HCL TECHNOLOGIES

Analysts/Investors Conference Call

April 19, 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 evening and welcome to our quarterly results announcement conference call. I would be very brief in my summary remarks so that we are left with enough time for question and answers. My brief remarks are as below, the first time I did attend our conference call for results announcement it was a meeting and then followed by a conference call, it was 6 years ago. During that time, our company had just been listed and we had a trailing revenue of about 150 million dollars and trading revenue of 20 million dollars profit and 6-1/2 years later I am happy to see that our revenue has grown 6-1/2 times, that means 650% revenues where we are and our profit has grown almost to 800% of where we were. In between, the industry went through a fair amount of turbulence in the technology area and in the technology area if we recall is where 75% of HCLs business came from. We were highly US dependent, something in excess of 80% of revenue came from US. Now we are 55 or 56% in that neighborhood from US with 24% coming from Europe and the rest coming from the other part, rest of the world, which is basically Asia Pacific and our revenue on technology has come down now to 28% of the total and we have cut five broadbased services. The number of people now employed by the company has almost touched 30,000 and if I look back I have great satisfaction in having reached a golden milestone of quarter billion run rate in this quarter. The second major achievement of a company, which is as young as this is we signed during the quarter the largest outsourcing deal, which is multiyear, multiservice, you know, it is not a contract which is made on an electronic RSP bid, it is multiyear, multiservice contract when in competition with one of the largest corporations in the world and it was significant enough for us to look at the listing agreements and agreements with the stock exchange to make a midquarter announcement which we normally do not make, so this is a two key, one it being a milestone and the other being an achievement which has happened during this quarter. The rest of the papers have been with you, all the highlights of the quarter financially have been given and I would now like to throw it open for question and answers for the rest of the next 55 minutes. Thank you and I would like to invite question and answer.

Moderator (Monali)

Thank you very much sir. At this moment, I would like to hand over the proceedings to Ichu 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 Ichu.

Moderator

Participants lines are muted. Thank you Monali, we will now begin the question and answer session for participants connected to the SingTel bridge. Please press 01 to ask a question. Right, question from Prateek Gupta of Citigroup. Mr. Gupta go ahead please.

Pratik Gupta

Yes hi, thank you. I just wondering if you could elaborate a bit more on the outlook for the rest of the year especially the next couple of quarters, in your last call you had mentioned that you are largely on track for a billion dollars in revenues and 30% net profit growth. I was wondering if that is still the case because that would employ a pretty substantial pickup in your coming June quarter and secondly in the media discussion in the morning, you had mentioned something about dropping some low margin deals, I was wondering if you could elaborate more on that, whether that is behind us or it is more to come and then last one final question is on the BPO business, the margins there still seems to be quite weak, when do you expect a pickup over there?

S. L. Narayanan

Pratik this is S. L. Narayanan here, I think the billion dollar number has to be taken more in a figurative sense, in fact, we will not be crossing a billion dollar in revenues for the 12 month ended 30th June. The billion dollar number that we mentioned this quarter is on an annualized run rate, so that is the answer to your first question and in terms of the second question I would leave that for Vineet to handle, the third part of your question was on BPO margins, during the quarter we have had 2 developments impacting on margins, basically we have had Northern Ireland grants which was being taken on a quarterly basis. That grant has run off substantially by 31st of December so that impact is about 1.8 billion dollars which has hit at the direct cost line, apart from that we estimate about almost half a million dollars in start up cost, which have got expensed, so this is a very exceptional kind of quarter in terms of margin outlook for BPO and we have also started on the second contract, the major contract with the telecom services provider and as a result of which the utilizations have been muted this quarter we expect the margins to come back in the next few quarters.

Vineet

Regarding the next quarter's forecast of profits, you know, we do not make the forecast, when we indicated any overall profit growth the profit growth numbers that we give normally is a rate, it is not accurate, you know, that we have been following this practice for more than 3 years or say.

S. L. Narayanan

The other point, Pratik, is you know we have deliberately not redeemed much of the portfolio because there was an advantage of maximizing the post tax yields on our portfolio, so as you can see from the footnote in the balance sheet, the unrecognized gain on the portfolio is almost of the order of about 40 crores, so these results have also have to be seen in the light of that upside which is there in the balance sheet.

