

HCL TECHNOLOGIES LTD

Q1 FY 06-07 Earnings Call

9.00 am (IST), October 17, 2006

Moderator

Good morning ladies and gentlemen, I am Monali, the moderator for this conference. Welcome to HCL Technologies conference call hosted by Prabhudas Leeladhar. For the duration of the presentation, all participants' lines will be in the listen-only mode. After the presentation, the question and answer session will be conducted for participants connected to SingTel. After that the question and answer session will be conducted for participants in India. I would now like to hand over to Ms. Parul Inamdar of Prabhudas Leeladhar. Thank you and over to you mam.

Parul Inamdar

Thank you, Monali. Good morning to everybody on this call and we welcome everybody on the post of results Q1 FY07 HCL Tech results conference call hosted by Prabhudas Leeladhar. We have with us the management of HCL Tech, which is presented by Mr. Shiv Nadar, Chairman and CEO. Mr. Vineet Nayar, President and Head (Software Services and Infrastructure), Mr. Anil Chanana, Executive VP (Finance) and Mr. Ranjit Narasimhan, Executive VP, President and CEO (BPO Division). Over to you sir.

Shiv Nadar

Good morning everybody. Thank you for joining us on this call, the first quarter call for HCL Technologies. Let me just briefly summarize the results which are in front of you and I am sure you all would have had an opportunity to take a look at it. I will summarize.

The revenue for the first quarter had gone up to 300.4 million up 36.2% year-on-year and 10.3% sequentially. I would like to add here that this puts a last trailing 12 months at slightly higher than a billion dollars. The EBIDTA before non-cash stock option charges stood at 65.1 million up 32.7% year-on-year and 6.4% sequentially. Net income at \$54.5 million is up 43.2% year-on-year and 7.6% sequentially. The board has declared an interim dividend of 200%, which is 15th consecutive quarterly dividend. There is net addition of 3825 people in head count taking employees strength to 36,452. This in summary was last quarter.

I would like you to note that this time HCL Technologies has provided substantial quantum of data and analysis more or less in line with the maximum disclosures that have been done by the industry. I am sure this will help you to analyze our company's performance better. We will continue to strive to not only provide this level of details but also we will try and get additional analysis as and when you seek them from us.

Amongst the data, which has been provided, I would like to draw your attention to the client list and repeat clients, this is one important information, though you would have noticed it, here we have given the list of million dollar clients and scaled it up. In addition to just giving million dollars and active relationships that are there, we have also provided multi service clients amongst these. When you go through the analysis you would see that the number of customers who are a million and above almost uniformly had not less than 25% of them, which is coming into multiple services. This is a very key strategic information that our strategy of working on development of multiple

services has finally started paying off and it is bearing results, these numbers give you a very clear estimation at which we are making this work.

One of the additional data which I want to point out is that a year ago out of the total revenue something like 96% came from existing customers, which presently stands at somewhere near 87%. What it shows is that deployment of what we have made in SG&A has started bearing results and new revenues - that means revenue from new customers, have started coming in making our revenue growth more robust. These are some of the inferences that you could draw. With these I will turn you over to Vineet and he will give you some of the highlights. Vineet.

Vineet Nayar

Good morning everybody. Fifteen months ago when we started on this transformation journey, we said our primary focus in the start of this journey would be employees. We would focus on reorganizing our organization in different clusters. This is what you are seeing as a culmination that we have organized ourselves more domain led. We have organized ourselves around five distinct divisions, which are industry definition of these divisions. We also have launched employee policies, which have been very well accepted not only within HCL but also the world over.

The second transformation initiative, which we had brought about was with reference to our customers where we had said that we would bring about a transformation in our relationship with them. We will focus more on value centricity, i.e. in volume centricity, and bringing multiple services to their for our customers to be able to increase revenues from each existing customer, and in the last two call, I have also said that we would be surrendering customers who do not see us as strategic or we do not see potential for growth because the revenue per client for HCL was very low and we thought we needed to fix it. In addition, the customer interaction was a big initiative within the company where we changed the way we manage the relationship with our customer leading to significant investment in sales, in marketing, in client relationship, in solution architects, and other initiatives were taken and that reflects itself in SG&A including the plan that we did a Global Customer Meet in December of 2005, in February of 2006, and we are doing one another Global Customer Meet in December of 2006, which as of now has 500 CIOs and CEOs across the globe who have confirmed attendance and that would make it one of the biggest event of its kind, so huge amount of investment in customer facing issues.

The third as Shiv rightly said in the beginning was with reference to our shareholders and corporate governance is a huge initiative within our organization. The disclosures you see here today are a result of one year of effort of putting the systems and processes in place, so that we can measure this matrix and share them with you. The first time we shared these details was in February of 2006 in a data book called the data book, which was shared with all those people who came to our meet in early February that now we have converted and we had said at that particular time that we will share this data starting next year on a more periodic basis, so you could see this data coming through to you on a quarterly basis, so that takes our transformation on the corporate governance and shareholder transparency multi notch higher.

