HCL Technologies

Investors/Analysts Conference Call

January 18, 2006

Moderator

Good afternoon ladies and gentlemen. I am Monali, the moderator for this conference. Welcome to the HCL Technologies conference call. 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 Mr. Shiv Nadar of HCL Technologies. Thank you and over to you sir.

Shiv Nadar

Thank you. Good afternoon ladies and gentlemen. Thank you for joining us in the results announcement conference call this afternoon. The papers have been lying with you for a while, and with your consent I take this as read.

I thought amongst what has been given, I would highlight some key factors. Amongst the major IT services company, HCL is the youngest of the lot. It is virtually this millennium company and hence has been running faster to catch up with the peers. I am pleased to note that in this quarter our revenue has crossed 1000 crores, and in the half year the revenue has crossed 2000 crores. It is a landmark achievement for us as we have done this in a space of little more than five years.

Another point, which is visible, the second point which is visible is that this year we will be a billion dollar company. This is proven by not only our revenue run record and the growth rates, but also the anticipated growth rate on the back of orders that have been won. So that is the key point which I thought I will emphasize on.

The third key point I would like to emphasize is HCL continues to dominate emerging services. If you recall, the strategy which we had outlined, which I had an opportunity to articulate to you many times, is from technology led services being our mainstay contributing to more than three-fourth of our revenue. Now it is between five different service offering, which is product engineering services, enterprise consulting services, application consulting services, infrastructure, and BPO services. They are all more or less equally spread and it is a very well rounded service offering that we have. Out of which, the new emerging services are independent validation and testing, SAP practice, total outsourcing, besides infrastructure services and big deal oriented BPO. You know smaller BPOs do not tend to be very profitable, larger deal oriented BPO. In these, we dominate, and some of the large contracts which have been won by HCL is on the back of this strategy.

The third point of note is, from last quarter to this quarter it is evident that we continue to win big deals. We have already announced four mega transactions and there are more to come.

Now a word on outlook before I hand you over to Vineet. The outlook at the current levels, we will close the revenue at about a billion dollar level and margins which we have firm grip on, you know, you could see for example that the utilization this quarter has gone up in software services. That is one reason why there has been no net head count addition during this quarter in software services. There are many actions that have been taken to improve our controls on margins, and what controls that we have established and the grip that we have established, we continue to keep, and we believe that we will keep the margins at the current levels in the balance months to come for the year.

With this I will turn it over to Vineet.

Vineet Nayyar

Good afternoon everybody. Thank you once again for joining us. It is a pleasure talking to you, and also I wish to take this opportunity of extending the invitation to all of you for the first investor conference, which is scheduled for February 10, 2006. We would have close to 60 of the top executives of HCL present in that conference for a day long interaction with all of you, where we will get into in depth discussions on geography, on verticals, or horizontals. So there are possible 60 conversations, which will happen simultaneously and I look forward to seeing you there where we could explain a lot more in detail what HCL has been doing and what it tends to do compared to what we can achieve in an one hour call.

I would like to make only one or two additional points compared to what Shiv has made. There is a blue ocean strategy, which we had rolled out at the start of the year and you have seen some results coming in from Autodesk and EXA being announced. The large telecom company deal being announced, IBM being announced. You also are seeing in the current results, we are announcing two more transactions, which are identical in nature. One of them is significantly large. We will talk about that subsequently, but the whole trend which HCL is trying to ride is in the total IT outsourcing based on its creation of multiple service lines is succeeding and you are seeing these deals happen, and we think you will see more deals, larger sized deals from HCL.

Coming specifically to the software numbers, the reason you are seeing a largish growth is because of this traction of larger multi-service deals which we are tracking. Growth in validation, legacy migration, and SAP is driving that growth.

Our utilization figures were way below industry largely because of the amount of freshers we had hired. We did not deploy them as fast as we should have. I am happy to note that we have been able to deploy some of our resources on bench. From 68% utilization we have been able to move up to 72.5% utilization, which has largely contributed to the profit growth despite the fact that there has been a salary increase. Our salary increase kicks in on October 1, 2005, despite the fact there is a $2 million increase in sales and support expenditures because there is a massive change in IT systems, which has been brought about to become more and more efficient. So our efficiencies are increasing. I think this efficiency trend will continue and I think that efficiency trend will fund for the SG&A increase, which we expect to grow further.

Our infrastructure business continues to grow as we had anticipated because it is a new business and it is on a low base. It tends not only to grow but also dominate the market place. As you remember, this is one more example of the fact that HCL creates new market places and once it creates new market places it dominates them, and we will continue on that blue ocean strategy of creating new market places and dominating them.

I am also very happy to share with you the progress we have made on the employee front. We launched the employee first program, which I shared with you last time. The employee first, customer second program has been very well accepted within the company and by the customers. We launched the transparency program where the employee is transparently aware of anything and everything which is happening with reference to him including i4excel, 360 degree appraisals, training systems. We have automated the whole thing and our employee does believe that he has Employee First experience in HCL compared to some of our competitors in the industry. We are launching similar initiatives on our customer interaction, and in the next six months you will see a significant difference in the value being delivered by us to our customers compared to some of our colleagues. We take these two as serious competitive advantages we want to create in the industry space.