Pratik Gupta

Sure, I understand that, but I was just wondering if you could elaborate a bit more on your large deal strategy, how is that progressing and especially given some comments you made about dropping some of the, you mentioned some deals, your some customers you are dropping, how is that planning out and how should we perhaps model in for revenue growth going forward for the rest of this year and next year?

S. L. Narayanan

I think, what we are trying to do is the large deal tenor is looking pretty good. We have already announced a couple of deals and I think we are on a good wicket moving forward, there are three stages to a deal, you know, if I can be maybe a little more specific here. The way we are tracking this is looking at 3 or 4 parameters, how much business, now I am talking only applications predominantly because that is the core of, that the company's growth strategy, I am not talking BPO and Infra in the analysis which I am going to put forward to you. If you track the amount of new business generated from clients who did not exist as HCLs customer a year ago, that is a very incurring figure of 15%, that means 15% of business is coming from customers in this quarter which is gone by, who did not exist as customers on 1st of July. Compared to that if you see the repeat business of most other companies is about 90%, 92%, 93% what it means is that we are doing more percentage of business with new customers and surrendering some revenues from existing customers. On an overall basis, including Infra, BPO and all that stuff we are at 91% but application specifically it is 15% coming from new business, so that is a indicator #1 of the strategy we are deploying of getting new business and surrendering some existing business. Why is the surrendering important? There are two reasons why surrendering is important, there are some projects that we are losing money, for some reasons we have made some commitments because the project sizes are very small and the resource deployed, the cost are increasing and the customer is not willing to revise rates despite dollar fluctuation. The second reason is some very good people get stuck in some very small projects which were supposed to grow and they do not grow and these projects are where people have been identified by me predominantly because of business continuity reasons and knowledge transfer reasons, so we have to unstuck these projects and unlock these good people so that they can leverage the larger deals because we need existing people who have been in HCL for a longer duration of time for larger deals, that is the reason we surrendering some revenues of existing customers and we are trying to map it along with growth of new business rather than just take immediate reaction. Last indicator of in terms of where are we on new bookings, the new booking looks fairly good, we are in advanced stages, I cannot give you guidance, but we are in advance stages, when I say advanced stages, the shake hands is over, we are in dealing phase and contract discussion phase on a number of deals which will make all of us pretty happy when we are announce them. Did that answer your question?

Pratik Gupta

Yeah, thanks, but I was just wondering if you could clarify on the large deals, does this imply some near term margin pressure over the next couple of quarters or you think the facts can be managed?

S. L. Narayanan

I think, the impact can be managed. As you know, if you really look at what we did was we upped the utilization by 2% this quarter to try and manage the margin pressure from the due diligence of one of these deals. The utilization is going to go back down 2% next quarter as we ramp up for newer deals, so as of now in the near term visibility the DD budgets which we have to take care for these deals, I think we are well provided for.

Pratik Gupta

Okay, thank you very much, all the best for the quarter.

Shiv Nadar

Pratik I will just give you one more perspective here, our broad guidance is that we would be growing around 30% in terms of revenue and 30% in terms of revenue translates of about 6.5% quarter-on-quarter or 4 continuous quarter. That will take you roughly 30% or so. This quarter we have grown 7.5%, the previous quarter we would have grown roughly similar percentage and you just add all of them we will come to, you know, we are not focusing so much on do we mean exactly 30, can it be 28, can it be 33 because we are driving more towards how to convert most of our business towards value business, then effort business, all our strategies, all our management attention is on that, not managing but whether it is 28 or 32. Infrastructure business, we are focusing more and more on how can we make it device based. Again, BPO business how can we get for number of resolutions achieved in customer care rather than number of FTEs involved in customer care. In technology business, we are trying to move more and more towards, can we convert the certain percentage of what we do to royalty based, you know with

Cisco we are successful in converting something like 20% of our head count deployed in royalty based revenue which is almost 50% more profitable than that. I just want to see, I mean want you see our efforts and in the light of this percentages. The next point where we are focusing very highly on is that our customer

Thank you.