The last transformation, which I have talked about last time was with the reference to our business model where we had shared that from our perspective the application services is a very competitive landscape and if HCL has to get back into a high growth, which is what all of you were expecting, then we would have to do something different. We cannot do what Infosys, Wipro, or TCS does well, we have to do something different, and there we had launched this blue ocean strategy of uncontested market spaces where we had created remote infrastructure management and the enterprise application services, we had redone that and changed our offerings and also changed

our offerings in output base pricing for our R&D and engineering services where you saw this is the announcement.

These were the four transformation initiatives we have taken. The results are in front of you. From an IT services point of view, we have grown at 43% Y-on-Y and 11% Q-on-Q, this is led by an application growth of 10% Q-on-Q and 17% on infrastructure Q-on-Q. For those of you who may think this is one off growth, please remember the last quarter from a rupee point of view we grew 13% quarter-on-quarter and 11% this, so it is two quarters consecutively, I think we would be amongst the top three Q-on-Q growing companies. 14% of our revenues this quarter have come from new customers who did not exist one year ago, which is amongst the highest in the industry, which also tells you that we are focussing on acquisition of new clients and changing the quality of revenue within our company, so that we can get growth clients. You will see that we have acquired 24 new customers, we have started now reporting the data, out of which there is one addition to 30 million, 3 additions to 10 million, 6 additions to 5 million, and as Shiv said 10 additions to a million. Our top 20 customers contribute to 50% revenue, but the good story is that these top 20 are growing faster than the company growth, which augurs well for the quality of business we have.

The US and Europe geographies are driving growth. So US geography is 14% quarter-on-quarter growth. Europe geography has grown 12% quarter-on-quarter, which means that both these geographies are growing at the expense of Asia, so if you see the offshore bill rate, which we have shared this time separately and on shore onsite bill rate, you will see the fact that our bill rates are under pressure because of significant growth which we saw in Asia Pacific last year. This year I am happy with the fact that the Asia Pacific is going down and US and Europe are the growing entities, which will yield higher yield per person for us. As I was talking about our success of blue ocean strategy can be measured from the fact that the enterprise application, which is largely driven by the SAP and Oracle practice, has grown 22% quarter-on-quarter. The infrastructure continues to be the dominant player growing at 17% quarter-on-quarter and I am very happy to report that our engineering services, which is something which was very important for the buying to start coming back, has started growing at 11% quarter-on-quarter on the back of the very good year last year also.

Our emphasis on big deals continue, as we had said that in blue ocean strategy if we have to be different we have to look at multi service large transactions and the reason for that is that we believe because of the portfolio of services which HCL has, we have an opportunity of registering higher win in that market space, so not only we announced large deals last year we announced Teradyne last quarter, which was very interesting because it was fought in a very competitive environment with global majors especially because Teradyne is a very big supplier of equipment to these global majors and despite the pressures from the global majors we were able to win Teradyne, which is application and infrastructure case study where the infrastructure, the data center, has been lifted and shifted to our hosting center. The data center has been consolidated and the application consolidation is in progress, so that we can deliver a larger saving to the customer than a typical application vendor would be able to deliver. We also announced one more deal last quarter, which we did not name because of the client confidentiality, and that is the way we see the progression of large deals. So with that I end my briefing on the IT services and hand over to Ranjit.

Shiv Nadar

We will now take questions. We are already 15 minutes into the discussion. Now I will turn it back to operator to start the question and answer session. We have present here Mr. Ranjit Narasimhan and Mr. Anil Chanana as specified by the moderator, so they will be able to take questions from the respective fields. Over to you.

Moderator

Thank you very much sir. At this moment I would like to hand over the proceedings to SingTel moderator to conduct the Q&A for participants connected to SingTel. After this we will have a question and answer session for participants at India bridge. Thank you and over to Ameena.

Ameena

Thank you, Monali. We will now begin the question and answer session for participants connected to the SingTel bridge. Please press 01 to ask a question. Thank you. The first question is from Mr. Sunil of Credit Suisse.

Sunil

Hello.

Shiv Nadar

Yeah, we can hear you.

Sunil

Hi, good morning sir. I just wanted one clarification. Why is it that the foreign exchange gain or loss it was a negative last quarter and it is positive this quarter though rupee has depreciated on both the quarters consecutively. Can you explain that?

Anil Chanana

Sunil, this is Anil Chanana on the side. Last quarter of fiscal 2006, we changed the accounting policy from hedge accounting to marked-to-market. As a result of which we undertook a charge of 3.6 million being the accumulated losses on forward covers at that point of time. With that this quarters we have a sort of a very small gain in that position, which is \$300,000, so we are consistently marking our forward covers to market and we will be reflecting the changes to the P&L account.

Sunil

Thank you.

Ameena

Participants connected to SingTel bridge to ask the question please press 01. Thank you. At this moment there are no further questions from participants at SingTel. I would like to hand over the proceedings back to India moderator Monali.

Moderator

Thank you Ameena. We will now begin the Q&A interactive session for India participants. Participants who wish to ask questions may please press *1 on your telephone keypad. On pressing *1 participants will get a chance to present their questions on a first-in-line basis. Participants are requested to use only handsets while asking questions.