I am happy to report to you that the attrition today in the infrastructure business is down to 6.3%, for people in the company for more than one year, and in the APS business down to about 13.5% for people greater than one year, and these are early indicators of the fact that whatever we are doing, whatever we are investing in would bring fruits and we are seeing the early success.

With that I handover to Ranjit to give you a brief on the progress we made on the BPO business.

Ranjit

Good afternoon ladies and gentlemen. During the second quarter, the BPO operation continued to sustain the growth and momentum both in scale and size of our operation. During this quarter, there was a net headcount addition of 1562 persons in the BPO division, the largest ever quarterly increase in manpower. Further, two new world class delivery centers, one each in Noida and Chennai became operational during this quarter, adding 157,000 square feet of operational space. These additions will get converted to significant revenue streams in the forthcoming quarters.

During this quarter, our revenue increased by 22.4% and EBITDA by 46% over the corresponding period last year. There was a significant expansion of margins, and our BPO operation continued to have one of the highest levels of profitability in the industry.

HCL BPO also continues to be one of the most preferred employer amongst its peers. The recent IDC-Dataquest Survey on employee satisfaction has ranked us amongst top five dream BPO companies to work for in India. We also have been judged to be the leader category for the global outsourcing 100 by the International Association of Outsourcing Professionals. During the entire calendar years of 2004 and 2005, we had consciously decided against acquiring new customers to ensure that the growth needs of our existing customers are satisfactorily serviced.

We have been acquiring new customers once again only in December 2005, when we added two new clients, a leading automobile manufacturer in India and a large European

Bank. We have had an extremely satisfactory quarter and we hope to sustain the growth during the forthcoming quarters also. Thank you.

I will now hand over to S. L. Narayanan.

S. L. Narayanan

Good afternoon friends. I do not have anything specific to add on to what has been introduced by Mr. Nadar and the others. Basically, all the numbers are out there and I just invite you straight away for the Q&A.

Moderator

Thank you very much sir. We will now begin with Q&A interactive session. At this moment, I would like to handover 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 Dianna.

Moderator (Dianna)

Thank you Monali. We will now begin the Q&A session for participants connected to SingTel bridge. Please press 01 to ask a question. Once again, 01 to ask a question. We have Mr. Anthony Miller from Arete Research, UK.

Anthony Miller

Hello gentlemen. I wonder if you could just bring us up to date with what is happening in Europe, I am afraid I have only had a quick chance to go through the numbers, but it looks like your growth in Europe was, well it looked like Europe was flat year-on-year this quarter, can you just talk us through what is happening there please?

Vineet Nayyar

This is Vineet here. The European market is at a very interesting stage right now. As you are already aware that there are some significantly large IT sourcing deals, which are coming up in Europe. HCL is participating in some of them. Most of the wins we have announced so far came from US, but we believe going forward they will kick in from Europe and we are very bullish on the Europe outlook over the next six months.

Ranjit

There is a large deal that was won in the BPO business from Europe and that is meant to start revenue kick in only from the first quarter of this year. Whereas we have added something like 2000 people to service just one single contract. So it is just a quarter addressed, nothing really to be concerned about.

Anthony Miller

Because most of your peers, in fact almost all of your peers do have their growth rates in Europe consistently higher than growth rates in US, which has not been the case for you for the past couple of quarters, do you see this situation reverting to what you might call norm?

Vineet Nayyar

Yes.

Anthony Miller

Over what period is that please?

Vineet Nayyar

During 2006.

Anthony Miller

Okay. Thanks very much for now.

Vineet Nayyar

Thank you.

Moderator

Thank you Mr. Miller. Next question, we have Mr. Pratik Gupta from Citi Group, Singapore.

Pratik Gupta

Hi. Congratulations on a quarter. I just wanted to, just talk a little bit more about this large deals going forward beyond the current financial year. I was just wondering if could elaborate a bit more on the pricing on these large deals, who is really the competition you are facing in these large deals and the impact on margins in the years ahead? And also in terms of the SG&A efforts, I was wondering is the bulk of the SG&A on such deals behind us or do you think, and basically I am wondering whether there is any leeway to bring SG&A down or any margin leverage over there? And secondly just to bring up the point on the utilization once again, you said utilization rates have improved, but I was wondering if there is any further leeway to improve utilization or do you think you need to increase your bench as you get into these larger deals?

