: Just if I could maybe take it forward, you try to answer the question on guidance earlier, but I realize maybe you have made some assumptions of non-strategic customers in first part of your acquisition. If we try to understand where is the underlying pro forma growth in the business in FY'18, FY'19 going onwards, what should be our expectation of growth adjusting for those kind of changes you might have made?

C. Vijayakumar: Ankur, we did a very detailed grounds-up planning account wise and wherever we have completed the integration, we have not really maintained pro forma of the acquired business and the existing business. Anil, do you want to add something?

Anil Chanana: Yes-yes, the nature of the business is very much the same like some areas where like PLM we are getting it, but other than that the lines of business are very similar. So it is difficult to sort of start identifying which came through acquisition and which one came through organically. The first quarter which probably you will have that till the time it gets integrated, maybe one quarter or maybe two quarters after the business as usual.

Ankur Rudra: The other question I had was on SG&A which jumped a lot. Was that because of the acquisitions or was that because you have accelerated maybe marketing in some area?

C. Vijayakumar: I think it looks like more of acquisitions I would call it.

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

Divya Nagarajan: Two questions: one to CVK. You spoke about accelerating growth in Mode-2 and Mode-3 services, you also at the same time spoke about cannibalizing existing revenue. How should we think about this going forward – does this mean that the rate at which you are trying to convert your Mode-1 into Mode-2 and Mode-3 should we expect an increase in the rate of change there where you are more aggressively cannibalizing Mode-1 to increase your relevance to Mode-2 and 3? And the second question was that if you could by industry vertical and explain which industry verticals are more eager to adopt or are more aggressively adopting your Mode-2, Mode-3 versus Mode-1? Thank you.

C. Vijayakumar: See, we do a year-to-year planning and we have assumed certain amount of canalization and further adoption of Mode-2 and Mode-3 services in our existing client base and that is how we came to 10.2% to 12.5% growth. Again, when we do this, there are some estimates we have to make and it is very-very difficult to precisely kind of establish this. I would request maybe to really give you color on adoption of Mode-2 services in different segments. I will ask Rahul and Karan to kind of give you commentary on Financial Services and then the diversified industries.

Rahul Singh: Yes, thanks CVK. So, this is Rahul here. I look after the Financial Services globally for HCL. So, obviously if you look at the Financial Services sector there is a lot of dependence on data as source of all Financial Services business and therefore the entire digital, analytics, and the Mode-2 kind of service line are quite prevalent in Financial Services including security which is obviously very critical in Financial Services as well. So, we are seeing a pick-up in the Mode-2 services certainly in our client base. And we are seeing this across two different vectors I would like to bring this out – Number one is that you know in our existing accounts. As a Financial Services business our strategy essentially has been to concentrate on our top 35, top 40 Financial Services accounts which really provide a bulk of revenues for Financial Services in HCL. And then we are seeing cross-sell happening through our client partner model into more digital side of the existing clients so, were seeing increase traction there. Historically, also we have had good traction in that area because some of our Retail customers have been talking to us and been doing Digital, Analytics work with us for the last three years or four years. So, that is one vector of growth where we are seeing Mode-2 services going in. The second is in brand new accounts, okay. So, there are definitely handful of accounts where we have been able to make breakthrough recently based on our ability to do higher quality of data integration and analytics work. And therefore, we have seen a couple of wins in multiple geographies I would say especially Europe where we have had a couple of wins based on our ability to provide digital services to our customer. So, I think both these areas we are seeing growth happening – one is existing accounts through cross-sell and second is new accounts opening up on the digital capabilities. So, that is where we are seeing traction. With that, I would like to hand over to Karan, to give you some flavor of the diversified industry as well.

Karan Puri: I will cover the other industries outside of Financial Services where I think there has been a very broad brush change that we are seeing now for probably three quarters or four quarters. The first big thing that is changing out there is the level of estimation that is required for companies to figure out what it will change to either re-peak the process they are underpinning their business on. So you are seeing the front office change quite substantially. Very quickly a lot of pilots getting into production what we call the roll-on effect in potentially the last three quarters and this is broad based again. It is pretty much going across any industry that has consumers. And the second big trend that is very secular is the fact that there is a large chunk of change that is happening in the broad middle as we call it effectively defining how data is going to restructured, data is going to be secured, cyber security is taking center stage out there and this data could be any amount of data speeds or streams coming from IOP devices or Cloud applications, SaaS providers, anything that is integrating with the enterprise with a fair amount of broad middle chain that is being put into play. Again, a lot happening in the traditional industries right where there is Supply Chain on one hand or Healthcare where a lot of feeds also aggregate depending on the market they are contributing to. The third element is which is almost redefining a lot of Mode-2 work is what we call micro transaction which is right from micro propositioning extreme profiling, elements which are redefining the way the consumer has seen in those to buy that business. So, I think somewhere we see broad secular trend is where a lot of this change is becoming relevant and actually getting played out into projects that we are now securing and growing with. So, just to cap, it is not specific to our industry, I think it is broad based clearly, the velocity and the focus on any of these three areas is what is defining the change within each industry.