First in line we have Ms. Divya Nagrajan from Motilal Oswal.

Divya Nagrajan

Hi, first a clarification on your billing rates, could you just explain again the kind of pressures that you said you were seeing there?

Vineet Nayar

Divya, the billing rates as of now we don't see pressure, you know I said this in the last quarter also, two positive impacts as far as we are concerned on billing rates are the quality of revenues which we had was at a lower billing rate, so whatever revenues we are getting now is at a higher billing rate, and the second is that fact that with Asia Pacific mix coming down, our billing rates would increase, third is the multi service deals which we are getting are also at a higher billing rate compared to what we have. However from a industry perspective, the pure application services is under pressure because it is increasingly becoming commodity, so yes there is for large transactions especially in banking and finance and some orders have already been announced, which have been auctioned, so those kind of orders have a negative impact, a negative pressure on the billing rate. But other than that the billing rate scenario across the world continues to be robust.

Divya Nagrajan

Right.

Shiv Nadar

The view which has been expressed by Vineet, this is generally for the industry per se. Specific to our company, the billing rate has not changed.

Divya Nagrajan

Right, so for most, I mean what kind of you know in case of renegotiated and new contracts what kind of billing rate hike are you seeing currently?

Vineet Nayar

Normally all the contracts have a cola agreement into it, which is anywhere between 3 to 4%, increasing billing rates in some of these contracts we are able to negotiate it and get it and in some of the contracts we are not able to negotiate and get. In some contracts where we are providing application services, we are able to go in and provide in enterprise SAP services or Oracle services or infrastructure services, which come at the higher bill rate. So that is the way we are handling these contracts.

Divya Nagrajan

Right, last quarter you talked about salary hikes, which would have come in during the quarter for about 85% of the work force, could you give us an idea of what levels of hikes is this has happened during the quarter and impact on the margin?

Vineet Nayar

On an average we have increased the compensation last quarter by 17% for people due, I am talking about the IT services business, for revision of compensation. Because of the large intake of freshers, if you see at the gross margin level we have been able to keep steady despite that increase. There is another trench of increase, which is coming up on 1st of October for the balance 15% of the managers, which I think would also be expected to be around in the similar range.

Divya Nagrajan

Right, I will come up for follow up questions later. Thanks a lot.

Vineet Nayar

Thank you.

Moderator

Thank you very much mam. Next in line is Mr. Hitesh Zaveri from Edelweiss Capital.

Hitesh Zaveri

Yeah hi. My question is on the infrastructure management side of the business end, the BPO side. On a steady state situation, I mean the growth in the both the businesses have been exciting. How do you see the margins moving over next 3 to 6 quarters in these two businesses?

Vineet Nayar

Let me make a comment on the infrastructure services side. The EBIDTA margin was 17.4% in the last quarter and it is 17.6% in September 2006, and earlier ago it was 12.5%, so I believe that we have now, you know it is stabilized on the infrastructure services side on margin as the portfolio between the India and the global businesses have stabilized, and therefore I feel similar margins or marginal improvement if not any significant improvement on the infrastructure services margins for the next 2 or 3 quarters.

Ranjit Narasimhan

For the BPO, the margins have been quite stable around about 23% and we have found that the margins in the offshore India-centric business is much higher than the margins for onsite business outside India, so we have been focussing on growing the India based business. So on a year on basis, the India based business have been growing in 59% and _____ which we see increased going forward.

Hitesh Zaveri

I am sorry, I did not get the BPO side of the business. As in you know I see revenue grows at the similar pace assuming it does over the next 2 to 3 quarters, would the margins be improving than what they are now?

Ranjit Narasimhan

Currently, the composition of revenues consists of 2/3rd of reserves come from India based business and 1/3rd of the revenue comes from global operation, and we find that the margins in the India based operation is higher than the margins in the global business, so we are focussing on increasing the share of the India based business. So currently the India business is growing, an year-on-year increase of 59%, so to that extent there could be a marginal increase in the margins.

Hitesh Zaveri

Sure. Vineet, I was bit surprised about the discussion on the billing rate area with the peer group is talking about strong margin outlook of having 3 to 4% increase in many of the renewal contracts and then new business coming in at higher rate. In HCL Tech you did describe the initiative that you have taken over the last 18 to 24 months, when do you see this translating into some kind of consistent billing rate improvements for you?

Vineet Nayar

See billing rates have dramatically improved over the last one year. If you look at our SG&A closely you would see that we are spending significant amount of SG&A disproportionate to the increase in revenue, and entire thing is being funded by billing rate increase, so if you really look at from a billing rate from a perspective, I think we would have increase on a overall basis at about 8% from the last year JAS quarter to this year JAS quarter.

Hitesh Zaveri

And what could be the outlook going forward for this over the next 3 to 6 quarters?

Vineet Nayar

That is what I am not giving an optimistic outlook just because the way we are, but if you look at what we have achieved in the last one year, we are constantly at it.