Shiv Nadar

Okay, there were many questions there. I will try and answer them, and if I miss some of them please advise me and I will come back to that. First is on large deals. I think in beginning of this year we said we will pursue large deals and the way the large deals are coming up is most of the deals we are pursuing are multi-service deals. Multi-service between infrastructure and application and package implementation. Some of these deals we have started pursuing now are also deals which are involving BPO. We see that increasing trend going on. The outsourcing deal, especially those ones which involve employee takeovers are sensitive and hence the customers request us not to share their names or make announcement. That is the reason, we are a little particular about sharing them, but the only indication which I want to give to you on going forward, we believe based on the pipeline we have and based on some of the shake hand contracts and about to be shake hand contracts, that the deal flow for HCL in the next six months will be higher than the deal flow for HCL in the past six months. The deal size for HCL will be higher in the next six months compared to the deal size for HCL in the past six months.

What is the competitive landscape on these deals? The competitive landscape is that if you want to win these deals you have to have a very strong infrastructure management piece. You need to have a very strong pricing methodology where you push in tech refresh, you push in support which is device based, and you need to have a very strong practice on application optimization and then development and maintenance. So development and maintenance is only a part of the deal. Let me pull back a little and explain this. What we have seen in the market place is customer comes in and says my spending is less than $100 million per annum. He takes out an RFP where everybody participates including Indian companies and global companies and saying can you bring this down, and he calls that an request for information, RFI. We all participate and climb on each other and try and give him different models. Ultimately, what we have seen succeeding is models where he sees flexibility, where we go in and saying that you know what, we will optimize your application based on which we will optimize your infrastructure, based on which we will consolidate your cost of operating the infrastructure, and then we will convert this into a financial package where we will charge you per transaction, per device, per month, or something like that, and we will put this innovative package together, which gives you flexibility over the next decade. Now this is our approach, a typical Indian software company would approach him saying that we will do the application, development, maintenance, and some part of optimization. They struggle to get the infrastructure piece in place, and the big 5 go in and say do not ask us question, you know what, we will cut the cost down by 10 or 20%, leave the rest to us. The wins which we are seeing, it starts with Autodesk where you saw us finally competing with big 5, you know the big fives of the world, and the deal which we have on table which are, you know, what I call shake hand deals, all have been finally fought with one of the IBM, Accenture, you know one of those big fives there, that is #1. #2 all of them involves an RFP process. There is no deal which is happening without an RFP process. #3, the length of this RFP process is anywhere between six months to one year. It is not going beyond one year, which is good from the size of the deal.

So, that is what is happening on that space, and given our dominance in APO, which is application performance optimization, as a new practice, given our dominance on remote infrastructure management, and the way we do financial engineering in pricing our deals including BPO, we are winning more than we are loosing, engaging and winning more than we are loosing as of today.

Coming to the second question with reference to what is the margin framework for these deals. I would say there are two kinds of deals, one kind of deals is the kind, which I defined to you, where we do all that staff. There the margin frameworks are the same as what we have today or slightly better. The reason for that is that when we are providing gains to our customers in an APO transformation, we retain some gains with us. So we believe that the margins would be better if we execute well, which I believe our teams are quite capable of executing well. The second deals are where we takeover some third party contractors. So you are going to see us announce some deals over the next six months where we will takeover responsibility of managing some third party for a fee. Now that fee obviously is much lesser than the fee which normally we get from our normal services. So to that extent the margins from a revenue point of view will get impacted for that part of the revenue, but that revenue is not going to be significant. So from an absolute point of view of margins, the goals which we have set we will definitely achieve it.

As a percentage, will it impact a few basis point? It may, depends on how much of the third party management will we take over as part of the total IT outsourcing.

The third question is with reference to SG&A, if I understand correct. I believe that the SG&A has been, there are two kinds of SG&As which are taking place. SG&A with reference to sales, SG&A with reference to due diligence, and SG&A with reference to amortization of tech transfer or knowledge transfer. I believe that SG&A our sales, we have over the last six months ramped up our sales organization dramatically. We are in the process and you will see more happening in that area. We hope to double our sales organization and that is what we are powering towards, and we have made significant investment and I think the scale of that investment is still left for H2. The SG&A in doing due diligence on large deals, yes, we have already expensed it, and therefore there is a potential benefit going forward, however, since it is a running business, we hope to be doing more due diligence and therefore that expenditure will continue and I do not see from that point of view an upside emerging from due diligence expenses already expensed and hence profit coming in in the future. We hope that the expense budget keeps growing that also ensure that we keep bidding more.

On the amortization of knowledge transfer, we have a fair program on that where the amortization is taking place. I do not thing there is a financial impact on our P&L because the way we are structuring the deals we are not absorbing anything upfront. We are amortizing it over, and when we amortize it then we amortize it on our P&L also.

The last question which you asked was from a utilization perspective. I do not think there is something called a perfect utilization. I think if we are in 2 games, one is the value engineering game another is the commodity supply game. In the commodity part of our business, we have to knock up the utilization higher and higher. As I said in my opening remarks there is a significant amount of investments we have made in IT, systems processes and applications to drive utilizations and efficiency up. I am not sure we are there as yet, and I think there is still more to be done there, but I think whatever we save from the utilization we want to plough it back into product development, into IP development, into reusable code, into creating certain center of excellence, and into creating some themes for exploration for ideas which do not exist.

So, going forward am I seeing a P&L positive impact because of some variation in utilization? The answer is no.

