“HCL Technologies Earnings Conference Call”

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Moderator Ladies and gentlemen good day and welcome to the HCL Earnings Conference Call. This is Rochelle the moderator for your conference. Please note that for the duration of this presentation all participant lines will be in the listen-only mode and this conference is being recorded. After the presentation there will be an opportunity for participants to ask questions. Should anyone need assistance during this conference call they may signal an operator by pressing * and then 0 on your touch-tone telephone. I will now hand the proceedings over to Mr. Vineet Nayar, thank you and over to you Mr. Nayar.

Vineet Nayar Good evening, good morning ladies and gentlemen on behalf of all of us at HCL, I wish you a very happy New Year. Welcome to our quarter two results announcement. I am joined here with my colleagues Anant Gupta who is the President of infrastructure services and also the head of public services. Steve Cardell who is the President of enterprise application services, Anil is the CFO of the company and the entire IR team.

The results for this quarter have been on the lines of what I think the street expected, backed upon a 9% sequential growth last quarter we have delivered 7.5% growth but I think what is important to see in this growth trajectory is two points, one is 7.3% fourth quarter CQGR and also the fact that if you take calendar ’10 over calendar ’09 and do a three year CAGR compounded annual growth rate you will come to a number of 24% so we have delivered compounded annual growth rate over three years of 24% and when you compare that with some of our other peers in the world you would see that the growth rate has been significantly higher than our peers. So, that is where the HCL’s growth story is and it continues to be robust and strong.

One of the things which you would see from a service line perspective and we will talk more on this is that I have been talking about the growth rate driven by discretionary budget and growth rates driven by run the business. So, the custom application growth rate story continuous to be strong and because that is going hand-in-hand with the infrastructure growth story, so both those businesses are doing very well and they are largely driven towards run the business. The change of the business growth story is about 6% sequentially which is both the enterprise application and the engineering services. You had GH Rao talking to you about the engineering services in the last quarter and I have invited Steve Cardell to talk to you about the enterprise application services and his take on how discretionary spend is moving and I have invited Anand to talk about how do he run the business spend is moving.

With Backed on a 5.7% growth in BPO services last quarter, we have registered at 2.8% growth again in BPO Services and we will talk a bit more about that, I am less concerned about revenues in BPO, I am more concerned about the transformation which we need to achieve and therefore there would be churn of revenues where we would replace the current contacts in the revenues with more platform based services. So, in the next four quarters, which is what we have guided on BPO, we would continue to have $6 million loss per quarter and profit would be in JFM 12. But more than and the $6 million loss is driven by 3 components, number one our investment in platform which we continue doing, we had a budget of $30 million which we are spending in creating those platforms for BPO. The second is driven by partnerships which we announced last quarter with publishing platform company and that resulted into $100 million deal in the publishing space which is the first success we had with partnership which is now on a revenue share basis and we will announce similar partnership on platform based services where we do not have to develop the platform but we buy in or enter into an agreement on a revenue share basis with platform based companies so that we can offer those services to our customers. And the third area would be the churn of revenues as I talked about the fact that we would disinvest or shut down some of the businesses which are not of strategic nature within this and replace them with platform based revenues, but all that would be done over the period of the next few quarters and we would be done in these four quarters and we would A, declare profit in JFM 12 that is our expectation and B, the losses in these four quarters would be $6 million and we do not expect that to go beyond the $6 million. So the revenue growth in BPO for the next four quarters, inconsequential and more is the margin profile and the revenue mix.

From a vertical point of view we have continued to see a very good growth rate on retail and CPG and we will talk about the GEOs and interlink vertical with GEOs to able to see why CPG and retail is growing and largely coming from the Americas .

We also see a very healthy growth rate in healthcare and healthcare at 55% year-on-year growth that means HCL's relevance and healthcare is fast increasing and the good news at which we have arrived is also 40% year-on-year growth rate on manufacturing so if you see the last four quarters the manufacturing growth rates have been very good which is indicating to recovery in base economy and also indicating to continental Europe performance coming in. So, the growth is back by actually manufacturing, retail, CPG and healthcare and energy and utilities have started improving on performance in the last two quarters and Steve will talk about why that is happening when he puts a GEO mix on that. Now, since Steve is here it is better that we get to hear the Geo commentary from him. Steve can you share what is happening on the geography side and what the growth rate is and why are the growth rates what they are.

Steve Cardell Sure thanks Vineet. So, what we have seen this quarter and we began to see this in the quarter before is a very interesting divergence between our three main trading blocks that we report on. So, a year ago the fiscal strategy being deployed by the United States, the Euro Zone and the emerging Asian markets was very, very consistent and what we have seen over the last six months is that those three trading blocks have now taken very divergent fiscal policies.

So, the Americas are continuing with stimulus investment with constant easing and so what we have seen in the Americas is a consumer led spend going on, we see discretionary spend emerging there and that is flowing into some of our verticals, so there is federal money going into utilities for smart grid and also into certain public sector and initiatives particularly around infrastructure and we also see that flowing through into retail and hence consumer spending and we see the growth there.

Europe on the other hand has taken a very difference stance, so beginning about six months ago we have seen one by one major European economies putting in their austerity measures and driving substantial cost reduction through government budgets which is then flowing into the private sector. So, what you see from our point of view is that certain propositions particularly around cost efficient run the business which has not been open to us in the past is certainly coming into the open, so whilst there is cost reduction it is generating opportunities for us and you can see the growth we have had in Europe over the last two quarters and we see potential there.

The rest of the world has continued with quite a loose fiscal approach and so what we see there is absolute growth projects, so expansionist projects that are going on. Asian companies are getting ready to be fully able to compete on the global stage; we see revenue based projects going on there. So, although we have had growth across all of the three GEOs the reasons and drivers for those growth and this last quarter have been entirely opposite and the verticals and the service lines that have seen growth in each of those three GEOs has become quite different. So, I think looking forward we will see some similar trends but it will remain to see how fiscal policy develops as well those trends remain through 2011.

Vineet Nayar Anant do you have a comment on that?