Hitesh Zaveri

I have question about the dividend distribution, which in your case has been very generous now, you know the growth rate in HCL Tech has been particularly exciting over the last year or so and you also announced campus investment plans etc. Would your dividend policy be changing because of this because of the campus that you need to build and M&A is coming up your way?

Shiv Nadar

I do not expect so, because our capex will be spread over a period of time. This is not a very high draw on the company, so I do not think so.

Hitesh Zaveri

And the M&A?

Shiv Nadar

Even in case if there is any very big M&A does come, the way of funding M&A need not be necessarily only from the company's cash available. Even early M&A there are some part of it which builds with debt

Hitesh Zaveri

Sure. Thank you may be I will come back with some follow up questions. Thank you.

Shiv Nadar

Yeah.

Moderator

Thank you very much sir. Next in line is Ms. Priya from Enam Securities.

Priya

Yeah hi, good morning to all of you all. My first question relates to the LPO deal which you have won in the BPO space, if you could give us in terms of what deal size are you looking at or what employee ramp ups you are looking at this front?

Ranjit Narasimhan

Yes, this is the first time we have gone into the KPO space and we have won a large LPO deal from a large property mortgage services company in UK. Due to client confidential data, we will not be able to give you the exact number of head count, but it is in order of a few million dollars per year.

Priya

Okay, my second question relates to the software services where they have been initiatives on the pharma sector per se with respect to the compliance, guidelines with respect to FDA, if you could give us the size of the opportunity and how it has been as with respect to client approach over here?

Vineet Nayar

See amongst the growth industries, the banking and finance industry has largely seen a lot of Indian players already, so you know changes there are difficult, so we chose a micro verticalization strategy of approaching segments which others are not there to be able to go in and dominate. Healthcare was one such industry we chose predominantly because (a) people were not focusing on it, (b) it had not offshored to a large extent. Now when we started focusing on this, we started focusing not only with our standard 4 or 5 services, which means technology development where we are developing endoscopy equipment, embedded devices, and dialysis machines, or lot of that, the application services we are doing a lot of SAP roll outs, but we also saw that there is an opportunity of unique services and unique solutions for this market space, so there is where we started developing our own IP and started launching products on our IP on private labeling basis and that has largely been very successful. Now it has not resulted into a significant revenue enough for me to report to you, but I think it has resulted into a very big door opener for HCL because of it our pharma life time practices growing in excess of 50% YoY.

Priya

Sure, that is really helpful. The third question relates to the depreciation charge we have seen, if you could highlight what has been the reason for the absolute decline and if you could tell us about the capex plan for the current year?

Shiv Nadar

I am requesting Anil Chanana to respond.

Anil Chanana

The depreciation charge this quarter is at 12.1 opposite 12.2 million last quarter and 10.2 million in the corresponding period last year. This is we are amortizing the asset over the life which we give in our account. Computers are normally amortized over 3 to 5 years. Basically, it depends upon when the life of an asset comes to an end, so far as the chargeability in the account is concerned, so if some of the assets have gone out of the period all of a sudden it will come down and then again it will start ramping up as the new capacities are getting created. So it is the linkage with the old assets coming out of the depreciation charge and new assets getting into the depreciation charge.

Priya

And what is the capex you are looking at for the current year?

Anil Chanana

I can give you the numbers for the first quarter. In the first quarter, we have incurred 28 million on capex and for the full year it is 100 million is the anticipation.

Priya

Okay, you know the disclosure in the current release has been pretty good, if I come to the client details that you have highlighted earlier in the call, if you look at 1 million dollar clients being 143 and 25% being where you have multi services delivery offerings. Just to take further this question what would be the sales and marketing initiative on the company's front to increase it 25% or further scale rather? I mean would it mean more investments in the service offerings or do you think it is the front end which is got to be made further strong?

Vineet Nayar

Yeah, so what we have done is you know if we go back about 15 months ago, we had a dominance of application services with customers and with dominance of engineering services with some other customers. We did not have enough cross sell within each other. For example, Deutsche Bank, we were providing BPO services and application, but we were not providing either infrastructure services or enterprise consulting services which is the SAP roll out or Oracle roll out. When we looked at the way we are going to get the growth engine back, we identified existing customers new services as a very focus area, so we invested a group of solution architects who would go after our top 50 customers and do an application portfolio optimization study and give a recommendation to a client of how we can bring about savings using new services, and that has resulted into 25% of our customers logging into new services instead of being only single service, and when I say single

service, it is either application services or infrastructure services or engineering services or enterprise application services, so that is the strategy we adopted. The second strategy which we adopted, which was discovery workshops, so what we started doing is we started going at the client location and co-creating what we call discovering opportunity in joint workshops so that we could look at how we could impact his cost or his revenues differently and we got experts from all different sides of our organization to help those discovery workshops. The third initiative which I think works the best was when we called all our customers into these Global Customer Meets, these are while the meet happens there are about 50 customers who speak to the rest of the customers as to what they are doing with HCL. Now when that happens the amount of sharing of knowledge which happens amongst the customer is so high that results into cross selling of multiple services, which my sales guys at certain times may not be able to up sell the services to the customers.