I hope, I have answered most of your questions?

Pratik Gupta

Yes, this is extremely useful. Thank you very much. If I could just get one quick clarification on the ESOP accounting, you will be taking into account stock option expensing from the June quarter onwards about $19 million. I was wondering if your comments in the press about 30-40% revenue growth whether that is before or after that, and also if you could just clarify your fx hedge position again please?

S. L. Narayanan

Pratik, this is SL here. See basically what is happening now is, since this is a new thing even for US companies, almost all of them are disclosing this in proforma account as a line item, and as the accounts are laid out this will not be netted off from the top line, it will be forming part of the compensation cost, but what we plan to do is in addition to the US GAAP accounts, we will probably issue proforma accounts at the time of finalizing this so that you know exactly what is the non-cash charge and what is the impact of the operations before and after. The second part of your question, I did not get?

Pratik Gupta

No, on the fx hedge if you could just tell us what is your current fx hedge position, and what rate, and so on..?

S. L. Narayanan

We are at about $469 million. Some of this beyond end of this year and we are at a weighted average of about 44.41.

Pratik Gupta

Okay, thank you very much.

Moderator

Thank you Mr. Gupta. Participants please press 01 to ask a question. At this moment, there are no further questions from participants at SingTel. I would like to handover the proceeding back to Monali. Over to you Monali.

Moderator (Monali)

Thank you Dianna. 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 are use only handsets while asking questions. First in line we have Mr. Pramod Gupta from HSBC.

Pramod Gupta

Hi, good afternoon everybody. Just wanted a couple of clarifications. What was the number of client add during the quarter, and also I wanted to know sir, are we getting it right that you are in effect guiding for 10% sequential growth for the next two quarters if you have to reach a billion dollar?

Shiv Nadar

Let me try and answer these questions. #1 is that this whole thing about client addition, you know, when we evaluated this beginning of the year, we found it quite funny because in our business we acquire a client for technology development purposes. He is a small client and then becomes big. We acquired a client for pilot purposes. He then becomes big or does not become big. We do some onsite deployment for seed investment into these clients, then they become big or they may not become big, so you know, I do not believe that the clients being declared in IT industry to be correct because everybody is seeding a lot of pilot projects onsite for these clients, however, our belief is that the best way to look at the client is as million dollar, $5 million, $10 million, and $20 million clients and that is the way we will continue declaring our customer levels.

The second question with reference to what do we need to do to reach a billion dollars? I would believe that whatever needs to be done to reach a billion dollars, we will reach a billion dollars.

Pramod Gupta

Okay thanks a lot and all the best sir.

Moderator

Thank you very much sir. Next in line, we have Mr. Pankaj Kapoor from ABN AMRO.

Pankaj Kapoor

Hi. Congratulations on the numbers. Just had a couple of clarification on the BPO business. Over the last four quarters, we have added about 3000 plus technical staff, but our revenue has just kept flat, while the margins have actually expanded by about 300 plus basis points, so just want to get a sense of what exactly is spilling out in this business?

Ranjit

Actually, the revenues have been flat for only last two quarters and in BPO the typically there is a 8-10 week gap between the commencement of the contract and the commencement of billing, and as you have seen we have added very significant number of people in the last quarter, and last quarter we added net head count addition of 900, and in the OND'05 it was 1562, and they have started billing in the middle of December and you will see the impact in the next two quarters, the significant effect will be seen in the next two quarters.

Pankaj Kapoor

And just one clarification on the large deals that we have recently been talking about, what exactly is the stage we are in with regards to these deals in terms of, have we signed the contracts or are we just negotiating, if you can elaborate on that?

Shiv Nadar

Let me just explain to you how these things work. You know, when we come into beyond the hand shake into a relationship with a major customer, let me give you the example, this is what happened with Deutsche Bank, this is what happened with BT, this is what happened with Cisco. We said that we are into a strategic partnership of transforming their company, so someone like Deutsche Bank would say that they have a $4 billion IT spend, now we want to reduce it to $3 billion, our total headcount is 95,000 and we want to reduce it to 65,000, and we state that we will work with you to see how we can reduce it, all of which is not part of the initial contract itself. So, there is an initial contract, and there is a very well laid out roadmap as to how to increase it. With Deutsche Bank if you recall, we started with about $20 million in the first year, and with British Telecom we started with a little more than 10, and Cisco possibly in the $1 million to $2 million category, but the intention was well laid out. Now as we talk all of these are above 50 million, Deutsche Bank is above 100 million, BT actually has a run rate to catch up with the 100 million. So first there is a deal, #2 there is a partnership, #3 there is a roadmap. Beyond 100 million in the third year, we may not be even able to absorb, so when we draw a roadmap, as a responsible partner we work with them to, you know, how to get to a larger figure. Larger figure helps the client because it reduces their costs, increases their quality, increases their efficiency. On this basis, we have concluded contracts with one customer for a largish transaction and we are in the last stages post hand shake of drafting one other large customer. These are all multiple year, multiple $100 million deals. This is as much as light as I can really throw on this given the sensitivities that are involved.