Anant Gupta Yes I think most of it has been covered by Steve but may be just two points. One in the public sector space, we are seeing significant growth in the travel transport and logistic sector, so whether it is railroads or airlines and the logistic sector itself we are seeing some fundamental changes in there which is driving both discretionary spend and then the subsequent operations around the business. Second, the rest of the world, while the Asia Pacific story continues to be strong, we are seeing an emergence of markets especially in Brazil and South Africa where we believe that they will have a much faster growth going forward, so these are just the additional points.

Now, coming specifically to the infrastructure services performance, I think we had another quarter of good performance. Revenues were short of $200 million up 9.4% QoQ and our EBIT grow 11.6% on a quarterly basis and 53% YoY. We were able to expand the margins by 110 basis points during the quarter. If you look at the demand side this is something that we have been maintaining it is really been the total market is pretty much has been kind of same, so our strategy really has been and trying to increase the addressable space for HCL so we continue to see significant win rates improve and what we call the second generation outsourcing deals which is largely moving business away from traditional outsourcers but kind of contracted in the early 2000. Second is obviously a much larger invitation from the sourcing advisor led engagements. Thirdly the integrated operation deals which has been a good story for us in the last couple of years it is now getting further enhanced with the managed hosted or managed ERP solutions which we are now seeing, so it kind of ties in with our expertise in the EAS space as well as our hosted infrastructure services at a joint proposition. If you look at some of the there is a lot word around the cloud and therefore dealing with large enterprises we are seeing that we are getting pulled in into actually helping them re-architect some of their private infrastructure and this is around whether it is consolidation or network restructuring or if you look at even end user computing around the fact that a lot more mobile devices are now coming into the workplace, so managing all these in a workplaces obviously creating a much higher demand for compliance side of IT

If you look at some of the strategies which we have successfully been able to invest and see some early signs. We have launched couple of new business models, one around shared services and second is really things around as a service, so we had launched what we call managed tools as a service three years back, we have got good traction, good customer base over there, we have taken that to the next level where we have included a layer for enterprises where they can manage the diverse public hybrid cloud that they will be going into in the next 3 to 4 years. Likewise we have launched a very strong portfolio of solutions around smart grid. This again we believe is, in different markets and will be in a different phases, so if you look at the developing markets it may just be setting up the base to put the smart grid framework while if you look at developed markets it is around increase in consumer experience, so I think around both these things, the smart grid solutions that we have, have helped us to increase some of our wins in the utility space especially electricity and in fact if you would see some of the recognitions we have got it will be kind of recognize as a leading player on the smart grid managed services offering and just one other firm in the globe. The other key aspect I think which got recognized by the industry is our zero defect in transition and the fact that we have very strong governance and account management structure. With that I will hand it over to Steve.

Steve Cardell Thanks Anant, so let me just run through the same overview of enterprise applications. One of the priorities for us in this quarter was to ensure that the market was aware of the capability that we have been building over the last year. And that the integration of the Axon acquisition with HCL's EAS Business that we have integrated internally that we ensure the market understood the proposition that was available. And so one of the things that we were particularly pleased within this quarter; is the three main analysts who review the SAP markets, so Gartner, Forrester and IDC all ranked HCL in the leader's quadrant. So for Gartner there are only five competitors in that leader quadrant, we are the only one of our peer group to appear in all three leaders' quadrants and for IDC we came third this year behind only Accenture and IBM in the market. And that is a key platform for us going forward, there is recognition now that we are leading player in this market and we want to use that to move forward in building our market position. Solid growth performance in the quarter 5.5% and as I talked earlier about the geographic view we pretty much saw Europe and the US are growing at similar levels within EAS but for very different reasons and a greater growth rate in Asia Pacific again for the reason that I have talked about earlier. We certain saw that growth come from particular segments so we saw strong uptakes and utilities in consumer and in life sciences and healthcare, either due to infrastructure spending going in or through long term cost reduction strategies for existing long term uses of either SAP or Oracle who are looking to move onto a single global platform and typically through a single instance. In terms of some of the developments that we have moved on in this quarter one is looking more about how we recycle solutions that have been built, so building platform or quasi platform solutions that allow us to implement faster with more repeatability in a number of core markets rather than we have seen that again for example an insurance and utilities that the solutions are very common company to company and we have been building those out and also continuing on our roadmap development with the ICARE product which is a solution for utilities industry that allows billing information and customer services information to be deployed down into iPhone and iPads and similar handheld technologies that puts control of the accounts into the hands of the customer.

The other trend I would highlight is that there is continued strong growth in the BI space, both across Oracle and SAP and that is partly around new releases and new functionality but more than that it is around the trends we are seeing for usability and mobility, so pulling together those two things making BI highly interactive and deploy down into various forms of handsets and mobile technology and I think we will continue to see significant growth in that, during 2011.

Anant Gupta So, it is coming to cloud, this has been a subject which is kind of in the industry or in the market quite a bit. We thought it would be appropriate that we introduce what is HCL doing in the entire cloud space, so we have obviously been waiting to kind of walk the talk before we kind of present our strategy, so if you really see we have about 35 plus customers who we believe are early adopters with us on their cloud journey. Our strategy is very simple, essentially we have divided our focus area into our sweet spot which is the enterprise market and where we have introduced services around assessment followed by implementation and then of course the operations and management. So, the first two blocks on the slide really depict those services over here and where we are kind of helping various customers and looking at how they could build and adopt the philosophies of a cloud operating architecture into their private enterprise and then look at utilizing some aspects of public cloud in their hybrid strategy as well. So, you know some companies that we are working with are in the leading airlines or whether it is a high tech manufacturer, these are companies we have been engaged within the assessment and one of the reasons why we have advantageous position in being able to do this is when you do run the business whether it is application or infrastructure or both we have a much higher visibility into how these two are really performing within the enterprise, so we have a natural advantage in kind of advising our customers on the best way to move forward. Subsequently, obviously where customers have taken a decision to move forward with their private cloud implementation we obviously then get into the implementation cycle and we have listed a couple of customers and specific use cases over there.