Rahul Singh: I would like to just add one more point what Karan said, this is Rahul again. There is a very remarkable change that we are seeing in a way digital is being consumed by customers at this point of time. So, two years or three years back, a lot of digital was consumed on the basis of smaller projects pilot, etc., as Karan mentioned. There is a growing requirement now for digital at scale which means that our customers want us to execute or to get into transactions with them where we are able to do scale-based digital work versus a niche small amount of work because the time period that our customers have to completely move out from their waterfall models to a more Agile DevOps model is extremely small. So, most Financial Services firms which hitherto were spending let us say 24 months to come out with new projects and new programs would like to now do it in a shorter period of time. So, the volume of work although the each project size tends to be small but the number of projects that can come out quite significant especially for the large Financial Services firms so that is another trend and trajectory which we are trying to attend to catch on to so this is what we call as digital at scale.

Divya Nagarajan: Thank you. Anil, just one question on the currency assumption, you said it was your internal budgeting number, that kind of relate to the hedges that you have for the year?

Anil Chanana: No, this is at an EBIT level. So, that hedge will come below that.

Divya Nagarajan: Or the other way round, is just a kind of rate that you have built into the contract that you have signed which look forward into the next 12 months?

Anil Chanana: No, typically I would not sort of go there, I would say rather this is the rate that we have assumed will probably will be for budgeting purpose because recently the rupee strengthened significantly. So, we thought this could be the rate which we take. So, the currency gains, etc., will flow on top of it which are the hedging right, which are below the EBIT line.

Moderator: Thank you. We move to the next question that is from the line of Ashwin Mehta from Nomura Securities. Please go ahead.

Ashwin Mehta: I had two questions, one on IMS which has been soft in terms of sequential growth for the last two quarters and this was soft even at Infy, TCS. So, are there some consistent trends here or any slowing of activity on the Rebid side that you are seeing? And secondly, from FY 2018 perspective do you think IMS can continue to outperform company growth which it as historically seen?

C. Vijayakumar: See, from an IMS perspective I would really encourage you to look at only year-on-year numbers. We have had a lot of history of top the growth and we should continue to look at year-on-year. But you may see some softness possibly because some of the decisions that we expected to happen in December and in the early January - February. We are taking a little bit more time to get those decisions done, so that probably has a little bit of impact. In terms of structurally, I do believe Rebid market is fairly intact but there are a lot of opportunities across the globe more so in Europe. I will actually ask Ashish to give a little more commentary on Europe. But other than some deal specific things, I did not see anything fundamentally changing. Of course, we have always been explaining about the impact of public cloud adoption, though it is a small impact but it does play into the numbers over a period of time may be Ashish if you could just give the deal activity in Europe from an ITO perspective that would be helpful.

Ashish Kumar Gupta: So, thanks CVK. We continue to see pretty active pipeline of ITO deals across the European sort of geography. So, Nordics has traditionally been very strong in ITO deals over the last couple of years, we see good growth over there. We see good growth in what I will call as integrated infra and application deals. We feel some heavy traction in Continental Europe. Remember that Continental Europe is actually especially Germany and France because of language consideration is slightly tougher than the English-speaking Nordics and the UK and Ireland sort of market place. But we are seeing some traction in Switzerland; we are seeing some good traction in Netherlands and UK and Ireland I think there was a bit of reduction in pipeline over the last may be 18 months, we are starting to see some large deals come about. So, the ITO market in some ways has been given for the last 10 years - 12 years on a very simple trend which is centralized, consolidate, simplify, rationalized, right? Over the next four or five years we see this market really aggressively moving towards cloudification or cloud adoption in the enterprise and we are starting to see a lot of our existing customers plus our new customers really ask us for skills which enable them to really get the next generation as a service type of platform constructed whether it is in the private cloud inside the customer's data center or on to public cloud type of environment. So, we see a lot of those types of deals which are starting to get more secular in demand across the whole landscape and fortunately we are starting to win a lot of those really speaking. So, I would say, the ITO market in different parts is starting to sort of gain momentum in a slightly different manner than what has driven it in the last 10 years.