Pankaj Kapoor

Yeah, fair enough. Sir, if I understand right, these will be more of a relationship involving multiple projects and not necessarily be a single project?

Shiv Nadar

Absolutely correct. This will not only be single project, even right the first one which we sign is multiple project because this is multiple services.

Pankaj Kapoor

Fair enough. Thanks and all the best.

Shiv Nadar

Thank you.

Moderator

Thank you very much sir. Next is Ms. Divya Nagaraj from Motilal Oswal.

Divya Nagaraj

Hi, my question is about the volume growth. If you could separate out the volume growth of software services, BPO, and infrastructure, how has the volume been?

Shiv Nadar

I think the numbers are there for you to see. The bills efforts have actually gone up quarter on quarter, in terms of man months we have disclosed this, from about 29,334 man months which is pure offshore and off-on gone up to 32,285 man months, and pure onsite there is a marginal decline from 5500 to 5200. Anything beyond we are not disclosing because on BPO we have a very different set of matrix and nobody discloses specific bill rates for utilizations and therefore we do not disclose BPO numbers.

Divya Nagaraj

No, even if the effort that you have given, if you could separate it out between infrastructure, services and software?

Shiv Nadar

These numbers are only for software.

Divya Nagaraj

Only for software?

Shiv Nadar

Yeah.

Divya Nagaraj

So, how has the growth been in infrastructure services, I mean, what I would like to know is what is primarily driven the growth in that area?

Shiv Nadar

No, we have had these new contracts, which we have closed, and it is a complete remix of the total sales breakup. We are shedding some hardware sales and adding services and within services we have added new global customers, which is translating into higher profitability. So if you see the sequential numbers, we have almost a 25% sequential growth in top line with almost a 49% growth in profits. So there is a lot of things happening there. In fact, we have been comminuting this steadily over the last eight quarters. The focus will be to reduce the dependence on equipment sales and transfer it progressively to a pure play service model and within that shift the client mix from India base to global customers, because there is a big opportunity, that market which is currently at about 118 billion will grow to about 180 billion by 2008 and we have a big advantage there in the sense of a headstart and we plan to ramp it up as we go along.

Divya Nagaraj

How is the growth in BPO coming along, you have seen past three quarters being slightly sluggish. How do you see this panning out?

Ranjit

No, here again, you know, the opportunity is always there to fill up seats, but our strategy has been to go after the larger and more durable engagements, so we knew that this contract was coming along, which we announced last quarter. It is a very large contract signed up with a telecom major in Western Europe, for which the recruitments started sometime in end of last quarter and progressed along during the most recent quarter. We have added about 1500 people plus. So the impact of those revenues and a very strong sequential growth in top line and bottom line should happen beginning the March quarter.

Divya Nagaraj

Right. One thing that I want to ask you is, you BSE announcements, you were talking about 270 crore net profit up on consolidation of five different companies and top line of 107 crores?

S. L. Narayanan

No, that is basically because of the impact of the merger, which is with retrospective effect from April 1, 2005. You know, the scheme was conceived some times in March and it was filed for action with two different High Courts because some of the companies were under the jurisdiction of the Karnataka High Court and some others were under Delhi High Court. So we got that approval only sometime in October. So it is because of that retrospective amendment that you have seen a huge increase in the current quarter. In fact that release very clearly states that there is no……..

Divya Nagaraj

It is a nine month figure, right.

S. L. Narayanan

So, you know, there is nothing that we can derive out of that and it will be a very misleading analysis even if one were to attempt it. You will have to then strip out the effects of the Deutsche software business, strip out the effects of India BPO business, and some other smaller companies, which are in the government services business. It will lead to nowhere because what is really important here is to look at the consolidated financials.

Divya Nagaraj

Right, no, what I would like to know is the impact at the net profit level has been quite high at around 90 crores difference, what I would like to know is what has been the reason for that kind of an impact because the top line wise the amalgamated figures are not really significantly different?

S. L. Narayanan

No, that is basically because of the retrospective amendments.

Divya Nagaraj

Right, okay, and one last thing, how do you see the pricing environment for software services and infrastructure management going forward?

S. L. Narayanan

I think the pricing is stable to marginally positive, nothing of concern at this moment.

Divya Nagaraj

Right, thank you.

Shiv Nadar

Thank you.

Moderator

Thank you very much mam. Next in line, we have Mr. Umang.

Umang

Hello.

Shiv Nadar

Yes.

Umang

In the last conference call you all had announced that you are acquiring a $100 million BPO outfit by end of December 2005. We are already in January 2006, so what is the latest development on that front sir?

Vineet Nayyar

No, I do not think we announced it in the conference call.

Umang

Okay, but this had come in some article also later on.

Vineet Nayyar

I think there was one which appeared in print, but that was I think a misquote. I do think we had any involvement in any such announcement.