Priya

Sure, thanks very much.

Shiv Nadar

Can I give the answer in one sentence may be?

Priya

Sure.

Shiv Nadar

Multiple service offerings is fairly unique to HCL and cross selling is something which we had been trying to learn, and the multiple service offerings themselves have to stabilize to get into each customer. #1, will this percentage go up? Yes, because most of them are now very familiar with the multiple services offerings. #2, the new customers when they are coming, good percentage of them are coming in now with multiple service offerings at present, so this percentage will show tendency to increase, but that is future.

Priya

Sure, thanks very much and wish you all the best.

Shiv Nadar

Thank you.

Moderator

Thank you very much sir. Next in line we have Mr. Shekar Singh from ICICI Securities.

Shekhar Singh

Hello sir, just wanted to know like some of these clients like Teradyne, they are existing clients of HCL Tech, so when you say like you have got a large contract is it the renegotiation of an existing contract or is it a new contract?

Vineet Nayar

I think this is a very good example of the previous version. Teradyne is a very large customer of HCL when it comes to technology development services, so we develop their core instrumentation. Their IP was largely outsourced to couple of big 5, so they came up with an RFP to outsource their IP and HCL was not even invited in that RFP process and it was largely going to the big 5, because they did not believe that anybody from India would have that capability. Because of the fact that we are in the engineering side, we heard about this RFP when the decision makers were two different decision makers and leverage to get into the RFP and ended up winning the RFP. Now the competition was largely fought with the big 5 MNCs, when I say big 5, I am talking about the IBM, the Accenture, the EDS, the CSC's of the world and that reason it was not linked to engineering, it was the completely different service decision making was different and decision maker was completely different. So the \$70 million deal which we have announced is in addition to the engineering services we are offering.

Shekhar Singh

Okay sir. Secondly, sir can you just touch upon like the SG&A or the percentage of revenues where do you see this stabilizing?

Vineet Nayar

I believe that from a year's perspective it will stabilize at the current quarter level and there is where it will be.

Shekhar Singh

Okay. Thanks a lot sir.

Vineet Nayar

Thank you.

Moderator

Thank you very much sir. Next in line is Mr. Manik from Daulat Capital.

Manik

Good morning sir and congratulations for the good results. My questions pertain to your operating matrix. What we are seeing is that there is an increase in the onsite proportion of revenues as well as the utilization levels have gone down. Is there any room for improvement on both these fronts and what will be the ballpark figure for these figures?

Vineet Nayar

There is always room for improvement in everywhere in life and the first quarter on utilization normally starts the lowest because that is the maximum amount of fresher intake and therefore there is definitely room for utilization improvement going forward. At the same time do I have a specific number to share with you or what it would be? I don't think so, I mean I think all you have to do is track our utilization levels which has been changing quarter-on-quarter for the last four

quarters and you will see a significant improvement from where we started to where we are today, and I think we would continue doing that.

Manik

Okay sir, thank you.

Moderator

Thank you very much sir. Next in line is Mr. Sameer Goyal from Alchemy.

Sameer Goyal

Yeah, right thanks on the revised matrix, which is much improved one. One question on the new matrix which we have given on revenue by industry, just to know a little bit on the trend side how is the BFSI space moving, it seems like what I have the belief is that the BFSI space as a percentage of total revenues has declined as compared to last year?

Vineet Nayar

I do not think the BFSI as a percentage has declined over last year. I don't have the data in front of me, but my gut feel is that it is not the right observation, the BFSI numbers has been going up, but from a overall trend point of view, the BFSI because of these large size of the industry is going to grow at slower rate compared to the smaller segments like the retail, the telecom, the media publishing, and the life sciences because they are smaller segment from a percentage growth perspective the smaller segments will grow faster and also media publishing and life sciences and retail are three areas where the offshoring has not been significant. In the banking and finance, not only the offshoring has been significant but also there is a captive center scenario, which has crept in the last two years, whereas in these three places we expect much much higher growth.

Sameer Goyal

Just couple of thoughts on that, actually in the data book which you have given during the analyst meet, the BFSI has shown a contribution of 26%, while in September 2006 you show at 22.8, so it seems like it has been degrowing or it has rather been recording a slower growth rate. And on the statements what you made that BFSI could record lower growth rates is contrary to what we have been seeing in case of Infosys and TCS where this segment has been in the fastest growing segment in terms of growth.