Ashwin Mehta: Thanks, sir. That is really helpful. Just one follow-up this is on Engineering Services if I axe out the IPDs and the Butler and the Geometric acquisition, this service line seems to be growing at mid-single-digits. So, when do you start to see a rebound happen there especially given the traction that you have talked about in areas like IoT and all?

C. Vijayakumar: I would ask Sukamal Banerjee to respond to this

Sukamal Banerjee: Yes, hi this is Sukamal Banerjee and I am answering your question firstly with regards to Engineering Services. So, in terms of the growth that we expect obviously, there are two different perspectives; one is what similar to what Ashish talked about which is there is from time-to-time lumpiness in terms of revenue. So, I think if you look at overall trajectory of growth it has remained very robust and we expect it to continue in that way. In terms of the growth which has been driven by specific new technology adoption like what IoT is going to drive definitely it is a very significant growth opportunity for the Engineering business. In addition, it is also important for us to understand that the drivers behind IoT has to do with the various different adoption curves which are going on in this industry and as CVK. talks about earlier the 150-client partner account that we have chosen is exactly that was focused directly on driving the adoption of IoT which will drive holistic revenue growth not just for Engineering Services but for some of the other revenues as well. So, we definitely see a lot of opportunities ahead and the momentum and positioning that we have created for ourselves in the IoT space it has been acknowledged by all analysts it is going to pay significant dividend.

Moderator: Thank you. Next question is from the line of Moshe Katri from Wedbush Securities. Please go ahead.

Moshe Katri: Can you talk a bit about what you are seeing in some of the larger protocols in terms of demand trends? May be talk a bit about I think you mentioned Financial Services is there a way to kind of slice it by may be capital markets, commercial Banking Insurance, etc., and then, at this point are we seeing some of the optimism reflected in many of the spending surveys earlier this calendar year for a cyclical uptick and spending actually happening or at this point given the fact that we are kind of in a mid-May, probably not going to see this year?

Rahul Singh: this is Rahul again. I will take that question. So, you know some verticals within Financial Services if you break them up into Banking, Insurance, Capital Market, the trend that we are seeing first of all let me address Capital Markets. Just for your information Capital Market is an area where HCL has a dominant share in terms of our percentage of business. So, in our Financial Services we have a larger share of capital market firms than we have Banking and Insurance. So, in the Capital Market firms we are seeing a pressure continue to be on the cost side. We all know that the rates in capital markets have been reset almost permanently and I think there is a lot of pressure how you can optimize cost and how you can reduce cost as well. So, we are seeing the churn happening in that market. I think number one is that existing contracts have been renewed and rebid and therefore, there is an opportunity for us to grab new market share as customer going for vendor consolidation. So, we are seeing that happening in our existing accounts. And number two is that because of our presence in Capital Markets, we are seeing certain news in new Capital Market firms where we do not originally have a presence. So, we are seeing that as well. So, there are two elements of growth there – one is increased participation within the existing firms and plus some new deals coming in outside of our existing accounts and these are more on the cost play. I would like to mention here that cost essentially would be more in the Mode-1 category which essentially for HCL is driven by DryICE which is a lot of automation, autonomics where we work with our clients to help them to reduce cost using more leverage beyond arbitrage model, beyond that high levels of productivity through tools and through automation devices, etc. Now let me just change the track to Banking and Insurance companies. In Banking and Insurance company in our client base, we are seeing larger trend towards the Mode-2 kind of services. These companies as we all know are being influenced by how do you keep the millennial population with them. So, banks are spending more money in terms of more mobile, more digital, data analytics, real time, more simplified journeys and so on so forth and so also Insurance company that is the trend. So, in our Banking and Insurance client place we are seeing a higher uptick of our digital services. And again, I would like to mention here that the wins which have happened in this segment are also around the Mode-2 populations where we have a couple of large accounts where we have managed to breakthrough this year for that business to happen. Now, the difference between Capital Markets and Banking and Insurance place the way they ramp up. Banking and Insurance because they tend to be the more Mode-2 kind of businesses, so they have to scale up so as the volume of the business increases, as new projects coming together ramp up impact that happens there while the cost take out tends to be more lumpy deals so that is the way the business model kind of evolves. So, we are seeing this kind of demand at least in our segments and I think on both Mode-1 and Mode-2 I think we are well-organized to meet that demand.

