"HCL Technologies Limited Q1 FY2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the HCL Technologies Limited Q1 FY2020 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sanjay Mendiratta, Head Investor Relations, HCL Technologies Limited. Thank you and over to you Sir!

Sanjay Mendiratta: Good evening and good morning, everyone. A very warm welcome to the Q1 FY2020 Earnings Call of HCL Technologies. We have today with us Mr. C. Vijayakumar - President & Chief Executive Officer, Mr. Prateek Aggarwal - Chief Financial Officer, Mr. Appa Rao, the Global HR Head and the other business leaders.

I now hand over the conference call to Mr. C Vijayakumar to give the opening comments.

C. Vijayakumar: Good evening and good morning to all of you. First of all, apologies for the delayed start. So, we have a small presentation that we will walk you through, followed by that we will take question and answers.

To start with I want to give you a very quick performance summary for the quarter. We have had a fantastic start to the year. We delivered $2.36 billion in revenue, which is 15% Y-o-Y growth in reported currency and 3.8% quarter-on-quarter growth. On constant currency basis 4.2% growth and 17% Y-o-Y growth, this is 17% Y-o-Y growth is the highest growth in the last seven and a half years so it has really been a stellar performance and I will talk about what contributed to this in one of the subsequent slides.

Our EBIT margin was flat on a Y-o-Y basis, and on a quarter-on-quarter it is now by about 6.3%. It is about 180 basis points drop. The margins are largely in line with what we had expected for various reasons in this quarter. The year-on-year drop is little steeper to 260 basis points. We will explain some of this in the subsequent slides. We had a very good momentum in our Mode-2 and Mode-3, a 20 basis points increase in the mix it is now 29.7% which is again a 300-basis points growth of the previous quarter last year.

Our revenue momentum continues, and we have been talking about very strong deal wins, large deals, which is what we talked about in three of the four quarters in the previous year and all of this has been contributing nicely to a growth momentum.

Last six quarters, we have had continuing acceleration in growth. A big part of this is organic growth. If you look at the last two, three quarters, every quarter we have a

reasonable run rate, which is coming from all our businesses. But the big uptick is really contributed by the large deals, starting with Nokia, in the middle of last year followed by the Broadcom Professional Services agreement and Xerox deal that we announced, which was one of al largest deals that we find in our history, which happened in March of last year and that has also contributed significantly to the growth.

Each of these quarters, one of the large deals is really contributing to the x-factor in terms of growth, and what is very notable is of the 17% which pretty much contributes to the 4.2% contributes about 95 million of the incremental revenue of that only 11 million of revenue is from inorganic growth, which is through the integration of Strong-Bridge Envision, the Digital Transformation Consultancy Company that we acquired last quarter and it is really kicked in from April 1st.

A significant part of this is from one of the large deals that we won in the last quarter, which transitioned a little faster than what we expected. There was revaluing opportunity to drive some acceleration in how the execution needed to happen. So HCLites all over the world have been very, very busy executing some of the wins that we have achieved in the last few quarters and more sharply the wins that we had in the previous quarter. So overall, it is a very strong momentum, in terms of overall growth in terms of organic growth, which gives us tremendous confidence to get to an industry-leading organic growth in this fiscal.

Moving on, if you look at our revenue by geography and vertical, America has grown 21.3% year-on-year, Europe grew 11.3% and Rest of the World was more or less flat. If you look at US, the large deals that we won was the key contributor to the big uptick, though there is a growth across a few other segments, which has also contributed to the growth in the US.

Europe was soft. They degrew 8% quarter-on-quarter, but if you look at the year-on-year growth 11.3%, obviously when we had the large deal there was lot of implementation and transformation, some of that ramps down and the deal gets into steady state and that is what is reflected in these numbers.

ROW has some contribution from India, but overall ROW performance has been soft, but we expect it to pickup in the coming quarters.

Across verticals you can see that Manufacturing, contributed by the large deals and Telecom and Media are two segments which has grown over 28% year-on-year. Most of the other verticals have grown good double digit, Retail, CPG grown 22.1%, life science is 16%, energy utility about 18%.

Financial Services, while the growth it is broad-based, which is getting offset by one of the client situations, which is continuing to evolve, and it has a downward impact on the financial services.

We traditionally talked about, in the last two, three quarters we've talked about two clients in Financial Services. I am happy to note that one of the clients have stabilized and we are going to see some growth there and the overall win momentum in Financial Services is also strong so I do believe in the second half or the last quarter of this year we should see some good growth coming in financial services.

One of the big highlights of this quarter is we launched an HCL Software. This is the new business unit for software products, which is really stacking up of all the IBM IP partnerships and the acquisition, which got consummated on July 1. This is really to provide modernized software products to businesses and our value proposition and vision for this business is to become the most client centric software product business in the world.

This is a philosophy which is guided as the innovation, client centricity and empowerment. And really focusing on adoption of the product is a very important theme and our teams have in the last two, three years have built a lot of conviction on how product adoption can help create stickiness and long-term benefit for a software product business and that is what we have got started and the deal got consummated and we will see the revenue momentum picking up from July.

We won about 12 transformation of deals, as I said earlier Financial Services was a good contributor here, of course Manufacturing and Retail, other segments which were the Top 3 in terms of contribution to the transformational deals.