Shiv Nadar

See, we have explicitly stated that any acquisition targets will be visible six months before and we have been maintaining that. There is none that has been visible, at least I have made this statement every conference call in the last year or year and a half or so.

Umang

Okay, and secondly sir, two new centers are coming up in the BPO outfit, so just wanted to understand like what is the current strength of employees in the BPO business and going forward by the end of this fiscal year what will be the total strength in BPO business?

Ranjit

We have added two new centers during this quarter, which resulted in addition of 157,000 sq. ft. of space, and this is to accommodate 900 additional head count last quarter and 1562 during this quarter and these additions will get converted into significant revenue streams in the forthcoming quarter. You will see the impact in the forthcoming quarter.

Umang

And just to get a feel, if you are looking at a billion dollar revenue by end of this fiscal year, what will be the contribution of BPO business in that?

Shiv Nadar

Accurately, we will not be able to break this up.

Umang

Thank you sir.

Shiv Nadar

Thank you.

Moderator

Thank you very much sir. Next in line, we have Mr. Sameer Goyal from Anand Rathi.

Sameer Goyal

Hi gentlemen. Actually, my question is how did the billing rate perform this quarter?

S. L. Narayanan

They are marginally up on offshore and marginally down on onsite. It is so marginal that, you know, I might just say that it is flat.

Sameer Goyal

Pankaj asked this question earlier that in the last four quarters we have seen a substantial increase in manpower in the BPO business say around 30%, however, the revenues has remained flat, while the direct cost on the BPO business has shown a little bit downward movement. Could you explain this how has this happened?

S. L. Narayanan

Yeah. See, this has to be seen in the light of our BPO structure. See there is also an onsite business, there is an offshore business. So the additions are actually happening in the offshore and our strategy has been to acquire a significant presence to start with a very important partner, and then the other thing that has happened is we have also had some grants which have been declared by the government at Northern Island for creation of new jobs, so those grants have also been coming in, in the last few quarters, and according to the accounting principles it was not disclosed as part of the top line, but the view is since it has been given for creation of jobs, any grant should be taken as a reversal of direct cost. So that is the reason why direct costs have also been under check.

Shiv Nadar

It is meant to defray training expenses, which otherwise add every quarter because of people turnover ratios being high in this industry.

Sameer Goyal

Would it be fair to assume that, the reason why I am asking is because if I calculate revenue per person in the BPO business, it shows a downward trend actually in the last four-five quarters, so would my analysis be right or would it be a better way to look at it?

S. L. Narayanan

The way to look at, see if it were to be so we should also be having declining profitability. The trick here is, you know, the mix between offshore and onsite. We are growing offshore and therefore our profitability has also been rising.

Sameer Goyal

Thank you.

Moderator

Sir, are you through with your question?

Sameer Goyal

Yes.

Moderator

Thank you very much. Next in line we have Mr. Ajay Mathrani from DSP Merrill Lynch.

Ajay Mathrani

Good evening and thanks. My first question was on the BPO business. Could you just give us some details in terms of how many large clients do we have, what is like the top 2, top 5 percentage contribution from them, just trying to get a feel of the business from that side, and what verticals?

S. L. Narayanan

See, we are just following industry practice here. We are not disclosing the BPO numbers separately because nobody is disclosing BPO specific numbers, so you know we do not want to part with these numbers till you know it becomes part of industry standard.

Ajay Mathrani

Sure. On the client rationalization phase that you have been talking about, do you think it is over now, meaning we have seen million dollar clients decline QoQ, we have seen onsite come off probably because of that, are we saying it is over now or do we have some more to go there?

Shiv Nadar

First is that the client rationalization phase will continue, and it will, I definitely see it continue for two or three quarters more.

Ajay Mathrani

Okay, but as intensive as this or do you think that…?

Shiv Nadar

No, let me explain. These are two separate questions and they are not linked questions. The million dollar clients that we were declaring in the past was that we were taking the quarter revenue and multiplying with 4 and declaring million dollar clients on a run rate basis. Now we have changed that and the current million dollar clients are on an H1 basis. By the time we end this year, we will declare the million dollar clients on a LTM basis.

Ajay Mathrani

Okay.

Shiv Nadar

So practically what is happening is the million dollar clients is actually increasing from a like to like basis but because, you know, there are some better IS systems and processes coming in place, so we have a higher visibility and client rationalization phase will continue to be aggressive, actually nothing has happened so far on that, I mean, other than talking to the customers and dropping some of them, we want to pursue further aggressive part of dropping them. Each one of them we have to give some advance notice and make sure that the transition takes place. So the impact of that you have not even seen so far.

Ajay Mathrani

Okay. On the employee addition now on the IT services part, is there any change in hiring strategy there, #1, and #2 was supply a constraint in terms of growth there?

Shiv Nadar

See, supply is definitely a constraint. If we calculate what we call missed opportunities, and missed opportunity number is quite frightening in terms of what we could have billed because of orders in hand and we did not bill. That has got to do with visa situation, that has got to do with training, that has got to do with induction, that has got to do with knowledge transfer. So lot of issues, so we are focused on that. That is one part. #2, from a manpower availability point of view, it continues to be a challenge for the industry at mid levels and senior management levels, at the fresh recruits anyway there seems to be an over supply of people.