The other market which is diverse from our core market which is the enterprise space is really being able to provide a full cloud stack application on to the infrastructure along with the various services around it and our focus really has been to explore or do pilots with market which are around industry clusters. So, not go to the small and medium business directly, but how do we create an ecosystem with industry clusters so that we can offer an integrated into an offering for this market. So, specific PUC where we are already engaged with in is really providing a hosted ERP stack for small and medium clusters, which obviously will then grow into other modules around the core ERP itself.

Some of our unique investments and intellectual properties, if you really start from the lowest point which is Cirrus it is really a framework which we have evolved for helping enterprises migrate their private to a public cloud or a hybrid model. Nimbo which is really helping customers enable the cloud especially on the provisioning and orchestration side, so once customers have standardized, consolidated, and virtualized then the next layer really is the orchestration and we have a very strong suite of IP over there which we have build in into our framework. Finally, the third element being Agora which is enabling ISVs to create a multi-tenant SaaS offering for the customers, we have a couple of customers where we have taken this service to the market. **MTAS** I talked about which is really managing the entire IT infrastructure which is now being built or kind of overlaid with our service management layer called My Cloud Control, so these are five modules which are tied with each other to kind of help customers, where we can not only migrate them into a hybrid cloud but also manage them on a sustainable basis over the course of the lifecycle.

Very specifically a few seconds on the POC we talked about which is for a small and medium cluster of exporters roughly about 50,000 exporters is the kind of overall outlay in terms of the potential where we are kind of offering this whole solution end-to-end for this cluster, so obviously we are working with industry underwriters over here who help us to take this to the market and kind of protect us on some of the downsides if at all there are any. Now, I will pass it onto Anil.

Anil Chanana Thanks Anant, here is the snapshot of the results for this quarter, the previous quarter and the corresponding quarter last year. So we did this quarter 7.5% quarter-on-quarter growth in revenues followed by 9.5% growth in EBIT and 24% growth in net income and SG&A as a percentage of revenue came down and gone up to 15.4 in July to September quarter but came down to 15.2% in October to December quarter. This growth has been a volume lead growth so you can see that this growth of 7.5% in revenue terms comes on the back of 9% growth last quarter so it is a volume lead growth which peaked to almost 11% and currently is at 7%. If you look at the chart below which states the utilization the onshore and the offshore utilization which is excluding trainees, we are currently at, we had peaked up at 79% in JFM but currently we are at 75%, so we have a room to grow further here. So, where is this 7.5% growth coming from? As I said it is volume lead, so out of 60 million, 52 million came from volume and 1% which is 8 million came from exchange, the major currencies which lead to this increase have been the Euro, the Australian dollar, the Singapore dollars meaning the Asian currencies. So you have seen us sort of a reporting good growth in Europe as well as in the rest of the world.

If you look at the margin analysis, if you look at the EBIT level, there is a growth of 20 basis points while at the net income margin level there is a growth of 135 basis points.

So, let us go down and see that the exchange this quarter impacted our numbers, our EBIT numbers by 58 basis points and had this not happened, we would have grown by 82 basis points in EBIT margin, which primarily came from the operating efficiencies, the SG&A reduction being one of them and the net income level we were helped by the lower hedge losses, the other income impact and of course slightly offset by the higher tax charge this quarter.

This slide shows the movement in the October-December quarter vis-à-vis October-December 2009 quarter, so in this period you see a very significant sort of a movement but I would like you to focus on the movement which is outside of exchange, so on EBIT we had lost 170 basis points but on the net side we gained 223 basis points. I will just continue with the EBIT margins slide, salary increase took away 280 basis points and the utilization took away 120 basis points. However, the operating efficiencies and lower amortization had helped us. Essentially you can see that the operating efficiencies and the lower amortization to a significant extent have been able to offset the salary increase and the lower utilization we continue to carry the lower utilization. You will see the benefits coming in the future quarters.

I take onto the next slides, how are we doing on the cash flow from operations, so on a rolling two year basis, I mean though there has been a movement between quarter-to-quarter or between year-to-year but on a two year rolling average basis, we have been able to convert 100% of the net income into cash flow from operations.

Well, how have we done this year, so this is very interesting slide, if you look at or CY this particular quarter, October-December we have been able to convert 90% of our net income into operating cash from operations. While for CY10 which is calendar year 2010 this is 92% slightly higher, shade higher. For some of these figures which are circled, I am going to explain where these changes are coming from in the operating cash flow.

Moving further we have the investing side where we are setting up campuses we have the assets for running our business, so we are currently creating 13,000 seats, something like 1.5 million square feet of area. I mean the investment on property and equipment has increased this quarter. However, we maintain for the full year we will be in the range of 160 million of CapEx. Another highlight point here is the dividend you see 44 million in as outflow on account of dividend which reflects the final dividend for fiscal 2010 and the first quarter dividend of FY11 which was 26 million so both put together coming up and lumped in one quarter.

I go on further and in terms of cash flow you had seen two line items which were the adjustments made to the net income, deduction of the net income by 21 million in JAS quarter and 8 million in October to December quarter, so we have a foreign currency loan which we use as a hedge against the receivables on our balance sheet and the impact, under the US GAAP is required to be sort of a not taken here but taken under a very different head so that 1.8 million is that and increase in the deferred tax asset again is required to be adjusted here, so these two adjustments lead to 8 million reduction in our cash flows.

Look at the account receivable increase, so while the increase in revenues in the last two quarters has been 66 and 60 million respectively. The increase in AR as a percentage of the increase in revenue which typically if we maintain the number of days will be 100%, so it is much less, so it is 55% and 38% since we have reduced our receivable in terms of number of days from 82 days in December '09 to 77 days in December '10.

I just took the balance sheet so that I could explain some of the major movements which have taken place in the asset side and also in the liability side. So, you see the other current assets, the current and non-current portion, which totals up to 495 million this quarter and which was 460 million a quarter before. There is increase of 35 million which increase is coming due to increase in inventories, the system integration projects we are executing for which the billing is to happen but for which we also have corresponding sort of advances from our customers. The interest accrued on deposits, which is not due as yet which will be payable when the deposits come off our payment. The deferred tax asset, the prepaid as advance taxes and then there is a reduction in the deferred cost which has been adjusted here.