Moshe Katri: And then just touching back on my question regarding expectations earlier this year versus where we are in terms of the calendar year on the spending patterns. Do we still think that we could see that optimism in Financial Services reflected in the service kind of translate or convert into some sort of an uptick this year or you do not think it is going to happen?

Rahul Singh: Okay. So, in the Financial Service firms that we deal with the overall budgets are flat. Now, I am talking overall IT budgets. So, the total budget that they have typically we are seeing that as flattening out or marginal growth of about 1% or 2%. So, I think the budgets are not reducing. What is reducing is categorization of what is in the budgets and where are you as an organization in that particular spend pattern, okay? So, for example if you are in the traditional people-based outsourcing, India-based outsourcing with an arbitrage model perhaps the budgets there are coming down because they perhaps are being remodeled by our customer into more digital spend as an example, right? Or if you are into extensive people based onsite models again there could be pressure because people are looking at how to make it more efficient. So, customers are looking at current spends and trying to make it more efficient so that they can create the room for new spends. A service provider which is in the new spend part of the business will typically have volumes and if you are trapped in the old spend and in the old model which is more arbitrage base you will have a little bit of an issue there because if I look at satisfaction levels which Financial Services have service provider in general I think recent reports that the satisfaction level with incumbents is rather low. So there is as much as 50% dissatisfy with the existing service provider in the large Financial Services firms. So, there is obviously pressure if you are sitting in that particular quadrant of the customer service spend. And therefore, there is churn happening. Financial Services firms are churning, vendor consolidation is a big thing. Almost every large firm is going through a vendor consolidation which essentially means they are weeding out some vendors and reintroducing new ones. So there is churn and it really depends on what part of that are you in. So, if you are in a churn-out scenario then you will have volume decline. At the same time when the vendor churn happens there is consolidation happening at the same time, so new vendors get created and they tend to get the market share. So, that churn is happening. So, to answer your question, what is happening to the budgets, the budgets are flat but that does not mean the types of spend in the budget is flat. The new spends are going up within that, old spends are coming down and I think that is it in the overall commentary.

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

Sandeep Shah: Most questions have been answered. Just a book keeping on this IP related. I think if you look at Anil the US GAAP account shows that for the FY 2018, the amortization would be close to around $73 million. So, can we assume that some portion of that will go as a deduction to the revenue and some portion will come as an expense in the P&L.

Anil Chanana: That is correct, absolutely correct.

Sandeep Shah: Okay. And can you give us what is the outstanding payment for the total $638 million for the IP acquired from the IBM?

Anil Chanana: I do not have it ready but I think it should be about $200-odd million.

Sandeep Shah: Which is pending?

Anil Chanana: Which is pending, yes.

Sandeep Shah: Okay. And just the last question, if I look at the Q-on-Q, the capitalization of IP there is an increase of $114 million while the last deal of IBM is close to like $18 million as per the Press Release. So, can you give us color for the balance $34 - $35 which is generally normal or this is something over and above IBM?

Anil Chanana: I think, this is because of the FOREX rate because of the Dollar-Rupee, Rupee strengthening, it is more of a conversion translation effect nothing else.

Sandeep Shah: Okay. And just last question for the last deal of $80 million what could be the expected revenue?

Anil Chanana: You can assume basis whatever we have given in the past. It is becoming very difficult to give deal by deal revenue profile and as Vijay said, we will be investing in this products and platforms area both organically as well as inorganically. So, this is the important part of our strategy and you will see these revenues go up.

C. Vijayakumar: I just want to add that we will invest in both Mode-2 and Mode-3 and that continues to be a very key component of our strategy, organic and inorganic capability building. You will see a fairly balanced mix of investments across these two portfolio of services.

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

Sandeep Agarwal: CVK I have one question only, if you see the way you have disclosed the Mode-1, Mode-2 and Mode-3 number. So, I just wanted to know as you rightly mentioned that we have seen a 30% growth in the Mode-2 and Mode-3 business but within that also if you see a bigger proportion which is 12% - 13% of the business is actually growing at mid-teen kind of number while Mode-3 is actually growing at a very high pace and we obviously do not know exactly how much of that may be coming out becoming of IBM or any other deals. So, my question is that Mode-1 which was 84 and has become 81. So, how do you see this panning out? Do you see this may not actually grow at all or may grow into very low rates and it will be quite a while by when Mode-2 and Mode-3 becomes substantial portion of the business to drive high single-digit kind of growth for the business on a consistent and more sustainable business ex of any acquisition?