We continued to have a strong local presence and participation in different geographies. We celebrated 20 years in Australia, New Zealand, we have a 1600-plus workforce at eight locations and we continue to increase our focus in this geography where our presence is significantly smaller compared to what the market opportunity is and we are investing in the geography to crate the growth that we need.

We are also very proud to announce that we have been chosen as a digital transformation partner for Cricket Australia. Again this is about fan engagement, something that we have done fabulously well in Manchester United. This is a theme that we want to repeat in Cricket Australia.

We also increased our focus and footprint on the cyber security business by launching a Cyber Security fusion center in Frisco, which is already off to some very good start with clients, including a government client in the State of Texas.

To give a little more dimension to the deal wins, we won a very large deal with the European Oil major, which is largely an infrastructure deal and application management is combined scope as a part of this deal. We have won a fairly large deal with the multinational based in Europe for Digital Workplace services, replacing one of the traditional providers. Here again, it is not traditional workplace services deal, it is a digital workplace where DRYiCE lucy is the cognitive agent and there is significant amount of user interactions which are enabled through the cognitive virtual assistant.

We also had a couple of wins. As I said, a large American investment company and a leading financial services group in Europe who expanded the relationship. It is largely a digital engagement which is continuing to scale very, very impressively.

Now as we discussed in the last call, we have now created new business segments in line with how we see the business progress. So, the Products & Platforms, Engineering and R&D Services (which was earlier classified under the software services) is now classified as IT and Business Services (which has infrastructure, application, and digital process operations) are three significant components. A lot of deals which are integrated, a lot of cloud migration deals and lot of digital transformation deals have all these three components. So that is why it makes sense to kind of combine this under one vertical segment.

We have also reorganized the sales channel which happened last year to have a vertical go-to-market strategy looking at selling IT and business Services. We have one integrated sales channel and we have dedicated delivery organizations to driving this.

Our Engineering R&D Services which has been a flagship service for us, we used to report the revenue contribution under services but we now have a separate segment, which is around Engineering and R&D Services and the focus and the target audience and the dynamics of this business are little different from the overall IT and business services and that is why we have segregated this as one segment.

The last is products & Platforms.Now the Products and Platform will have all the standalone product businesses that HCL has. To specifically call out, HCL Software will be a part of Products and Platform. The Actian acquisition that we did that will also go under Products and Platform segment and then IP partnership that we did with DXC which is also

rolling up into the Products and Platform. These are three standalone product businesses where we have made significant investments and we wanted to provide your visibility on how this stream is performing and that is why we have called it out.

There are some product businesses within the IT and business services as well as Engineering services which are largely embedded within those business services even though there are dedicated group, but it is overall under an integrated leadership. So, they continue to be classified under ITBS.

The organic IP products, which we have built and that is what continues to incubate with these business lines. So overall Mode-3 will consist of Products and Platform, plus there are organic products in IT and Business Services and Engineering and R&D services.

Just a little more double click into the HCL Software. The deal was closed as all of you would know end of June. It is a $1.8 billion, seven software products in some specific areas like security, marketing, commerce and digital solutions. This is a group of products around the Unica, around Domino's and Connections. So that is what is a part of digital solutions. So, there is a tremendous amount of work that has happened in the last three, four months, in fact last six months we signed a deal in December. We have been setting up this entire business units which includes on-boarding a lot of partners, getting all the approvals from the government while continuing to focus on creating product roadmaps and product releases.

The key differentiator that we envision for this business unit is in the Software Products Business, I think there is a unique need for a very, very customer centric product company. And this strategy worked extremely well in some of our core services where the services that we offered were very similar to what other providers had. But we came in a very refreshing approach of really providing a very friendly contractual construct and a very customer centric approach where we have not just focused on selling a product but we have evangelist, product evangelist, customer evangelist who are focused on adoption of the product and the value realization as a very important success metrics, which we believe will be the right long-term success criteria. That long-term success will be driven by some of these attributes.

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

Prateek Aggarwal: Good evening, good morning, whichever part of the world you are. I will start of my commentary with the biggest news that we have in this quarter is stupendous growth, huge

beat on revenue in Q1 17% year-on-year in constant currency and what I am also very pleased to share is that comprises about 14% is organic in nature.

I also want to point out that we are keeping the guidance the same exactly what we communicated three months back both on the topline, as well as on the bottomline.

In terms of numbers, they are on the screen mostly been commented up on. The EBIT if you can see is lower on a quarter-on-quarter basis by about 180 basis points. That is partly contributed by four factors. Some of the factors common to the industry are our forex headwind of about 15 basis points, typical visa costs that come in this quarter of about 15 to 20 basis points and as we had pointed out in the last call there is a 50 basis points impact in the SG&A, which is largely investment that we had already made in the previous quarter in anticipation and in readiness for the HCL Software revenues to start flowing and taking charge of the front end of the market in that business.

There is an additional 110-odd basis points in the ERS business, part of that was about one-third of that or actually more than one-third of that was driven by some one-timers in the previous quarter in that particular business and balance part of that was driven by some investments made in the ERS business as well as some onsite centric growth that we experienced this quarter and also some costs where we need to take some action going forward. So that is the EBIT walk for the quarter.