I move onto the liability side you see the current liabilities, the current and non-current portion aggregating to 873 million which is an increase of 23 million; this is primarily the taxes payable and some increase in the accrued employee cost but has been offset by the reduction in deferred revenues and other line items. So, I talked about the bills receivable, bill receivable has come down from 82 million to 77 million and it has primarily, in this quarter it has been the decrease in the unbilled receivable which was at 19 days as of September and it is currently at 16 days. So, as a footnote I have indicated why these unbilled receivables are high because different billing cycles, milestone billing in the fixed price projects or there is a requirement to meet the customer's specific requirement, I mean if the customer has a specific requirement we have to meet that before we can bill the customer. So, there is a very tight control so far as the wherever the billing has happened, we are able to collect and also on unbilled part.

The funds position, we have half a billion of cash on our balance sheet and our loan liabilities are something very similar 580 million. On the treasury and other income, treasury return is 7.8% while the cost of our loan is 5% so there is a very marginal arbitrage opportunity which is 1% and I provided the schedule of the debentures we raised as well as the foreign currency loan when they are payable. Going onto the deferred revenue and deferred cost, the deferred revenues are 216 million as of September. They have come down by 8 million, the deferred cost have come down by 7 million, we have indicated the various line items which give rights to the deferred revenue and this is the way we have been accounting and we have been accounting consistently, so these are the fixed price contracts or the annual maintenance contracts, where the billing is done is advance but the revenue recognition is deferred. The transition services which are recognized over the steady service period, the multiple deliverable projects, where the accounting is recognized based on the fair value for the part of the contract which has been delivered.

I go onto the hedge position, we continue with our hedge policy that our hedges at any point of time will not exceed, net inflows for the next two quarters with hedging tenure not to exceed one year. We use simple hedge instruments, so we currently have 256 million of hedges and fortunately the hedges which were taken three years back are all over and we now have a new hedge position and most of our hedges are options and forwards which are 35% of our total hedge position and you can see the booked rate the mark-to-market rate which has been applied. So we are currently not carrying any hedge losses in our balance sheet. So, whatever is there has been already been flown through the P&L account. So, these 256 million of hedges cover our cost of 60 days of inflows, though tenure goes up to 1 year.

I talked about the ForEx loss, so this quarter there was three million of Forex loss for cash flow hedge accounting impact which are sitting in the balance sheet has come out passed through the P&L account, there are M2M the restatement of assets and liabilities, which is less than a million, so 3 million has been passed through the P&L this quarter. We carry the other comprehensive income on the balance sheet a positive amount of 2.8 million, so now we are back to the normal cycle, so I have not given any split over quarter-by-quarter. Tax provision this quarter has been marginally higher from 20% to 20.5% we have given you the guidance which is stated here.

The board this quarter decided to increase the dividend. This is the 32^{nd} quarter of consecutive quarterly dividend so for the last 8 years we have been giving dividend on quarter after quarter and so in last quarter you had seen the board stepping up the dividend from Rs.1 to Rs.1.50 paisa and in this quarter it has been decided to further step it up to Rs.2 and so this dividend is one-third of the net income which will be distributed to the shareholder, so we continue to follow a liberal approach in terms of dividend payouts.

We have stock options which are outstanding, which is equal to 4.3% of the capital of the company. In quarter two there was a charge of 5.6 million and going forward in the table you can see the charge of 5.8 million in quarter three and 4 million thereafter. So, with this I will handover to Vineet.

Vineet Nayar Operator we are happy to take questions now.

Moderator Thank you very much sir. Ladies and gentleman we will now begin the question and answer session. To ask a question at this time please enter * followed by 1 one your touchtone telephone. If your questions are answered you may withdraw them from the question queue by pressing * followed by 2. Participants are requested to please use their handsets for asking questions. To ask a question please enter * followed by 1 now. Our first question is from the line of Vihang Naik of MF Global, please go ahead.

Vihang Naik In the media you had spoken about targeting margin expansion over the next two quarters so I just wanted to understand what is extent that you are expecting, can this be around a 50 basis point margin expansion or can we expect it to be nearer to the historical average margins for HCL.

Anil Chanana Our goal is that by April/May/June quarter we should be close to but not exceed the April/May/June 2010 margins on constant currency basis. This is what we are aiming at.

Vihang Naik Okay and correct me if I am wrong, you said that you will be targeting the two primary drivers for margins going ahead would be your utilization and SG&A so what could be the utilization levels that you could look at over the next quarters?

Anil Chanana It is going to be a combination of slightly more than that. First, utilization would have a play. Second will be we have cost of living adjustments in some of our customers contract which we will get the benefit of. Thirdly, the we will get the benefit of the SG&A optimization also. So all these three factors put together will give us that benefit.

Vihang Naik Right and just one last question I think you said that the pricing environment is still pretty tough and we haven't got the price hike this quarter. So can you put some more color on where the company's competition is emanating from, is it the smaller players or even MNCs?

Vineet Nayar First is, I would like to make a comment on the margins guidance which Anil gave, so that all of you are very clear that for the next two quarters we are going focus sharply on margin expansion and the management intention is going to go to margin expansion and therefore that is you know our internal goals is shared with you. The second aspect is, there is that competition in different geographies is coming from different people. Steve alluded to the fact that his competition is largely is the IBM, Accenture. For Anant in our infrastructure, run the business it is EDS it is IBM, it is CSC and you saw us lose a deal to CSC which was announced in the newspaper and in certain areas like BPO it is a lot of Indian players. It is difficult to nail down one competition. I think for different businesses we have to add that for our engineering business, it is the captives in India which is our competition. So for different businesses there are different competing entities.

Vihang Naik Right, I may come up with for follow up questions later. Thanks.

Moderator Thank you Mr. Naik. Our next question is from the line of Pankaj Kapoor of Standard Chartered, please go ahead.

Pankaj Kapoor My question was on the enterprise services side given that generally the license sales have been recovering as what SAP and ORACLE have been referring in their results. I was little surprise to see not too much of a traction happening especially in this quarter, in this particular service area. So I was just wondering that if you can dissect what we have seen the growth in the enterprise services side may by the currency impact here and what kind of a volume or the price increases you are seeing over here. Thanks.