Vineet Nayar

Yeah, so there is one change in our reporting. The data book which you saw was only for IT services. This data book is not only for IT services, but for all our services combined, and if you look at only for IT services, the data book was it is 26% is the BFSI revenue which is at about \$67 million and it has grown. Now when I said I was talking about percentage growth basis on BFSI. From an absolute point of view BFSI is the largest growing segment. So let me explain to you what we have done. BFSI from an HCL perspective even at 26% is much lower than the industry standards where BFSI contributes anywhere between 35 to 45 for various our colleagues in the industry. So what we have done is we have taken three steps. #1, we had changed the head of delivery of the organization, so you have seen our announcement of Harsha Mutt has moved from Infosys to HCL to head the capital market. Then we have Vish, I think he has moved from TCS to head our retail banking. We have changed our head of sales in US, who has moved from Patni and

who was head of BFSI in Patni, and we have added close to about 18 more senior solutions and sales executives in US and Europe alone in BFSI, and we have hired a consultant on the BFSI space to help us explore that market because we do have very serious intention of getting into some of those large deals which are already existing with some of our colleagues. So the result of that is that amongst the top 5 investment banks, 4 work with us today, which was not through a year ago, and you will see similar steps happening on the retail banking side and similar steps happening in insurance side. The capital market last year was a very big success for us in getting into account we were not present.

Sameer Goyal

So that was the only reason actually I just thought that HCL is one of the leaders in terms of capital market success, so why not that success be repeated in BFSI. Okay fine, thanks a lot and best of luck.

Vineet Nayar

Thank you.

Moderator

Thank you very much sir. Next in line is Mr. Nithin Gupta from Karma Capital.

Nithin Gupta

Good morning gentlemen, I just wanted to know how you are seeing the competition from captive BPOs in the BPO space and what is the trend like?

Ranjit Narasimhan

Captive BPOs is obviously by nature and not competition and the growth in BPO..., currently as we stated earlier revenues from Indian operation have been growing it 59% on an annual basis and we shall continue the sustain the momentum of growth.

Nithin Gupta

Okay are the salary hikes over for this year or are you going to take some more salary hikes?

Shiv Nadar

Vineet just answer this question, I will repeat this for you; 85% of the people the salary hike date fell on 1st July, and 15% of the people falls on 1st October.

Nithin Gupta

And this is for the managerial level or entry level?

Shiv Nadar

There are of course many levels before managerial and entry. This covers the entire spectrum in terms of number of people, for 85 on 1st of July 15 by 1st of October.

Nithin Gupta

Okay and my last question is related to your billing rate, what is the trend like on a year-on-year basis on the billing rate front, I think you had mentioned 8% or something like that.

Vineet Nayar

The point which I was mentioning in this previous question is that billing rate we have seen significantly move up in the last one year largely because of the three strategies which I articulated, and we are working very hard to make sure that the billing rates move up further because we believe there is scope for moving up and we are working on it. That is the impact I had given on billing rates. I do not have a specific number for you, what is the billing rate to go up, all I am saying is given the actual data on the table on are absolute billing rate, there is a scope, more scope with HCL than just in the rest of the industry.

Nithin Gupta

Okay, thank you.

Moderator

Thank you very much sir. Next in line is Mr. Sandeep Shah from Motilal Oswal.

Sandeep Shah

Sir in this quarter we had a salary hike, apart from that the offshore revenue contribution has also gone down, the utilization rate both on the offshore and onsite has also gone down, and despite that our gross margin has slightly improved. So can you explain how the gross margins have improved during this quarter?

Vineet Nayar

I believe that the gross margins there are three impacts that I think we explained in the last quarter. The FBT charge, reclassification, where it has moved from one place to another, there is a shift towards US and Europe from Asia and there is a higher visa charges which happened, which was large in April-May-June, which were not there to a significant extent in July-August-September. These are the three factors that helped us maintain the gross margins where it is.

Sandeep Shah

Okay and sir just related question to that, our software revenue growth, core software revenue growth is around 10% but our volume growth is around 5.5%. So can you explain the difference of 4.5%?

Vineet Nayar

Which is identical answer, the utilizations are going up, our billing rates are going up, our model of more risk reward is less linked to employees because of which we are able to get more from our employees compared to what we were, and this is not only for this quarter this is consistently what you have seen in the trend over the last one year and hopefully we will be able to demonstrate over the next one year. If you consistently see over the last one year we have been able to grow our

revenues more than effort. It started with July-August-September of last quarter and consistently followed the last five quarters.

Sandeep Shah

Okay, but sir the utilization has gone down actually this quarter?

Vineet Nayar

That is because of the fresher intake.

Sandeep Shah

And what would be your take in terms of the efforts man months billed, do you believe that risk reward ratio the trend which we are seeing for the last 2 to 3 quarters will continue in future where the effort bills will be lesser but the revenue growth will be higher?

Vineet Nayar

This is what the attempt is. You know if you go down and look at the absolute numbers, which are now in front of you, there is definitely a scope of improvement from an absolute point of view, we are not the highest in the industry, so there is a significant effort being made within HCL on trying to see if we can up the revenues and not increase the billable people at the same rate, because there is a scope to do that. Now we have been successful in doing that for the last five quarters. I can only say we will continue to make that attempt. I don't have a promise for the next few quarters, but that is one huge area for focus for HCL because we see a huge opportunity there. Would we succeed? I don't have an answer for you right now.

Sandeep Shah

Sir on the tax rate do you believe it will stabilize at current rate or there would be some increase going forward?

Anil Chanana

The tax rate last year was 7.5% and this year current quarter is 8, I think it will go up to 10%.

Sandeep Shah

10%?