I also want to talk about the ETR, the effective tax rate, which you would have noticed has gone up this fiscal to a number of 24%, which is largely driven by the consummation of the seven software products acquired from IBM and its related accounting. While I'll go into the accounting in the next few slides, just on the ETR, the impact is largely coming from the goodwill that is recorded in the financial books, which is tax deductible at an accelerated rate of 25% written down value, under the Income Tax Act. However, in the financial books, as you know, goodwill is not amortized, and this leads to a permanent difference between the profit as per the financial books and profit as per the Income Tax Act.

So, the impact of this is about 2.2% of profit before tax, PBT. So were it not for this one factor, our ETR would have been something like 21.8% or there about. This is a GAAP dictated non-cash charge, which basically on the other side results in a deferred tax liability being created. It's a liability, which is not payable to anybody at any point in time, and is therefore, completely non-cash like I said. So that's the factor that is pushing up ETR, and I just wanted to explain that to you in some detail.

Moving onto the next page these are the graphs which basically show a longer-term three year CAGR that are close to 12% revenue growth over a three-year period, resulting in close to 9 billion in the last 12 months, July to June. Both EBIT and EBITDA have also shown good traction with EBIT close to 9% . EBITDA which is more representative in a business that is investing heavily. EBITDA which is a cash metric tracks cash very closely and is growing at 13.1% ahead of 11.9% in revenue terms.

Net income # year CAGR is at 7.1%, but that is, as I said earlier, impacted by non-cash factors like the amortization, as well as the effective tax rate in this quarter that I already spoke about. And therefore, at the bottom right-hand corner, you see the two-key metrics from an earnings per share perspective and the cash EPS is the number that we like to track because it is cash. It excludes the factors like amortization and the ETR factor on that we spoke about. And that is at a healthy INR86.2 per share and that cash EPS has been growing at a 14.6% CAGR.

Giving you some color on both the segmental margins, as well as the Mode 1, 2, 3 margins and the revenue mix. So, if you look at the top half of the page, the growth of 4.2% quarter-on-quarter in constant currency was driven largely by Products and Platforms this time 7%. Also, ERS, Engineering and R&D Services grew 5.6% and IT and Business Services on that large base also grew at 3.6%, which is pretty much in dollar terms, is the biggest contributor to the --close to $100 million growth during the quarter. In terms of Mode 1, 2, 3, again, all the three contributed significantly in very meaningful numbers across as you can see on the right-hand bottom side.

With that, I'll move on to the next page and give you some more details about how the IBM deal closure, which closed on 30th of June has been accounted in the books. To be very clear upfront, there is not a cent of revenue or EBITDA in the June quarter from this deal, because the deal was closed at the very end of the quarter. The number on revenue and EBITDA starts flowing from the next quarter, which is July 1. However, in the balance sheet is where you see the biggest impact of the deal having been closed and also on the ETR which we spoke earlier.

Moving to slide 19, out of the total value which we had announced $1775 million or $1.8 billion to round it off, the consideration, which is kind of fixed consideration is $1.625 billion and half of that has already been paid out on actually a couple of days before June 30, the Friday was 28 and the balance $812 out of that fixed a consideration will be paid on the June 30, next year.

The second component there is the 150 million which is earnouts which are payable in three installments. And each one of these three has been present valued. Of course the first one is at the same value and the present value of the second payment of $812 million is $794 million and the estimated payout and present value of the balance $150 million is at $129 million which completes the total of $1736 million as you see on the bottom of that page.

The right-hand side these shows remind few of the seven products that we are talking about. Five out of seven already existed in products under the IP partnership that includes BigFix, AppScan, Digital Experience, Domino and notes and Unica / Marketing software. The new products that we have got for the first time are Connections and Commerce.

Moving to the next page, the story doesn't finish on the $1,736 million which I called out on the previous slide. Because of the five products which we already have as IP partnerships, there is an unamortized present value of the licensed IPRs, which is of the order of $427 million, and once you add the $1,736 and the $427 million, this is what the purchase consideration, which has been allocated across the various assets, which we will get to in a second. So, the total value is $2,163 million or to just round it off $2.2 billion, which is broken into four primary parts.

The largest asset that has been quantified is the customer relationship, which is a $903 million. That is going to be amortized over 10 years in the proportion of the estimated revenues. So, we have forecasts across the period of 10 years based on which this will be charged to the P&L.

The second largest asset quantified is the technology or the IP intellectual property, which is of the order of $352 million and the basis of amortization of that is over a period of seven years to 10 years. It differs for each of the seven products. Some of them are at seven years, some of them are at 10 years. On a weighted average basis, it is about 7.5 years to 8 years, kind of a number. And this will be amortized over that period of time for each of those products based on the simple straight-line method.

There is a third net liability, which is nothing but the deferred revenue. And deferred revenue is a significant part of any software business. And so, it is here. The gross deferred revenue is of the order of about $402 million. That's the liability that we are carrying in our books, which will service over a period of time. And against that as per our negotiation with IBM, we have close to $400 million sort of as a receivable from IBM, again, over a period of time, which on a present value basis is quantified at $391 million.