Steve Cardell This is Steve, just to make a couple observation of that, I think the first thing is that there is always a lag in time being license sales being made by SAP and Oracle in the flow through of services revenue that comes from those license sales. So obviously the highest licensed quarter every year is the last calendar quarter of the year and you will often see companies increase their license amount because they will get the best deals in that quarter. They may not utilize them later in the year. Secondly both Oracle and SAP they enjoy very, very strong license sales in the business intelligence space. For SAP particularly business objects and that leads to different profile of revenue for open a different timing of revenue. In terms of the pricing in the market itself the pricing was stable, so the growth in this quarter was volume based and we see slightly different trends in different geographies but across the board what I would say is that we are in a stable pricing regime at the moment and we will see in the coming quarter where is there is any movement in that.

Moderator Thank you Mr. Kapoor. Our next question is from the line Ankur Rudra from Ambit Capital please go ahead.

Ankur Rudra Thanks for taking my question. Congrats on the strong quarter, good to see cash generation return. Following up on the previous question, could you comment on given discretionary spending environment is improving. So are seeing engagements in enterprise apps and transformation deals lengthening in size and scope.

Steve Cardell This is Steve again, we are seeing larger deals that come around in Europe with a slightly longer procurement cycle but we are seeing some large deals happen there and what we are seeing in the America's is a higher volume of smaller deals which is more the nature of discretionary spend that we see there. So again those two flow in a slightly different ways into our revenue but that is the trend we are seeing at the moment in the market.

Ankur Rudra Thanks. On remote infrastructure, we have noticed that one of your competitors has reported substantially stronger growth in the previous quarter. I can understand it could be seasonality but also there was a large deal loss. May be you comment on the current competitiveness of that service line.

Anant Gupta See if you were to look at our competition space it largely global players. So one aspect is the second generation outsourcing coming from the churn in existing contracts which therefore largely have been with traditional outsources be it global or regional players in specific geographies within the continent. So that is where we see say 70-80% of our competition.

And about comparativeness it is really about the mix of the deals. Our philosophy continues to be that if the deals are extremely asset heavy in nature, we let them go. That is not our sweet spot but if you look at areas where we have been able create a differentiation and some of the points mentioned, it would be around zeroed effect in transition, our track record is excellent, the fact that we are building in transformational engagements as a part of the run the business itself so be it data center migration, consolidation, virtualization, strategies are looking at end user computing labs and I am trying to bring in the mobile devices which is coming to the workplace. So I think some of these areas besides in our management tools as a service are pretty strong differentiator for us.

Ankur Rudra Right just one last question, noticed a very strong growth in rest of world. Vineet could you comment on the nature of what service lines or verticals are driving that strongly, thanks.

Vineet Nayar I think Steve alluded to the fact that enterprise application is leading the growth in the rest of world followed by infrastructure. So these are two are in some of the deals we had announced in this quarter. I think the customers came and shared their names also.

Anant Gupta And if you look at it from the vertical perspective I think some of the public services and utility space from a vertical point is growing, some of the financial markets again in the rest of the world is our growth sector.

Ankur Rudra Thanks.

Moderator Thank you Mr. Rudra. Our next question is from the line of Dipesh Mehta of SBI Caps Securities, please go ahead.

Dipesh Mehta We have seen now focus is shifting towards margin; I just want to understand whether we are now more focused towards margin than growth. Second question is about I just want to understand we have signed 17 transformation deal some details of some of those deals. Third is about margin when we say we expect constant currency improvement in margin, the 6% rupee appreciation which happened during the period what kind of impact we would have on margin considering our sensitivity?

Vineet Nayar For the next two quarters margins will take precedence over growth and management's attention will be towards margins. So that is guidance we are giving number one. At the same time we will deliver industry average growth during this period that is number 1. Number two, your question is the flavor of 17 deals. This was amongst the biggest quarter in booking we have had, if not the biggest ever and the deals, one-third of the deals are enterprise application led deals include component of enterprise application deals one-third of them are total IT outsourcing deal which have the application and the custom and infrastructure and the third of the deals are coming from transformation of engineering projects and some business process in the engineering projects. So that is the basic split of the 17 large deals which we have signed. On the answer in margins, Anil

Anil Chanana To answer your questions on margins, as I said this is going to be in constant currency terms whatever the average rate prevailed in April, May, June of 2010, if we take those rates, these are the rates which prevailed in particular quarter which was October-December quarter, assuming some of these thing would have changed. But it is not only rupees the other currencies as well which are in play. So going forward if these rates continue to be what they are, we would be reporting the 50%-55% margin which I alluded to.

Dipesh Mehta I need two clarifications, what would be the TCV what we have signed for 17 large deals and second what would be your sensitivity of 1% appreciation of rupee.

Vineet Nayar So we are not sharing the TCV data, other than the fact that it has been amongst the biggest quarter on 1%...

Anil Chanana On 1% sensitivity with reference to dollar/rupee of 30 basis points

Dipesh Mehta Thank you sir

Moderator Thank you Mr. Mehta. Our next question is from the line of Rahul Jain of Dolat Capital, please go ahead.

Rahul Jain We already have a very broad based growth, do we have that differential in the confidence of clients across verticals because our checks with some of the peers is that some of the vertical spends are happening but are temporary and may not last long as you know similar kind of stuff.

Steve Cardell Steve here, I will just give you a view on that I will speak on behalf of all of the service lines. I think we definitely saw, in this quarter, differential growth across sectors, one thing that we were pleased on our performance was all of their verticals on which we report saw growth but we certainly saw different rates growth in these verticals and I think certainly, looking forward to the next couple of quarters we will continue to see I think differential growth so what we saw this quarter was consumer utility in public sector and health care posting stronger growth and I think those are areas where we will continue to just see that. Retail consumer really depending on how much discretionary spend remains particularly in the Americas but we have seen growth across all the sectors as you can see.

Rahul Jain So if I may ask something very specific, what is the sense of the spend that will remain in manufacturing or retail kind of industry?