Anil Chanana

Yeah, as the units come out of 10A.

Sandeep Shah

Okay, so for the year as a whole we expect 10%?

Anil Chanana

Yeah.

Sandeep Shah

Okay, thanks.

Moderator

Thank you very much sir. Next in line is Mr. Vivek from Standard Chartered.

Vivek

Hello, good morning sir.

Vineet Nayar

Good morning.

Vivek

Just a couple of questions. First I understand you cannot have a specific figure as to the billing rate or how they have moved up in the last quarter or so, but as far as the margins are concerned do you have a specific target in mind for the year as to say 21.7 or 22 or this is the number that you would want to maintain for the next 2 to 3 quarters, any internal target or something like that?

Shiv Nadar

I thought Vineet has already this question that so far as the gross margin ratio as in EBIDTA margin to the net income ratio is concerned you may notice that there has been a marginal decline. EBIDTA margin and the net income margin, whereas the gross margin has actually stacked up despite the increase in direct cost and over price that has gone up a little bit. It is expected that we would stabilize that around the last year's rates when the full year went out.

Vivek

Okay, and just one more question in terms of deal pipeline do you have any specific number or any number of deals or size wise that you are targeting or pursuing at this point of time, anything that you can.

Shiv Nadar

Not much of data, the advantage would be we will deal with data and not with projection.

Vivek

Okay, right. Just one last question on the BPO front, if I am right then the India part have grown by 59% QonQ, YonY?

Ranjit Narasimhan

59% is growth year-on-year.

Vivek

This is a higher margins business as compared to the global BPO business is it?

Ranjit Narasimhan

That is right.

Vivek

Then again in this quarter there has been a marginal decline in the EBIDTA for BPO, any specific guidelines as to why?

Ranjit Narasimhan

Yeah, you would have observed that this quarter we have had the highest amount of net head count addition of 1769, and in BPO normally there is a lag between the recruitment and billing since you are training for about 8 to 10 weeks, so the billing happens about 8 to 10 weeks after the people join the company, so this addition of 1769 people will get in the steam of revenue in the future quarter.

Vivek

So as of now this is mainly because of the training, and because this was basically the training part that they were going through the fresh, the new recruits?

Ranjit Narasimhan

There is always a lag of 8 to 12 weeks since the time the person is recruited to the time he gets billed.

Vivek

Okay, thank you sir. Thank you very much. This is all from my side.

Ranjit Narasimhan

Thank you.

Moderator

Thank you very much sir. Next in line is Mr. Ruchit Mehta from HSBC Asset Management.

Ruchit Mehta

Hi, good morning sir, and congratulations on results. Sir, I was just wondering what is your outlook for tax rate full year?

Shiv Nadar

It is a question which I was dreading that somebody would ask because we have stopped giving guidance for a while and we thought that we will make sure that you have all the data so that you can make that projection and please allow us to stay that way.

Ruchit Mehta

Okay, sir also on your employee hiring plan, any indication as to how the hiring is going to pan out for the next 2 to 3 quarters and what is the sort of if you can share the number of offers you have made for FY08?

Shiv Nadar

The expectation is that overall hiring for the year would be somewhere between 8000 to 10,000 people that is what is the expectation.

Ruchit Mehta

Okay, thank you sir.

Shiv Nadar

Thank you.

Moderator

Thank you very much sir. Next in line is Mr. Girish from East India Securities.

Girish

Yeah, I just wanted to know you had this gross margin expansion quarter-on-quarter in your core software. Can you give the mix, I mean what is driven it in terms of pricing or offshore, I mean what are the different elements which have contributed to this gross margin expansion?

Vineet Nayar

I think I have already answered; it is the changing geography mix. If you see US has grown 14% QonQ, Europe has grown 12% QonQ, and Asia has gone down. The enterprise application, which is the SAP practice, which is the larger gross margin compared to the core application for us has gone up 22%. Engineering services has gone up 11% QonQ, and infrastructure has gone up 17% QonQ. So all these are contributing to the quality of revenue improvement and as the quality of revenue improves the gross margin impact is already there as a service mix changes. Both _____ as services point of view.

Shiv Nadar

I will just add one more factor here. You know we have been maintaining, this is one question which has been coming quite repeatedly since large contract which HCL gets into do they reduce the margins? We have always been saying, no it does not reduce the margins. We never said actually it increases the margin, that is the truth. Now the revenue from these large deals takes a few quarters to kick in. If you have noticed last two quarters we have been growing at a higher rate

than industry. We have been in the No. 2 and No. 3 in the industry, that is because the revenue from the large deals have started kicking in. Typically, the margins in them also turn out to be higher in our case because they are multi service deals. This I believe is the reason why there is some margin expansion you will notice.

Girish

Yeah, I wanted quantification in the sense you have the salary increase coming through and I believe the geographic mix change is basically price related, so if you can quantify this salary related down take and the price related uptake in the margin expansion that would help.

Shiv Nadar

We will try and do that for you and Mr. Chanana is noting this up. Would you give your name again so that we will have it sent to you?

Girish

Okay, thank you.