So, you can see basically kind of offsetting each other, the net value is a net deferred revenue of about $11 million, which will flow into the P&L over a period of more than a year actually. The balance then is the goodwill, which is amount of $919 million. This as we discussed earlier in the context -- in another context, is not going to be amortized. And that is what is going to be in the books and it will be tested for impairment if and when there is a trigger that requires us to do that.

Moving to the next page. This is the chart, which gives the amortizations based on the principles I enumerated on the previous page, over the next five years and the balance thereafter. So, for the balance three quarters of this fiscal year FY '20, the amount is $196 million, and then for the balance four years after that is given in the table on Page 21. And in total, this is $2,023 million. By I must clarify, this includes not only the seven products that we are talking about, but also all the previous non-products acquisitions that we had in the services business, as well as the IP partnerships where leaving aside these five products, which have become owned now.

So, with that, just to reemphasize, we are sticking with the guidance of 14% to 16% in constant currency at a total level. As you know, and as we discussed last quarter, this in our estimate had included about 7% inorganic and organic was supposed to be 7% to 9%, but of course, given the one-month delay in the deal that we talked about, that 7% has gone pretty much near the 6% mark, and the difference of whatever that 0.7% or whatever it is, is kind of being made up in the organic part.

Margin continues to be at 18.5% to 19.5% and given that we are at 17.1% in the first quarter it is the number that we are retaining and we expect to achieve based on all the cost factors, actions, that are already taking place as well as the IBM deal that we talked about, which will contribute handsomely to the margins starting July 1, 2019.

With that operator we can go to Q&A.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: Hi, thanks and congratulations on a good execution on the revenue side. Could you elaborate, last quarter you had said that organic growth would probably be bigger in the first half and pick up in the second half. Given that it's been so strong, I think you said 14%. Has that view changed and what drove that?

C. Vijayakumar: Ankur Yeah. Ankur, thank you for the question. When we started the year and when we did the planning, there were certain dynamics, which were there and to kind of break that into a little bit more detail, we had headwinds from three clients, two in Financial Services and one in Manufacturing, where based on the situation at that point of planning, they were to ramp down significantly. That was one.

Of course, we had the large deal ramp up which was there, the large deal that we signed in March and announced in March, where there were some uncertainty about how the rebadging will go and how much time it will take, all of that. I think some of that went absolutely flawless and we could maximize the revenue from the new deal that we signed.

And the headwinds that we expected one of the financial services clients actually things turned around. We could gain some market share in one of the accounts and the second account did not ramp down as much as we anticipated and same was true for the manufacturing client as well, so collectively things panned out much better than what we anticipated and of course that is what shows up in the revenue.

Ankur Rudra: Going forward, do you think this will be the first quarter that was significantly stronger than the trend and we see organic growth actually now fade out a bit, or you are seeing the momentum sustain?

C. Vijayakumar: I think the headwinds in some client-specific situations at least one in Financial Services, and one in Manufacturing are the challenges there, and we see some softness from those two large clients in this quarter and maybe even in the next couple of quarters. But we are also constantly booking new deals and -- overall, I would hesitate to make a comment on how Q2, Q3, Q4 will go, but overall, we remain within the guided range. And as Prateek already highlighted, our organic growth has already contributed some $60 million more which will offset the one-month delay in IBM.

So, our overall organic growth will be better than what we had anticipated earlier. So, there may be higher contribution from organic and lower contribution from inorganic. But given the momentum and the consistency with which we are able to win the strength of our overall proposition, the integrated offerings, our ability to combine services and also understand the client situation in a very, very pragmatic manner and create win-win solutions, I think that gives us a lot of optimism on a large deal pipeline. They are not -- they may not be driven by RFPs, but we are able to create some strong propositions and kind of convert large transactions. So that gives me confidence though it may not happen every quarter, but there is enough optimism on the booking and what it will translate.

The only reason we have not increased the guidance is, given the macros that are playing out and the trade situation, I mean, obviously, there can be always some surprises, and this will be not the right time to kind of increase the guidance. So, we remain cautiously optimistic, but overall momentum is good and we are positive about what we can deliver. An industry leading organic growth in FY2020.

Ankur Rudra: Thank you Sir.

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

Sandeep Agarwal: Yeah, hi. Thanks for taking my question and congratulation on very good set of numbers on the revenue side. So, I have two questions on -- one on the demand side. While you amply clarified that you don't want to risk your guidance with uncertain macros, but I just wanted to dig a little deeper. Are you seeing any kind of signs which makes yield – make this conservative assumption, one? Are you seeing some anecdotal signs of stress in some of the segments like high tech or in the product engineering side or even on the financial side, that is question number one?

Question number two is more about bookkeeping from Prateek and Prateek has very well explained the whole amortization. Just one question which I wanted to understand in short was that is it right to assume that out of this total IP deals consideration, which we are paying we will be broadly writing it off around $200 million every year for the next 10 years on an average and balance 1 billion or 900 million will be goodwill, which will not be written off unless there is a impairment assumption, so is my understanding is correct?