Vineet Nayar I think it will remain strong.

Rahul Jain Okay. Thanks.

Moderator Thank you Mr. Jain. Our next question is from the line of Ashwin Mehta of Nomura, please go ahead.

Ashwin Mehta Hi sir, congratulations on a good set of numbers, just had one question in terms of our headcount addition in core software which has been soft at around 3%, so given the focus in terms of margins would you believe that the addition could actually be softer going forward in the next two quarters and the focus would be on improving utilization.

Vineet Nayar The answer is yes, not in a relative basis on O&D**,** but yes we would be focusing on increasing utilization and hiring less and that is the reason we had this just in time hiring strategy and I had explained to you that we saw an opportunity of lateral of hiring which we accelerated in July, August, September, which led to market dilution. But now when you see most of the results which has been announced the percentage of lateral hires have suddenly jumped quite dramatically which is what I was indicating to you in April, May, June and July, August, September the lateral will be under scarcity. So we have the laterals which we wanted to hire and hence new hiring is going to be less and therefore the pressure on HCL is going to be less. And we would be able to expand our utilization as long as we are able to control attrition.

Ashwin Mehta The second question in terms of lateral hiring we have been hiring for almost 80% lateral so is there a strategy in place to possibly increase the fresher hiring or the proportions towards may be our historical rates of between 50-60%

Vineet Nayar Not in the next two quarters, we will be revaluating and sharing with you our strategy for the next financial year.

Ashwin Mehta Okay. Thanks a lot.

Moderator Thank you Mr. Mehta. Our next question is from the line of Divya Nagarajan of UBS, please go ahead.

Divya Nagarajan A couple of questions could you just give me a sense of what you define is transformation deals in terms of the services involved as well as hurdle rate for revenue please.

Vineet Nayar What was the second part of your question?

Divya Nagarajan The hurdle rates for revenue for you to classify it as a transformation deal if you have any?

Vineet Nayar I have got the size the deal for you to call transformation.

Steve Cardell So this is Steve. The transformation is really determines by the degree of change, that we are looking to execute for the program that we do so we have transformation deals in the infrastructure space, the transformation deals in the enterprise application space and an increasingly what we see is transformation deals that exists across service lines, whether it is a multi-service line proposition. But transformation is really determined by, if the customer looking for a step change in the performance, or whatever part of the operation we are coming into look at. So it is very common place in application deals clearly if it is a Greenfield implementation of SAP Oracle that will tend to be be a transformational program but in same vein we are transformational outsourcing deals and infrastructure deals. The sizes of those deals vary typically between 20 and 100 millions is where most the deals will sit.

Divya Nagarajan Thanks that was helpful and Vineet last quarter you talked about how you have seen the deal pipeline expand in the market place and you would go aggressively after these deals and spend sales and market in dollar. I think we have also indicated that from the 15.5% kind of sales and marketing as percentage of revenue we might see an increase as we aggressively go after deals. Is there have been a change in stance here because we have not really seen that come through this quarter.

Vineet Nayar I think we expanded our sales and marketing $10 million at the drop of the button, when I had made that comment. Frankly speaking that the deal flows and revenues, which we got into this quarter was higher than initially I had expected. So you are looking at it from a BPO's point of view and I am looking at it from the total spends so we had upped our SG&A spend by $10 million. The second is where I got some benefits from BPO point of view that some of our investment in SG&A which is expected to be in this quarter actually got billed to the customer. We were thinking we will do it on our balance sheet but fortunately that got billed to the customer so we got that benefit of SG&A growing into direct revenue that would not be remaining in SG&A. But our going in strategy was the same, we came out with different results but we significantly upped our SG&A in the last quarter. So when I said that our focus is going to be on margins and not deals and growth I was indicating towards SG&A.

Divya Nagrajan Thanks and all the best for the rest of the year.

Moderator Thank you Ms. Nagrajan. Our next question is from the line of Madhu Babu of Systematix Shares. Please go ahead.

Madhu Babu Sir in terms of infrastructure management services the year-on-year growth in revenues was nearly 50%. Going forward what is the sustainability of this growth in IMS and what is the outlook on the margins for the service line?

Anil Chanana This is Anil; we don't give any guidance so excuse us. We don't give any revenue overall guidance or service line guidance what we only show is our results.

Madhu Babu Okay sir thanks.

Moderator Thank you Mr. Babu. Our next question is form the line of Shashi Bhushan of Prabhudas Lilladher. Please go ahead.

Shashi Bhushan Good afternoon sir, in our software services business our gross margin has declined for this quarter despite having lower hiring any specific reason for that?

Anil Chanana This is Anil again, I had explained at the company level there is a 60 basis point impact on account of currency, so outside of currency actually there's been a gain.

Shashi Bhushan So that is the only impact in the gross margin?

Anil Chanana That is correct.

Shashi Bhushan Okay, thanks that is all from my side.

Moderator Thank you Mr. Shashi Bhushan. Our next question is from the line of Mitali Gosh of Bank of America. Please go ahead.

Mitali Gosh Yes hi good evening. Vineet on the BPO strategy that you touched upon in your opening comments if you could just detail out a little bit probably on that in terms of investments you have already done something like over 20 million over the last few quarters. So is one saying that there is another 10 million kind of investments left to be made in this space and also if you could elaborate on the partner strategy and the divestments of some of the non-strategic services on that segment?