Moderator

Thank you. Participants who wish to ask question, please press 01. Participants who have questions, please press 01 now. Right, I have Anthony Miller from Arete Research, UK. Go ahead Mr. Miller.

Anthony Miller

Yes good afternoon. I wonder if you could give us your views on what salary movements and pricing that you are likely to see during the coming quarters please?

S. L. Narayanan

What really happens is, there are two aspects to this, salary and cost per average person, so obviously in India the salaries are going up and if you go by the Hewitt Survey, recently published, their average for the entire IT industry is about 16-17% growth in compensation of an individual employee, but what really happened in IT services space because of the huge bench of fresh hiring which we do and value-based pricing we are able to add. Keep the average cost per person the same which is what we have. Our current cost per person in this quarter is the same as cost per person same quarter last year and we believe that based on the fresh intake of engineers and deployment of them in the projects, we would be able to keep them, keep that cost the same. In addition to that, other inflationary factors get compensated by these and change in business model more towards value-based pricing.

Anthony Miller

You say something when your salary increases are scheduled then please?

S. L. Narayanan

Our salary increases are scheduled in three trenches. First is till junior levels, it is on first of July, this is for people with greater than one year experience, people with less than one year experience will get into the cycle when they finish one year, and then we realign everybody towards 1st July and managers and above will get into the 1st October cycle and most of the people because the hiring is very large in every year will get into a cycle of either 1st of January or 1st of March whenever they become due after finishing one year.

Anthony Miller

And have you set the increased levels for the July and for the October increases in numbers.

S. L. Narayanan

No we have not set any increased levels as of now, we have not taken a decision of what we want to do either in July or October, that decision will be taken in June and September.

Anthony Miller

Okay and do you have any views on the mix of freshers versus laterals that you will be taking on these coming quarters?

S. L. Narayanan

Our goal is towards taking 60:40 ratio of 60% freshers and 40% laterals, however, that remains purely a goal largely because once the projects comes in the profile of the project determined the kind of laterals we have to take. Last year, we have been able to achieve 60:40 ratio, most of our other colleagues in the industry have been able to achieve 90:10 ratio, so it will vary between 60:40 where we are to 90:10 depending on the kind of projects we get. I think the company of our kind which is chasing more larger deals will be around 60:40.

Anthony Miller

Okay, the answer on the pricing question please?

S. L. Narayanan

Yeah, I will answer the pricing question, Shiv just corrected me most of the answers which I have given to you are with reference to application business. BPO business on among the freshers is, so the answer for BPO is also same which is thus 60:40. The pricing, which we are seeing in the market is I believe there is two very interesting events happening in the market place. In the financial services space, lot of bids are coming for re-auction and consolidation, so what is happening is large financial companies, banks especially which are have been working with 7, 8, 10 vendors are trying to consolidate and in the process of consolidating auctioning their base which are coming up for renegotiation and hence the prices are dramatically going down, we as we said in the morning are not participating in these auctions, we are participating for courtesy sake, but we are not participating in price wars and we are not picking up these large deals which are very low in price, predominantly because we want to focus on the value. So there is a price pressure on that side, there is a price improvement significantly on the technology side where the number of people available in aero industry, auto industry, semiconductor industry, so we are seeing a price improvement in technology, we are definitely seeing a price improvement in SAP and ECS practice, SAP-oracle practice. We are seeing a price improvement in infrastructure projects after we have established our traditions and creditability, people are willing to pay us more and we are seeing price pressures in the raw vanilla application space which we are trying to convert into value-based pricing and hence recover something on that front, so that is what is happening on overall pricing, on BPO Ranjith.

Ranjith

In BPO based, moving away from input based pricing to output based pricing and we are seeing a continuous improvement in the realization consequent to movement towards output based pricing.

Anthony Miller

Okay, and can I just ask one clarification question on BPO as you are talking about the margins just before to another caller and I think you said your expecting margins to improve again over the next few quarters, if you could just add a little bit of clarity to that where are you targeting BPO margins to reach, please?

S. L. Narayanan

Anthony this is S. L. Narayanan here, I do not think we can give any precisely calibrated forecasts on margins now, suffices to say that it will start improving but I think we are having this contract which are scaling up. It will be very very difficult and I do not think we would want to give you precisely calibrated targets now, but it should improve.