C. Vijayakumar: Let me answer the first question and then Prateek will respond on the second one. So, Sandeep, overall the demand environment, if I look at it -- first is to look at it really quantitatively. The pipeline that we had at the end of last quarter and the pipeline that we have at the end of this quarter, it's more or less the same. Now in terms of verticals, I think there are some verticals where there is some slowness in some decision-making, but they are more projects type of work, where there could be some kind of delays that we have seen. However, I think the traditional Mode 1 business, there is enough opportunities, which will continue to be happening in the market.

And I think on that front, we also feel extremely confident of our differentiated positioning, especially on the infrastructure business, the number of good quality players who have viability, whom the customers consider as a viable a provider, that's going down quite a bit. And then we are in a pretty unique situation to really capitalize on the deals, renewals and

rebid market. So, I think that's very strong, and I do believe some of the macro things may only accelerate some of those things.

In In terms of some verticals, there is delay in decision-making, though I wouldn't really attribute it to macros. It could be based on the deal dynamics. So I would say it's a mixed trend, that's why we are a little bit cautious and this whole trade and some of these challenges, it hits our customers' bottom line significantly, especially for the clients who have a significant exposure to some of the markets, which are -- kind of impacted due to this trade tensions. So, they are -- when they come under cost pressure, of course, they will have a little more expectations from some of the providers. So, all these things are just playing in our mind. So, we are being cautiously optimistic Sandip.

Prateek Aggarwal: To answer your question on amortization, I mean you asked me a specific number, which I don't think is the right way to answer. It is an -- in the first year, it is a number close to that number, but you can just do the math. I mean we publish this information on a year-on-year basis every quarter, so you just have to take the March quarter disclosures and see this quarter and you can see the difference.

The other deal that we closed is Strong-Bridge Envision, which is much smaller in size as you know. So, there will be a bit of that, but really just compare the two quarter-on-quarter amortization schedules published.

Sandeep Agarwal: Thank you. That is very helpful.

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

Sandeep Shah: Thanks for the opportunity and congrats on good execution on revenue. Just the question in terms of the guidance. So, if I look at the second quarter, you will have an incremental revenue contribution of almost $140 million, $150 million, which may be coming to IBM deal. That itself may give you a 6% QoQ growth. So at the midpoint of the guidance, which is close to around 14.4%, you are actually guiding almost a flat growth in the next three quarters on a QoQ. So, is it more a conservatism or is it some other client-specific issue, which you may be foreseeing going forward because of macro?

C. Vijayakumar: Sandeep I know your math's are -- I absolutely agree. So the contribution from IBM deal may not be $140 million, it will ramp up, but overall on a 12-month basis, we feel confident about the $625 million that we talked about, when we announced the deal. So it may be a little smaller to start with and then it will pick up. Some of the transitions, which are

ongoing especially rebadging kind of deals, so revenue could come down when you go into the next two quarters, but some of that could get filled as well through other pipeline.

And the client-specific situations, I've already called out. One Financial Services client and one Manufacturing client, there are some specific challenges. So there is some uncertainty and that's why we kind of kept the guidance the way it is. And we will look at it next quarter. And depending on how we -- how we feel, and also the whole IBM deal also may have a -- while annual revenue looks intact, but the ramp-up could be a little bit slower in the July, August, September quarter and it may peak in OND and a little bit moderate in JFM.

So there are many, many variables, and overall 14% to 16% was a healthy guidance and we want to remain within that. And we will update you in case we feel there is an uptick. It's possible.

Sandeep Shah: Fair enough. Just the follow-up, sir. In terms of margins, just -- because we called out that first quarter, we would be lower than the lower end of the guidance, largely because of the product side ramp-ups. So that should be Mode 3. When I look into the margin QoQ, the Mode 3, Mode 2 margins have slightly improved. While the Mode 1 margins have gone down. So there is some amount of confusion versus what we foresee and what has come, if you can help us in terms of reconciling.

And Prateek, what should we model for the tax rate for FY '20 and going forward basis, beyond FY '20?

Prateek Aggarwal: Sandeep, let me answer your first question first, which is, see, P&P is a product business and that applies to any product business anywhere in the world. You should not see it on a QoQ basis, because that's great to see for a services business, but product companies you have to see YoY, and that's because the seasonality that is there in terms of license sales, which is in turn determined by when do those clients come up for renewals and things like that, so if you see and that data is given in this accounts where you will see the QoQ -- I mean the margins in the previous year quarter, was about 30 percentage point, 31 percentage point. So compared to that, 24% is lower because it was 31.4% and that is down to 24%, which is a 7.4% drop. So that is the drop, which is really the investments which we made in anticipation and readiness further deal to start from 1st of June, and that didn't happen and that was -- we had kind of baked that into the guidance we gave three months back, but then the deal closure got delayed by another month. So that is the difference that is really the investment that has gone in months back, but then the deal closure got delayed by another month so that is the difference that is really the investment that has gone in.

Second question was on the tax rate.

C. Vijayakumar: If you just look at the AMJ2018 through AMJ2019 for the products and platform segment you will see a substantial increase in cost so that should give you some indication of this.

Prateek Aggarwal: Yeah. Going to your second question on the tax rate for FY '20, it is determined at 24%, like I explained earlier. And while it's kind of difficult to guide you for the next year FY '21 at this point of time, it would tend to be slightly higher, maybe 24% to 26% is a good range to work with, but these things are determined on a fiscal-to-fiscal basis. So this 24% is for this entire fiscal.