C. Vijayakumar: Sandeep, directionally a strategy remains same as what we stated in August. We believe in three years to four years FY 2021 approximately we expect our Mode-2 and Mode-3 revenues to be about 35% of our portfolio and I think, we are making good stable progress. And obviously, when you have to really bring about a dramatic change in the way you are being perceived in the market, in terms of your capabilities, in terms of the speed of execution that you need, speed of scale up that you need in Mode-2 and Mode-3 businesses I think it is a very wide strategy to kind of use organic and inorganic approaches. However, we are very careful to ensure that these are not diluting our margins. So, we are kind of defining a margin band and we will drive towards that kind of dynamic as we move forward.

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

Ravi Menon: I had a quarter about how the IBM deal has panned out over this year. If you look at Mode-3 you have added about $180 million in annual run rate in the last 12 months. So, this seems that most of the revenues from that deal has already come through, should we expect a lot more incremental revenue over next year?

C. Vijayakumar: So, Ravi as you would know these products have been acquired at different points in time. Some of them would have reached a stable state; some of them are still in the ramp-up state. It is difficult because even in last quarter we did a few things, it is difficult to say whether it is stabilized or not and we are going to continue to invest, so it is an ongoing thing.

Ravi Menon: Yes. If you recall last quarter you had said that you are expecting a total of about $116 million or so from the IBM deal and Mode-3 if I know it correctly, it does not have too much right now rather than IBM, so that is why my question.

C. Vijayakumar: No. See, our Mode-3 revenues are about close to 6% of our revenues which is on a $7 billion it is broadly $420 million approximately. So, definitely part of it is IBM but there is a large part which is non-IBM.

Ravi Menon: If you look at Mode-1 if I back out what would have come in from Volvo there seems to be about 3% kind of growth. So, should we say this is because there is a lot of cannibalization of this base that is going to feed into Mode-2, it has seen good growth and Mode-3 as well?

C. Vijayakumar: I mean you are partially right. But is very difficult to define which segment of your portfolio and which geography you expect more cannibalization and things like that. So, based on some trends we made some broad estimates which has gone into our planning.

Moderator: Thank you. Next question is from the line of Ashish Agarwal from Principal Mutual Fund. Please go ahead.

Ashish Agarwal: Yes, sir, actually I have a couple of questions. First of all, the India growth, what is leading such a high growth in India? Just wanted to understand that?

C. Vijayakumar: I presume you are talking about our growth in Rest of the World. Rest of the World has several large geographies outside India as well. So, India as such we are very focused on a few select opportunities, we are not playing the whole market, there are a lot of SI opportunities that we are not participating in.

Ashish Agarwal: No, sir. But if you look at the revenue detail which you showed in the US GAAP number, so nine months last year it was $142 million and it has grown to $284 million this year for the revenues from India, so just wanted to get a sense on that?

Anil Chanana: So, this is basically primarily some of the system integration project which were awarded earlier and which are getting completed part of it. So, this is basically that competition of some of the SI project which will not be there which will not reoccur in future. This is the area of being deemphasize, so where we were contractually committed to complete and I think, there only we are doing it. So, these revenues will come down, you will see them drastically coming down.

Ashish Agarwal: And secondly sir on this Mode-3 just wanted to get a clarification, you said you will go and invest inorganically in this business and acquire some other IPs. So, going forward we have spent almost greater than $600 million this year on acquiring these IPs. So, similar type of a number should we be doing for next couple of years, am I right? Just wanted to get a sense on that?

C. Vijayakumar: Ashish, it will all be driven by the attractiveness of the opportunity while we are open to invest it will get driven really by the attractiveness of opportunities and of course, we also want to create a balance between Mode-2 and Mode-3 that will also drive a little bit of our investment allocation.

Moderator: Ladies and gentlemen this was the last question for today. I would now like to handover the floor to Mr. Vijayakumar for his closing comments. Over to you sir.

C. Vijayakumar: Thank you all of you for a very keen interest in following our results and the commentary. We will look forward to talking to you in the coming quarters and also in other calls that we will have as a next step. Thank you for your time today.

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.