Anthony Miller

Okay, but is this what we got to look forward to in future, that everytime you start up a large contract.

S. L. Narayanan

Yes, in fact this has happened before, if you look at almost 9 quarters back when we started services with another telecom services provided in the United States. We went through the same kind of periods, it almost moves in a lockstep fashion, there is a sudden jump and then it ramps up and then it plateaus, and when it plateaus profitability increases and then you get another contract and there are upfront costs which are related to knowledge transfer and new kinds of you know training, which have to be expensed off at the point of starting the services, so in that sense you know we are going through a little bit of a gestationary investments in the second part of the contract which we started late December 2005, for which the recruitment also happened in a big way in the previous quarters.

Anthony Miller

Thank you very much.

S. L. Narayanan

Thank you.

Moderator:

Thank you, at this moment there are no further questions from participants at SingTel. I would like to handover the proceedings back to Monali.

Moderator (Monali)

Thank you Ichu. 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. Participants are requested to use only handsets while asking questions. First in line, we have Mr. Sameer Goyal from Alchemy Research.

Sameer Goyal

Yeah Hi, thanks my question has been answered.

Moderator

Thank you very much sir. Next is Mr. Mahesh Vaze from Brics Securities.

Mahesh Vaze

Yeah, Hi. Sir, I just wanted to understand this profitability movement in BPO, now there were some capitalization in earlier quarters right, is that what cost deepened the margins?

Shiv Nadar

This is Shiv Nadar here. Let me just explain this to you. You know, we undertook in Northern Ireland a major increase and additions to staff and it caused for a very large stream. In India, we are not used to governments you know providing subsidies for employment because employment in BPO sector specifically cause for very large training investment. These training investments in many overseas countries get defrayed, so there was a substantial defrayment of this nature that was taking place right till the OND quarter, that was done by the government of Northern Ireland. You may have seen the government of Northern Ireland taking out several advertisements with the picture of the British Prime Minister saying that how well we have you know worked it out in Northern Ireland. That was also very actively supported by them financially, so that cost defraying inflated the profit levels in the previous quarters, now currently those costs as it takes place in India because the growth is now much larger in India does not get defrayed by anything here. So you would find these profit figures of BPO being affected by this lack of defraying, that is why there is an 18% increase in profit, however it is 18% increase in revenue where as there is not a corresponding increase in profit because of this reason.

Mahesh Vaze

Secondly sir, continuing on the BPO side we had couple of flat quarters, but we are recruiting very strongly for the large deal that we have got and after that we have seen this quarter where they has been a very strong growth in top line so from here on what should we be looking at, would there be another quarter of strong growth or will come back to normal now?

Ranjit

See, unlike other business, BPO contracts are typically large and longterm multiyear contract, so the growth and revenues more of a step function than a continuous function. Some of the recent contracts that we have undertaken are all 1000 plus people, so you would continuously stabilize and one more increase and each of the increase will be pretty substantial.

Mahesh Vaze

So are we in that stability phase now sir?

Ranjit

We are mainly in stability phase for the next quarter but subsequently each of the orders that wins that brings will take us to the next higher level and consciously we have decided not to take any small processes, which are less than 200 people strong, so you will see the continuing step function on an ongoing basis.

Mahesh Vaze

Vineet what proportion of the 130 crore infrastructure services would be exports?

Vineet

I think we have reached the 50:50, although I will get S. L. Narayanan to get back to you with a specific number, I think we will be around 50:50

Mahesh Vaze

Okay, and couple of small details S. L. Narayanan, one thing is what is the kind of tax rate one should be looking at next year because we have seen the tax rate go up, so that is one thing and secondly you have mentioned that we will have to take a charge of about

USD 19 million towards this SFAs, so after this charge, what would be the ongoing charge like post this charge, and this will be a one time in nature but in 2007 what will be the charge like?