Sandeep Shah: Last question, if I can pitch in, is in terms of the product growth on a QoQ and what we understand is seasonally this is a slightly softer quarter where there could be a QoQ decline. So what has led like good growth versus the seasonality, which was expected in the Products and Platform business?

Prateek Aggarwal: I wouldn't agree that this AMJ June quarter is seasonally weak. I mean, typically the strongest quarter, of course, is the December quarter, but June quarter is second out of the four quarter. The weaker quarters are the March quarter and actually, the March quarter and September quarter.

Sandeep Shah: Thanks for the clarification. All the best.

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

Viju George: Thank you for taking this question good quarter. Just had a question on Mode 2 margins. I think it's low teens. And I guess your Mode 2 is probably more comparable with what peers call digital, in terms of the kind of offerings may not -- not as percentage of revenues. And generally peers called this out as normally a higher margin business. So I'm curious to see whether the margins on this are quite much lower than what you would expect it to be, considering peer commentary.

C. Vijayakumar: Viju, I think we have discussed this before and our gross margins are definitely higher in this business, but obviously the practice overheads what we have invested into all four areas, it kind of dilutes the gross margin that is why EBIT is lower and as the business scales up I think this should improve; however, if we look at the overall opportunity there are a lot of areas where we need to do proof of concepts and especially some platform led deals that is some ground work that we need to do to kind of help showcase the right

outcomes, so we continue to look at that as the right investments that we need to make in the long-term to kind of scale this business.

And the way the whole practice investments has helped us is, today it's a very, very strongly differentiated service and we are able to win again some of the strong established players. And the conviction of our own sales teams to really go after large-scale digital deals has tremendously increased. And I really attribute it to these strong practice investments that we've made. And we will continue that for some time. I think still that business is in a very early stages and we can really do some significant scale up in the coming years. So that's why the margins are low. Quarter-on-quarter, there may be some marginal improvements, but fundamentally, the margins are going to be low in the foreseeable few quarters.

Viju George: But CVK you are saying on the gross margin side, they are tracking quite well above company average, okay?

C. Vijayakumar: Yes, there are two elements there Viju. One is, of course, there are large clients where you have a certain rate card and sometimes we end up not necessarily differentiating this, because they are large relationships where the whole change in rate card and things like that is taking some time. So -- but in any new deal, if we were to bid and win, we are very, very conscious of the rates and the level of gross margin that we need, so that in the long term it is kind of driving the right profitability profile here.

Viju George: Sure thanks. The other observation was on return on invested capital when I look at over five year basis and sometimes margin in terms of capture this the declining trend, your ROIC has declined by 15% points as per our math from where they stood at 2013-2014, a part of it may be due to the acquisition led strategy as well.

How do you see this going forward because I mean it is also not just about the income statement but also the balance sheet and the acquisitions, so how do you manage for this going forward and what might be a desirable level for you, you have stayed on the margin side that anything on the ROIC side as well?

Prateek Aggarwal: I think I referred to that in the commentary at the beginning. First of all there are, as investors we need to look at cash metrics more than accounting metrics because IRR is really the metric that we should be tracking as internally when we make our business cases for all these investments that is how we measure it and that is how I continue to sort of look at the overall metrics.

The second thing I also want to point out is we are looking at return on invested capital as a percentage, while percentages are great,we also need to look at who is investing how much. You can take an investment of 1 billion and return let us say whatever 100% on that that is the return of 1 billion, but if you take investment of 5 billion on the other hand and even if you return 20% on that that still 1 billion in hot cash, I think as investors I tend to look at the actual 1 billion that is coming in and what is it expected to deliver year after year after year puts it in DCF calculation and that gives me what it means to me in net present value terms. That is the way I look at it. Obviously you have to make up your minds, we did exchange a few mails on this as well.

Viju George: Last question from my side, I think CVK you did mention this, better than expected organic growth is that coming because of upfronting of revenues in accelerated manner or better revenue traction from other clients as well, so what I am trying to say is that does this sort of mean that because of upfronting we are expected to sort of scale off a little bit towards the end or the second of the year?

C. Vijayakumar: So maybe a little bit, I would not say that too much has been upfronted, at least for two of the large deals that we won, I think it has already reached the stable state as it is reflected in the numbers in this quarter. For one of the deals of course, there is going to be some reduction. That reduction I do not see it significant in the next two quarters, there will be some reduction, but nothing that should substantially change the dynamics.

Of course, when you go to the next year, there could be some more pressure on this. But I think that's where we are now looking at our business as there is a run rate business of momentum that we have. And then on top of it, we need to look at proactively constructing large, mega transactions quarter-after-quarter, and that success is what will really drive a truly differentiated industry-leading organic growth in a consistent manner. I think that's the mix and formula that we believe we are getting it right consistently in the last few quarters and we want to see how to perfect that art. And I ensure that we will have at least one mega deal every quarter, so that it really gives you the differentiated growth organically that we wanted to achieve.

Viju George: Sure. Thank you. All the best.