Vineet Nayar Mitali, so first is headline news on BPO some expectation is a $6 million loss per quarter for the next 4 Quarters and JFM 12 to be profitable. So whatever I say this is the boundary condition which is very important so whatever I'm going to say going forward will be within this boundary condition. The reason I'm providing this boundary condition is because this is what we are attempting to do. We are attempting to tear down the revenues profile of BPO to largely voice based and grow up the revenue in more strategic services, which is platform based services. So not only we have to make investments in platform based services but as the revenues come from platform based services we will have to see if we can tear down some of the non-strategic business because we have taken six Quarters and 4 more are left. And we want to make sure that we finish this transformation within this period of time and that would mean some capacity utilization will be less, our people utilization will be less, some investments which we have made which would not be amortized over a period of time and some businesses will disinvest or just shutdown whatever we need to do. We need to do it in a phased fashion over the next 4 Quarters. So it is combination of all these things we are playing and we are not going very aggressive in making investments. We are making sure that within this framework we have defined we will be able to achieve it. Now I am happy to report couple of things to you. Number-one the platform based services which we lost as I said Rahul shared with you last time that we already done about $172 million worth of deals. On platform based services out of which $100 million is originating out of partnerships with a publishing platform and based on that we got the deal. We have a similar partnership with a logistics platform; again we got another deal on that. We're trying to create partnership with two other deals, one in the financial services area and another in the telecom services area. So which we will announce as and when those partnerships mature and the reason for this partnership is that the capacity for HCL to invest and develop platforms, you know that we are developing platform in the insurance side which is where most of this money is going in and it is also been co-funded by some of our technology partners by the way. We have been successfully able to get funding for those platforms therefore joined go to market of those platforms. But there is limited capacity and capability to develop platforms in this day and age given the fact there are very large number of verticals but opportunity is very large. And therefore what we are doing is we are entering into revenue shares arrangements with some of these existing platforms. Now these platform companies are not very large companies. It would have been easier to acquire them also but we do not know whether those platforms will work, will they need change. So our phase one is to try and get into alliance with them, align ourselves completely with them. If we have some competing products compared to their products then we will shutdown our competing products so that we sell off our competing products to them or whatever we need to do to align ourselves completely vertical by vertical, have those partnerships, have it on a revenue share basis so that the margins improve, we do not have to put the capital asset. We can test the market space with that partnership and the customers are happy that we already have the platform and go forward with it. So that's what we're trying to do on the partnerships side.

Mitali Gosh And basically over the next 6 quarters you are saying there would be another 30 million investment in BPO?

Vineet Nayar I'm sorry I said it in next 4 Quarters. So October-November-December 2011 will be the last loss quarter for BPO. After that whatever investments we need to make will be funded out of growth which is exactly what enterprise application and infrastructure is doing. So our investment is a long-term investment, it is actually a 7 more quarter's investment. But what we're saying is we would be able to find that investments starting JFM 12 by the margins we accrue from growing business and there will be no further losses is our expectation in BPO business effective JFM 12, that is our expectation.

Mitali Gosh Okay and these next 4 Quarters are roughly a 30 million kind of number?

Vineet Nayar I do not want Mitali to put a number to it. I just want to put the loss which will accrue because we are not capitalizing it I'm running it through P&L, that is what had shared six quarters ago. So there is no capitalization of any investment which is happening in BPO So I do not want to give an investment thesis on it because if I was capitalizing it then I would have said I'm investing $30-$40 million and I would split it over 3 to 4 years. I'm not doing that. And the reason for that is very clear Mitali that we as a company are doing well so I can afford to pump in the $6 million a quarter through my P&L rather than take in to my balance sheet. And since I can afford it I'm doing it. That is my view on this.

Mitali Gosh Right and Vineet in terms of the margins if one just look at post this transformation when there is steady state kind of volumes in the BPO business on these platforms that you are developing. How should we think about BPO margins in the platform based services as compared to the IT services that one does?

Vineet Nayar It's early days Mitali I would definitely make a comment in July when I come on platform margins. I have answer in my mind; I have an expectation in my mind. We are working very hard only because we see a margin profile which is attractive. But let us get some proof point on this so that I can come back and tell you on this $170 million what is the margins we made in April-May-June and I think that will be the basis on which I will give you margin guidance, on the margins we based on platform based services. But the reason we are doing it so that it is margin attractive. Remember this is same thing which I said about infrastructure management and lot of people did not believe that infrastructure management they though at 8% to 10% margin profile, it is margin dilutes and all those concerns were there and you can see that infrastructure margins are actually exceeding software margins. So trust us, give us some time to make this investment, test the market and we will come back in my annual results announcement to try and give you specific guidance on margin profile of platform based services.

Mitali Gosh Sure thanks in this. Secondly on infrastructure Anant we saw improvement in gross margins this quarter, what will be the key reason for that is there a mixed kind of impact as well?

Anant Gupta No I don't think. First of all none of the deals which get concluded in that quarter, reflect in the margin profile for the quarter. Most of are engagements are long-term, have a significant gestation period for transition, then moving into service levels and the steady state. So I really think these margins the expansions has really come from two accounts, one is if you look at the number of large engagements we have signed 3 to 4 quarters back they have gone through their phase of transition, they have gone through their couple of quarter's of steady state operations and normally when we get into first time large-scale engagements we do over invest in the service management on governance. So once we see the proof points of the service delivery exceeds what we have planned, we take out the service management over insurance that we have put that's not point. Second if you remember that the number of our engagements still have some third-party components and over a period when we do have a much better visibility of the need for different third-party components we obviously optimize those aspects as well. For example it could be some service which we may have contracted with third party may have been in a gold category in and we were paying x dollar and maybe a percentage of that moves to bronze category which for which you pay x/3. So a factor of this how we optimize the margin profile on the large engagements.

Mitali Gosh Just in terms of margin again profile and infrastructure compared to software Vineet you mentioned that while infrastructure certainly been improving over several quarters, it is still tend to be a little bit lower than software so how do we see that in the longer term?

Vineet Nayar You set up a trap for me Mitali. Let me just not answer that question.

Mitali Ghosh Okay alright thanks.

Moderator Thank you Ms. Ghosh. Our next question is from the line of Rahul Khanna of Ladder Capital. Please go ahead.

Rahul Khanna Hi I just wanted some clarity in terms of what would be the budgeting sense that you are gathering from your client interactions that have been happening and secondly in terms of any kind of pricing environment improvement or what is the state on pricing if you could comment a bit on that?

Steve Cardell Hi it's Steve, I think in terms of budget interactions we come back again to a different view by geography and by vertical so I would say in Europe we are seeing total IT budgets being looked at very harshly but where the spend is going there are attractive opportunities for us. We see in the America at the moment, we seeing some discretionary spend going into IT budgets and the question will that last another quarter or two quarters or is that here to stay and age specific what we talked about we see good trends. In terms of the pricing in environment we continue to see this push, where clients are looking for deals certainty so fixed price deals or other deals that contains certainty also if you will, the day rate price we achieve is as much about delivery efficiency as is about the day rates that is incumbent in the deals when it is priced. But my overall comments on it is we are seeing pretty static pricing maybe some potential uplift through to cover across the board fairly stable pricing.