S. L. Narayanan

It is too difficult to predict that at this time Mahesh, I really wish I could answer the question. This is something which all of use will be doing if for the first time, so that is why you know we have not actually expensed it off but disclosed this as a footnote. Till recently even the methods to be deployed for pricing of these options was subject to great debate and so I would not want to put any kind of numbers but once we have clarity on this, because I think there was lot of there are thought has been expressed by various quarters, after that we would be able to give you some kind of an indication on what the quarterly charge is going to be. Till that time, you know, it will be very very premature to engage in a discussion. It is not a onetime charge, it would be there every year as the company goes forward because as far as the companies stock options are not based for one year, it is spread over several years

Mahesh Vaze

Sir, are we continuing to give stock options at this point in time.

S. L. Narayanan

Yes we have been announcing stock options in every shareholders meeting because it goes for approval.

Mahesh Vaze

And the tax rate S. L. Narayanan?

S. L. Narayanan

Yeah, tax rate, you know, we got a move up this quarter in terms of effective tax rates, from 10% it has gone to about 12.5%, I think the effective tax rate should come down next quarter because we have made some additional provisioning this quarter. For the next year, my guess is the effective tax rate would creep upward because some of the units will complete the 10-year limits on STP, so I think it will be definitely be higher than the current 10% run rate but next quarter effective tax rates should come down.

Mahesh Vaze

Thanks a lot.

Moderator.

Thank you very much sir. Next is Mr. Ajay Mathrani from DSP Merrill Lynch.

Ajay Mathrani

Yeah, hi thanks. The first question was on the supply side. I was wondering, if you have seen any uptake in attrition and what has been our experience in hiring particularly in the 3-5 year band?

S. L. Narayanan

I do not know if you have just seen our new ads which have been appearing, we have in our database now about 75,000 bio datas which are in excess of peers, based on the recruitment campaign which we had launched this quarter and we spent a lot of money this quarter doing that, but you are right in terms of quality manpower in 3-5 years is a challenge and we are doing a lot to attract it and that is the reason our employees first program and the emphasis on employees is largely due to the attracting talent. Our attrition is down, we are at 12% company when including BPO for greater than one year, people who spent more than one year in our company, which I think is the lowest we have achieved till date

Ajay Mathrani

The question was on volume growth in software services now. If you look at in terms of largely pure onsite which grew this quarter, and you know, it did grew the previous quarter so I was just wondering if there are any trend there or just a claw back of what we lost last quarter?

S. L. Narayanan

I think what you are seeing from an onsite-offshore is, it is 2 things, if you compare it with our competitors we are too much offshore and less onsite, so my preference would be to try and see if we can creep in on our onsite as a strategy. Number 2 is as the ECS grows up which is the enterprise consulting which is SAP services grow up and they did not grow up that much this quarter, but as they grow up you will see more onsite content. Third is as we move more into transformation deals like the Dixon's, this largely originating out of Dixon we have seen a sudden growth in Europe from 21.4% to 25.7%. So what happens is we re-batch employees and we bring them on our roles, so these are the 3 reasons why the onsite has gone up, but from a long term point it is not something that you can you know really strategies and say I want to increase my onsite but if we had more onsite in HCL I think we would be better off.

Ajay Mathrani

This kind of leads to a next question, in your bid of the large deals in terms of where we are in terms of ramping up?

S. L. Narayanan

In terms of ramping up.

Ajay Mathrani

The 3 or the 4 deals that we are now to know what stage are we in, to reach say steady state?

Vineet

Yeah, all deals which we have announced Dixon's will be full blast next quarter, Autodesk will be full blast effective 1st July and EXA will be full blast effective September and the other 2 deals will be anywhere between this July and September.

Ajay Mathrani

Okay fair enough. Thanks a lot and all the best.

Moderator

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

Sandeep Shah

Yeah sir, the software margins have increased despite a sharp increase in the onsite volumes, what is the reason beyond that.

S. L. Narayanan

You should not look too much into it, there are two things, first is we have focused on increasing the 2% of our utilization, which in my mind is an abnormal increase and I think we will go back to our utilization of previous quarter, so that is 0.2% increase in utilization of off shore which resulted into that. Number 2 is, when we surrendered some customers the mix of profitability changed that we got from high value customers and actually loss making customers were surrendered. So actually those were loss making customers. Number 3 is, transition in transformation deals is always of higher margins, so the initial billing on one of the large transformation deals which is in application transformation was actually billing at $150 an hour and that resulted into a higher margin but on a longer term basis, I think we would settle back to the old EBITDA margins which we had indicated.