Ajay Mathrani

Okay, but at the margin, is the number of or the amount of missed opportunities increasing?

Shiv Nadar

This is what we called missed billing. It is not order loss.

Ajay Mathrani

Sorry, I got that.

Shiv Nadar

We have just about this year started computing that internally to try and see, you know, I told you about the whole impetus about trying to improve our operational efficiency. So, right now we are only measuring it and then putting systems and processes on how we can from concept to bill increase it. There are six processes we have identified which will want to improve upon, one of them is from thinking to billing.

Ajay Mathrani

Fair enough. Thanks a lot and all the best.

Moderator

Thank you very much sir. Next is Mr. Shekar Singh from ICICI Securities.

Shekar Singh

Hi sir. Congratulations on a very good set of numbers. I just wanted to know like on the technology led services side, how is the environment looking like and are you seeing any growth or possibly say flattish growth over there?

Shiv Nadar

You know, there is good news in technology spending. We are seeing increased positive news there. If you see our past five years, one of the issues which had impacted us was the low growth in technology. We believe going forward, you will see a higher growth in technology, not higher growth, I think technology spending is going to come back. It is not going to happen in a quarter or two quarters, but I think over a period of 12 months, I think in the calendar year 2005 versus calendar year 2006, I think technology spending in calendar year 2006 will be much more than calendar year 2005. So we are pretty bullish about the where we are seeing our funnel in technology services. We are pretty positive about the way that is going to move, but it is not going to happen in a quarter or two quarters.

Shekar Singh

Secondly like, since now we are talking in terms of large deals, it is like a question which I think is applicable to all the software services companies, why cannot Indian companies now start talking in terms of the order backlog that they have because anywhere we are talking in terms of large deals which are going to drive growth?

Shiv Nadar

I think people need to have orders to talk about order backlogs, and orders of the kind where they are not project orders, but they are orders which are contracted for multi-years, and I think we will next year take the first initiative of sharing that with you if that makes sense, but let us walk through this year, and it is an interesting idea, we will see if it make sense to talk about that next year. We will see some of our global colleagues in the industry do that and if somebody does or follow that practice and it is something, which helps you, we will try and see if we can think and adopt that.

Shekar Singh

Definitely. Thanks a lot sir.

Moderator

Thank you very much sir. Next is Mr. Supratim Basu of Deutsche Bank.

Supratim Basu

Thanks, good evening. Could you actually tell me what is the percentage of lateral hires in IT for the last four quarters and what is the typical training period for a new recruit straight off campus?

Vineet Nayyar

Supratim, I presume that you would be joining us on February 10, 2006, would you?

Supratim Basu

Yes.

Vineet Nayyar

So, you should ask this question to a team of five HR people who will be there, and they will have a pleasure answering this question to you. I do not have this data right now, but I will tell them to be ready with this answer for you.

Supratim Basu

Okay. No, because, here is were I am coming from Vineet, you talked earlier about missing a priceful number of revenues because you did not have the resources, yet in this quarter your total technical manpower has actually gone down and utilization has gone up, which is fine, but if you are actually looking at reducing that mess going forward over the next three to four quarters, I would imagine that you would want to continue hiring?

Vineet Nayyar

I think Supratim, if the business was as easy as that, I did not say that we missed the billing because of people availability. I said we missed because of three or four reasons, one of them is the right people with the right skill with the right training at the right place. So there are visa issues involved here. There are knowledge transfers involved here. There are training people on the customer, for example if the customer gives an order today, theoretically speaking I should bill him today. Practically, it is not possible to bill him today because we have to do knowledge management, we have to train him on customer processes. Those are what I call theoretical inefficiencies in the system. That is what we are focused on. So do not try and link that with availability of people. Availability of people, HCL still continues to hire. Only 4% of the people are applying to HCL. So if HCL senses an opportunity of deploying people, I think we will have enough people, as many as we want joining us at all levels.

Shiv Nadar

Can I put across to you, if you have seen we have been growing very robustly in BPO for about eight quarters, and two quarters the revenue looks flat, but these are the two quarters in which the BPO division hires a maximum number of people. 900 people in one quarter and close to 1600 people in the other quarter where as the revenue stays flat. That is because the order visibility, as I mentioned to you because of the relationship based orders that we receive, some of these contracts begin dialogue one year before they consummate and they take another six months before they get through to execution. We work very closely with very top people of our clients who are large organization. When you talk about software businesses, the hiring has been done and completed quite some time ago. At the same time, if we are talking about a revenue miss because of a particular skill not being available that is something to do with, it maybe a visa issue or maybe at that particular time that particular featured person is on leave or not available. There could be very many reasons, which does not have to do with hiring. You know, we do not go about hiring a person when an order is available, when order is to begin. That activity takes place some six months before. You have to see it. You have to understand HCL differently. HCL is not just in the business of taking projects of application development and maintenance. We are in the transformation business of our clients.