Rahul Khanna Okay sir secondly I would like to know what will be the tax rates that you guys are looking towards the end of this fiscal and probably going into the next fiscal as well.

Anil Chanana This is Anil; we have given the guidance of the tax rate. Currently it is 20% but it will step up in the last Quarter of this year which is in the April-June Quarter to 25%. So for the whole year FY 11 we expect to be 22% and for FY 12 it will be 24%. But we continue to look at it in line with the business scenario, in line with how the business is happening in the various countries the spread, geo spread and etc so forth. As and when there is a change we will certainly come back to you.

Rahul Khanna Thanks.

Vineet Nayar Mitali coming back to your question I am sorry I got a bit confused. So infrastructure margins at EBITDA level is 18% and software services margin at EBITDA level is 17.5%. So infrastructure just tipped software services by 50 basis points for the first time in our history, I was referring to that so I don't want to talk about future margins on both sides, I just wanted point that out. This was the first historical event in HCL which is completely different than what most of us had expected. Our next question please.

Moderator Thank you. Our next question is from the line of Amar Morya of India Nivesh. Please go ahead.

Amar Morya Hello sir congratulation for fantastic quarter, I wanted to know what is our current hedge position?

Anil Chanana This is Anil; the current hedge position is $256 million which covers us in terms of inflows for next 60 days but these hedges extended up to one year.

Amar Morya Thanks.

Vineet Nayar Operator can we have a last question please.

Moderator Sure thank you sir, as requested the last question is from the line of Pinku Pappan of Nomura. Please go ahead.

Pinku Pappan Hi thanks for taking my question. Just a couple of things, one could you talk about your progress in smart grids margins and the kind of opportunity size and kind of investments you are to make there?

Anant Gupta The investments are not really about assets, it’s really about the solution stack that one has put together but if you really look we have two smart grid labs today one in India, one in US and if you really look at the kind of solution which is going beyond IT. So it's not just about the back office application, front office or analytics and the infrastructure but a significant number of components which fits into our grid right from the meter that sits in the home to meter the consolidation points, the different SCADA equipments which are there. So in this smart grid lab so obviously we have the strong ecosystem of partners. So we have different grid players from the respect of industries who participated in this lab so that was first biggest investment which is having working lab where large utility firms can come and experiment with different requirements of putting in there, deciding the journey of implementing a smart grid. Now different markets will behave differently, markets in India or other emerging markets are looking at how one can extract savings from transmission losses and put them back in. So lot of investments would come from there. Obviously for the developed market it's all about this whole concept of real time utility pricing as we all know that electricity is a single price per unit but given the demand on that there is move to have a time of day kind of charge which obviously calls for a lot of engineering right from the front, at the home level, all the way back into the back office systems. Obviously all this entire solution stack is based on a expertise we have a very strong expertise within the EA space which is around the back-office, the analytics and the BI, infrastructure obviously being able design on and implement and obviously in the vertical domain where we have strong know-how of different components in there. Interestingly, there is a new report from Pike Research which is a leader in clean technology market intelligence space and they have come out with a report on smart grid managed services and HCL is only two companies which have been featured there as thought leaders and the way we are driving this specific space.

Pinku Pappan Just a follow up. How big is opportunity size for you and when do you expect to become a large player in this particular space?

Anant Gupta The opportunity size could vary; it could be pure assessment and recommendation on design phase, so it will be high-value no volume but when these decisions do happen there will be large scale implementations. Last year for example we are already engaged with two very large implementations one in US it’s a customer we announced three quarters back Energy Future Holdings, and a very large state in India we are actually implementing to very large scale implementation.

Vineet Nayar Both of $100 million plus.

Anant Gupta Yeah both of these are $100 million plus engagements but like I said they would vary and different utilities firms will be indifferent journeys and we also recognize the fact that the number of utilities, thousands of them who may not be able to implement a dedicated stack and that's where the entire strategy of a smart grid managed services which is leveraging the internet grid management is really coming about.

Pinku Pappan Okay, my next question is on the second-generation outsourcing deals. Now many of these are asset heavy. So if even you are going to shy away from taking asset heavy deals what exactly should strategy penetrate into this particular deal space?

Anant Gupta Given the fact that there is about $40 billion worth of TCVs coming up for second-generation outsourcing there is enough market size for one to be able to pick and chose from those. We kind of pretty much decided which areas we will focus. So asset dependence largely is around, value added areas like the management tools that is the core strategy for us. Investment around the management tools as a service which is an indirect investment in assets but it is very miniscule piece of the overall asset overlay. So the simple answer is the market is large enough and we do have focused qualified market in which we would like to play.

Pinku Pappan Are you planning to invest more into more data centers?

Anant Gupta No our philosophy has been that we have a very strong ecosystem of partners with data center providers. We continue to do that given the fact that we deal with global enterprises across the globe. I do not think we would be able to build data centers to satisfy the needs of our customers so our strategy has been to work with ecosystem of partners, we continue to do that because of which employees who are pure play providers is a complimentary offering to us and non-compete offering to us and the value that we can therefore combine offer to our customer it is much larger instead of us having to invest in millions of square feet and trying to build the proposition which is largely around square feet or number of racks and power supply.

Pinku Pappan Okay thanks a lot.

Moderator Thank you Mr. Pappan. Ladies and gentlemen we take as the last question. I now hand the conference over to the management to add closing comments.

Vineet Nayar Thank you ladies and gentlemen for joining us in our Q2 result announcements and we look forward to talking to you on the Q3 result announcements and have a great year and happy new year once again to all of you and your families. Thank you and good night.

Moderator Thank you very much members of the management team. Ladies and gentlemen on behalf of HCL Technologies that concludes this conference call. Thank you for joining us on the Chorus Call conferencing service and you may now disconnect your lines.