Shiv Nadar

We have your name and we will have it sent to you.

Girish

Okay.

Shiv Nadar

Anyone of you who have quires of this nature please feel free to raise them with Vikas. Vikas is actually on the call, he is noting this down, and even there is plenty of them you can always reach him and he will make sure that you get the response.

Moderator

Thank you very much sir. Next is a follow up from Mr. Hitesh Zaveri of Edelweiss.

Hitesh Zaveri

Yeah hi, my question is about the employee increase. You know the number of employees as compared to the last year are by about some 37%, however, the employee increase in the IT services is roughly about 22% year-on-year basis, you know lying severely. Do you have any view why whether that will change when you add the employees in the next 12 months whether this ratio will be in line with the overall numbers?

Shiv Nadar

Yes, I will respond to you because it is a mix of the services.

Hitesh Zaveri

Sure.

Shiv Nadar

BPO services saw an increase in Ireland during the course of this year and a large number of people who are in contracts were converted to the employees in Ireland. In India when we grew 59% year-on-year it had a very sharp increase in manpower. Now next year going forward there wouldn't be any corresponding increase in Ireland because Ireland has reached its full capacity more or less, so when there is not much of increase there only the India increase will take place and there would be an increase that will take place when the other service offerings in software as well infrastructure. So the proportion of people increase would be altering during the course of this year, more weighed in favor of infrastructure services than software services, which are IT services.

Hitesh Zaveri

Sure, actually what concerned me little bit is the growth in the technical employees in the IT services on a standalone basis, which is up by only 22% on year-on-year basis and a demand scenario which is described as very, very positive.

Shiv Nadar

Just give me a second I will respond to that. See BPO services when we say total offshore technical, that the technical word does not mean like what we mean in software. In software what we mean is fully qualified engineers or people who are engineering qualification; whereas in BPO, technical means people who respond to technical help desk kind of work and it does not mean all of them are technology people. The answer is you know for your sake of comparison just ignore this word technical.

Hitesh Zaveri

Sure. Sir actually it is more rather than comparison it is more about the standalone IT services actually.

Shiv Nadar

Yes.

Hitesh Zaveri

Rather than I was not putting too much emphasis on comparing the growth rate versus BPO industry employee growth which continue to be impressive. On a standalone basis, the IT services employee growth is at about 20 odd percent roughly half of what your overall growth is and so the standalone number growth I thought is below expectations.

Vineet Nayar

Yeah, see I think I answered this question early on this call where I said that if you look at our utilization level at beginning of the year and look at our utilization level at the end of the year there was a huge inefficiency on utilization and that is resulting into a lower number of manpower addition compared to the revenue, but going forward we expect the revenue and employee addition to more

or less be similar and at the same time we will keep attempting to increase the revenue higher than the employee, but it will not be to this extent.

Hitesh Zaveri

Sure, that helps. My one last question is about your industry revenue break down, the high tech manufacturing and telecom combined they roughly account for about 48% of revenues, as a portfolio you know 48% coming from this, how is the outlook there could it lag the overall services these two verticals or they will be in line or they will be marching forward?

Vineet Nayar

I think you know I will give this another cut to look at it because if you look at standalone for IT alone, high tech contributes to 36% and it is up from 25% in December 2005, so that means that the high tech segment is growing quite dramatically, and because of the BPO British Telecom deal, the telecom sector is at 17% whereas from an IT services point of view it is only 9%, so from IT services point of view we have what I call a 45% between high tech manufacturing and telecom, and because it is 9% from telecom there is a huge upside because for everybody else telecom contributes 13 to 14%, so I see a huge upside in telecom, I see good growth rates in high tech and manufacturing from an IT services perspective.

Shiv Nadar

Ladies and gentlemen, we will take one more question because as it is has been announced we have to appear on CNBC Boardroom exactly 5 minutes from now.

Moderator

Okay sir, we will take a last question that is Mr. Aman from Reliance Mutual Fund.

Aman

Yeah, thanks for this. I believe over the last one year our success at the big deals have been very good and also the sales cycle for this is quite large. If you have to just compare how the pipeline now looks like after having had a very high share of success over the last one year, if you have to compare the pipeline today as compared to what it was last year, any comment on that.

Shiv Nadar

It is a nice question to wind up with, before that I will put a qualifier. All of you may have questions because this time we have provided a lot of data, upon analysis if you have further queries please send them to Vikas and Anil and they will respond to each one of your queries. Your answer is very simple; it is one word, the pipeline looks robust.

Aman

Sure, thanks a lot.

Shiv Nadar

Thank you.

Moderator

Thank you very much sir. At this moment I would like to hand over the floor back to Ms. Parul Inamdar of Prabhudas Leeladhar for final remarks.

Parul Inamdar

Thank you sir for giving us the opportunity to hold the conference call on behalf of the company and we wish you all the very best for the future.

Shiv Nadar

Thank you.

Moderator

Ladies and gentlemen, thank you for choosing WebEx conferencing service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you and have a nice day.

NOTE:

1. Blanks in the transcripts represent inaudible or incomprehensible words.