Supratim Basu

Mr. Nadar that actually supports what I am driving at very beautifully because I think on the BPO side, your strategy is very clear, you know, you are getting people on board two quarters in advance of a large contract coming through and you have got great visibility on the BPO side. Now if I were to flip that onto the reverse on the software side, what I see is that you have hired about 3500 odd people in the previous three quarters and then you stopped this quarter. That kind of tells me that visibility seems to have weakened?

Shiv Nadar

Visibility has improved a lot. In the last six months, the visibility has improved enormously and that is how we found out that our deployment which was somewhere around 68% we could raise it to 72%, you know, logic of what you are talking about is if anyone is working on 76% then his visibility will be very low. That is not the way it works.

S. L. Narayanan

Yeah, actually to add to that Supratim, we used to run at almost 79-80% utilization not long ago. It is only because of the need to scale up and be ready for execution of these large contracts, so the hiring was absolutely robust, right through calendar 2005. And just to put it in a different perspective, just about 4 percentage point increase in utilization means almost 3000 man month increase, you know, it is a big number.

Supratim Basu

Okay, and just one final question there then for you SL, so are you actually planning to drive your utilization up again to 79-80% levels?

S. L. Narayanan

No.

Shiv Nadar

I will give you a firm no, because the contracts that have been signed are in the process of getting signed or where we and the customers are doing due diligence of each other to see how much more we can expand our structure of bandwidth. It is too large for us to work anywhere around 79-80%. 79-80% is nothing. 50% is least and 5% mismatch you take you are already at 80% running shift too close, too tight.

Supratim Basu

Okay, if I can just get in one more data question on the BPO side, I think it has been touched upon by a few people earlier, but I just wanted to get some numbers here. We are basically looking at something like 2500 odd people having been hired over the last couple of quarters.

Shiv Nadar

No, revenue has come up?

Supratim Basu

No, I am okay on the revenue side. I am actually looking at the direct cost side and I think I find that a bit surprising because I would expect that your cost would continue to rise even if you are hiring offshore. So, what is the absolute grant amount that is bringing down these costs and is there anything else that play here?

Shiv Nadar

There is a play of training cost in Ireland being defrayed by the Irish Government, and that amounts to, we will give you the correct figure, something roughly a million dollars a quarter.

Supratim Basu

And that takes care of the entire increase in hiring?

Shiv Nadar

Entire increase in hiring, no. See, you cannot put one to one. This is like consolidated fund of India. It is overall finally when it deletes itself, this is the net financial result that you get.

Supratim Basu

Okay, and then one final request, I mean, we spoke about this last quarter and I think a few quarters earlier as well, my request for Indian GAAP consolidated numbers?

Shiv Nadar

We will have it sent to you.

Supratim Basu

Okay excellent. Thank you very much.

Shiv Nadar

Thank you.

Moderator

Thank you very much sir. Next in line, we have Mr. Depen Shah from Kotak.

Depen Shah

I just had the same question which the previous speaker was stressing on. I think while the reply has been given, we are still not convinced about how the direct cost over the past four quarters has gone down by 4 crores when you added about a 3000 employees in the BPO business, but anyway, if there is any further clarification, which you can give it is okay, otherwise I am fine with it. Thank you very much.

S. L. Narayanan

Yeah, there are actually two more contributing factors. One is the, see direct costs includes the salaries and wages, it includes the cost of bandwidth and includes the cost of transportation and staff welfare. There has been a very significant reduction in the cost of bandwidth in the last one year. In fact, in many of the cases the cost of bandwidth has come down as much as 50%. So that resulted in a saving in direct cost. At one point of time, the bandwidth cost accounted for about 12% of our revenues. Now it is down to about 5% of our revenues. And second, part of the training cost for the onsite has been defrayed, which has been reflected as grant. Third, we have also enforced certain economies of scale. We have a separate value engineering department, which focuses only on cost controls, and consequently we have been able to bring down the cost of transport per employee. The cost of transport in BPO, as you are aware in BPO we provide free transport for all the employees, and the cost of transport accounts for close to 25% of the salaries and wages, and by adopting various cost control measures, we have been able bring it down to about 18%. So these three components put together, reduction in the bandwidth charges, reduction in the transport charges, defray of training expense by way of grant by the Government of Northern Ireland, together have resulted in a reduction. And the third aspect is that now many of these people are getting into billing, like in the billing cycle, so consequently the buffer carried on the system has also come down.

Depen Shah

Okay, thank you very much.

S. L. Narayanan

These three things together has brought down the direct costs, and consequently the gross margins are about 50%.

Depen Shah

Okay. Thanks very much.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1.

Shiv Nadar

We have scheduled this for an hour. We are through for an hour or so. I suggest we close this conference if there are no further questions.

Moderator

No, there are no further questions.

Shiv Nadar

Ladies and gentlemen, thank you for joining us, and have a great year in 2006. 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 evening.