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

Ashish Chopra: Thanks for the opportunity. I had a question on the overall margins. So while you start the year at 17% and Prateek you articulated the headwinds that pulled it down, but how should

we expect the trajectory from here on, for you to be delivering upon the full-year guided bank? So do we expect you to get back in the range immediately with the integration of the IBM IP purchases, or should it be more gradual and spaced out over quarters for you to see the improvement from here on?

Prateek Aggarwal: So obviously, the math works out to meet the guidance. We will have to be in the guided range from next quarter onwards. However, I see a slight peaking in OND and little moderation in JFM, and an uptick from AMJ to JAS. Exactly where it will land, I don't know, but our expectation is, we have enough levers to make the right metric. So overall year is where we will be between 18.5% to 19.5%

Ashish Chopra: Got it and Prateek you had also mentioned about the onsite heavy nature of the deal that ramped up in the quarter. So, were you referring to just one deal that did contribute a fair share of this quarter's growth or that would be probably the nature and dynamic of some of the other deals as well that you have been winning substantially large sizes?

Prateek Aggarwal: Yes, I do not want to get very deal specific, but yes there was that one large deal which we announced at the end of March, which really ramped up and contributed significantly to this quarter.

Ashish Chopra: Thanks for taking my question. All the best.

Moderator: Thank you. The next question is from the line of Parag Gupta from Morgan Stanley. Please go ahead.

Parag Gupta: Good evening. Just had two questions. So CVK, I guess, you have stopped giving any sense on infrastructure management in your metrics, but could you give us just a qualitative sense of what is happening in that area? What kind of deals are you seeing and what's the outlook out there on the infrastructure management side?

And the second question was on transformation deals, I think while you continue to win several of these deals, there has been a little bit of a downtick in this quarter versus let's say, what you've been doing on an average for the last couple of quarters. So is there anything that we should read into what is happening in the macro environment or is it just a slight downtick, which doesn't really mean much from a dollar perspective? Thank you.

C. Vijayakumar: Let me start with the infrastructure management, of course, we are not going to call out the specific numbers, but I'm very, very happy to provide a qualitative commentary on IMS. This quarter again, we had some good wins, couple of them I called out. The rebid market is -- continues to be very strong. A couple of large players are continuing to weaken and the

customers are concerned. So there are lots of opportunities at the infrastructure business. But we are still being selective, because we obviously need to maintain a certain margin profile compared to some of the other players who are seeking -- who have a operating model, which allows them to operate at almost half the margins of what we anticipate.

So, there is enough opportunities. We are picking and choosing the right opportunity, so that it helps us to scale the infrastructure business in a profitable manner. That's as far as the new deals are concerned. If you look at the existing deals, obviously there is some year-on-year reductions, which are structured as a part of the deals. Obviously we take over, we optimize, we bring in significant amount of automation, DRYiCE, all of that. So that would mean that the subsequent annual reductions will happen.

And the third element is, I mean, even if -- either during renewals or even midway in a deal in a large client relationship, sometimes customers do ask for some reductions. So we try and make it a win-win proposition on how we can gain other businesses and support the customer ask. So there are three dynamics which are playing in. And the whole cloud adoption journey, I think I said this 3.5 years back, that 30% will go to a public cloud. There are many analysts who've written, it will go to 50%, 40%, 70%, but everybody seems to be trending to come back to the 30% that I quoted about four years back.

So, I think conviction on how much will move to public cloud is very high, the percentage is very high, some of the traditional enterprise workloads, hybrid cloud is the right operating model. A lot of new workloads around some of the new things like Advanced Analytics and IoT or Autonomous Driving some of those workloads could be in public cloud, so the core enterprise IT landscape will continue to adopt hybrid cloud and our capability there is going to continue to differentiate us to win this transformation programs.

On the deal momentum, I mean in the last year of the four quarters, three quarters we had increasing peaks and this quarter of course it moderated. We didn't have a mega deal like what we would have had in the other three quarters, but if I look at the pipeline, I mean, there are opportunities, which are large, but I do know when they will convert. But we are constantly looking at how to create these large opportunities. So it's a matter of one or two quarters. We should get another peak in the booking.

So, nothing to get concerned. I do not think the lower bookings this quarter was anything to do with macros, but some of it could be us being a little bit more selective in some of the opportunities but nothing on the macro which kind of eroded some deal bookings this quarter.

Parag Gupta: CVK just to clarify when you say, you are being more selective, is that largely from a margin perspective or are there other considerations as well?

C. Vijayakumar: Not only margins, yes, of course that is a consideration. I mean, of course, we obviously look at ,we have a client profiling and all of that, but in a great customer, if you are not able to see the right margins with all the levers that we have then obviously we are being selective there.

Parag Gupta: Thank you, CVK and all the best.

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

Ashwin Mehta: Thanks and congrats on good growth. I had two questions; one was on margins, so Prateek just wanted to check what was the nature of one off in ERS costs in this quarter? And secondly, you had indicated earlier there will be a $30 million hedging cost on the IP deals this year. So, has it significantly come through in this quarter or there will be a flow through in the subsequent quarters?

Prateek Aggarwal: We have G.H. Rao who is the President of our Engineering Business; I think he can provide a little more details on the dynamics on the ERS business?

G.H. Rao: We have two active clients and the margins if you see in the immediate quarter one is one off as you pointed out that is beyond a large deal. There is write off in this quarter. We had one similar program and over a period we expect the numbers to transit to offshore. To see some of the programs start with onsite and new offshore, but if you take some of the higher technology areas, we must service the customer sand operate continuous period of time in onsite.

And also you see, we have our own portfolio products within the ERS. And the yield has been lower in this quarter compared to the earlier quarters. So that also has been contributed to lesser margins and we are also investing for future growth in areas 5G or Industry 4.0.

Prateek Aggarwal: The second question, you had Ashwini was on the hedging cost which I had mentioned in the previous call, that is already flowing in as we speak. This quarter was about $6 million to $7 million odd, and I am just speaking from memory and that will play out like I had, we cannot give you an exact sort of guidance for next quarter and quarter-on-quarter for a simple reason it depends on how the exchange rates will play out.

Ashwin Mehta: My second question was in terms of the IBM IP deal, now that we've signed it and we have more clarity, what's the kind of EBIT margins that we would make on that deal. We had earlier indicated that will be a little lower in the first year and then improve in the second year, but now that we have more clarity in terms of how amortization will work, what is the kind of EBIT margins that we will make on that deal?

Prateek Aggarwal: So Ashwin, like I had mentioned earlier, the EBITDA is going to be 50% plus and the amortization is of the order of about 20%. It changes on a year-on-year basis. So in net terms, EBIT terms, it would be something, which is around 30% on the incremental revenue that we are talking.

Ashwin Mehta: Thanks a lot. All the best.

Moderator: Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: Thanks for taking my question. Just wanted your thoughts on the Actian product primarily because I think in the Hadoop ecosystem we have been seeing a lot of marked downs and write downs across the ecosystem, so just wanted your thoughts on how that is doing at this point?

Kalyan Kumar: So, I think, see Actian typically does not operate on the Hadoop ecosystem. They are a high speed in line analytics. Basically they are three products. They have superfast, really fast inline analytics engine, which can handle processing, so they use Hadoop as a five system feeder, so whether they could run on Prime Hadoop, they could run their own file system or they could run off any Cloud based after file storage that is why the Avalanche product has and they are a data integration platform, which works in the Hybrid landscape both Cloud and On-Prime.

And then third, they have edge embedded analytics and embedded databases object as well. So they are pretty much immune from the Hadoop ecosystem perspective. So it doesn't have any material impact on what they are currently trying to do.

Nitin Padmanabhan: Thanks for that. And just one last one was, with respect to the ERS sort of margins of that you saw this quarter, how much of that do you think can be recouped in a quarter or so, or do you think that will be spread over the remainder of the year?

GH Rao: I think, we will start seeing some recoup in next quarter itself. However, I think it will take a while for us to the recoup most of it, but nevertheless, there are some permanent cost headwinds, which are there. It's probably -- we have more non-perm impact or more

permanent impact, which we are trying to find an alternative to recoup. So in a nutshell, you would see improvement in just what we've seen.

C. Vijayakumar: Just to kind of add a little bit more. I think the cost aspect that GH talked about pertains to getting some higher-end skills onshore, which is a very, very unique skills from our Engineering portfolio, especially around 5G and some of the new ones which we are doing. And there are some cost increases and we have a structured plan on how to address it. But it's not an immediate solution. It is going to take some time. So there would be some improvement in margins in the next quarter and subsequent quarter, but it would not come back to this whatever average margins on this business for a few quarters. So there is some real heavy lifting to be done to get it to be the historic margin levels here.

Nitin Padmanabhan: Thank you CVK and all the best.

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

Ravi Menon: Thanks for the opportunity. CVK, no wonder the EBIT margins are surprisingly low at 17.8%, you know the cost of the IBM products obviously should have come under Mode-3, so what has really impacted your margins? I know it is a large deal for managed services, and a shared services program that you signed in March, but that alone should not have really dragged this down so much? So what else has been the headwind?

C. Vijayakumar: A lot of ERS business is also get classified under Mode 1 and as GH just highlighted, the drop in margins in the others would also reflect in Mode 1. And of course, we had a large deal, but I don't think it is, I mean, diluted in any meaningful manner the last year, maybe marginally. But definitely, for a size of the deal, we -- I think it was – it didn't really create a big impact on Mode 1. It's largely around ERS. I think if you do the math, anyway you have – we have a segmental profitability and the other business segment profitability, you should be able to see how Mode 1 has come down.

Moderator: Thank you. Ladies and gentlemen this was the last question for today. I now hand the conference over to Mr. C Vijaykumar, President and CEO of HCL Technologies Limited for closing comments. Over to you Sir!

C. Vijayakumar: Thank you everyone for joining this call. In closing, we remain very positive about what we can accomplish. I want to close this call with two forward-looking comments; one is we are very committed to deliver an industry leading organic growth and as we have said in the

last quarter we are all excited for chasing a $10 billion target and team here is really going up to the aspiration of hitting $10 billion and deliver a margin within the guided range.

So, thank you for joining us. We look forward to meeting you either during meetings in between or during the next quarterly results. Thank you and have a good day and good evening.

Moderator: Thank you very much members of the management. Ladies and gentlemen on behalf of HCL Technologies Limited that concludes this conference call. Thank you for joining. You may now disconnect your lines.