Sandeep Shah

So today morning in CNBC you said that the margins will be near, 23% for FY07, so you maintain that stand?

S. L. Narayanan

I did not say it, and neither some of my colleagues said anything, nothing so precise. I think all I would say is that on the applications and the infrastructure margins will improve, obviously as the mix of global business is increasing and the application margins will remain what they are on an average for the last 9 months. I think the point here is there are no spicular shifts in margin structures. There is too many moving parts here, you have the rupee impact, you have salary increases, you have a mix between various horizontals and then you have depreciation cost, you have effective tax rates, you have the impact of interest rates impacting on other income, so I think these combined effects of this will still be able to manage the business in a way that it is fairly stable story going forward.

Shiv Nadar

Yeah, I want to bring your attention to one specific issue, you know while S. L. Narayanan is saying I hope you have seen that we have increased our utilization over the last 3 quarters and whatever we have saved from that utilization increase we have redeployed it into SG&A in form of significantly increased on marketing strength, so if you see our marketing presence, our brand building presence, our feet on street has doubled actually, number of sales people, so there is a significant investments going in that direction. So what we are doing is on one side focusing on cost of initiatives within our company and removing inefficiencies so that we can save some cost and taking them and deploying them back into the market, so we are doing this balancing act and we will continue doing this balancing act and that is the reason despite there are opportunities for increasing margin definitely exists in the company but we are going to redeploy that cash generated back into business because I think we need to invest more if you want to go towards the value centered leadership we have talked about.

Sandeep Shah

And sir, you also talked about changing revenue mix so does that mean that the revenue mix within BPO service and infrastructure management services will increase or decrease and if it decreases will that result into higher margins. As you said that the high margin business are expected to grow in coming quarters?

S. L. Narayanan

See, the revenue mix between the three services will remain the same, I do not see a significant increase, because on the application side the enterprise consulting is firing, on infrastructure side it is firing on its stand alone, the global is increasing and that percentage is increasing and as the money sales by increased margin in infrastructure we are going to re-deploy it into marketing and brand building and BPO is where it is. It has increased in percentage of the total revenue and I think there is where it will remain. The question with reference to the revenue mix was more to do with and we will do more revenue with less number of customers rather than do, I do not know whether you remember in the beginning of the year we had 496 customers and 496 customers for a billion dollar run rate in our mind was a little too much, and that is what we are trying to rationalize and try and do more business, more mutiservice business as you have said, what is the logic of this, let me try an walk. What really is happening in the market space is that every single application business is coming up for tender, either under price renegotiation or consolidation or captive or all this business is coming under threat. There is no stickiness in this business. There are some businesses in technology side which is very strictly because of the knowledge transfer but in pure application maintenance, not development, there is still stickiness in development but once the development is over and it goes into maintenance you have done good complementation thanks to CMM level V. There is no stickiness. Now at HCL, we see this as a major threat on a longer term basis and to create stickiness what we want to do is either shift our business model on pricing model to different models which we talked about output based, devise based, noneffort based, solution based, or fixed price base, or make the customer multiservice so that add infra into it, add SAP into it, add apps into it, add operations into it, production support into it, testing into it, BPO into it, so that it is difficult for the customer to walk away from an engagement or tender out an engagement, so increase the stickiness, if that is the reason what we are saying is our service mix would change in each client engagement rather than service mix changing overall.

Sandeep Shah

Okay.

Diviya

Hi, Diviya here from Motilal Oswal, I have a few questions on your infrastructure services. Infrastructure services flowing down this quarter, how do you see this going forward and how will this change in in revenue contribute to the 30% target that you are talking about?

S. L. Narayanan

Sorry, infrastructure is going down, I mean, the infrastructure team will feel very depressed by that comments.

Diviya

Slightly slow at around….?

S. L. Narayanan

No, I think you are comparing it with the 20% growth rate of the last quarter and therefore 9% sequential growth rate is looking low for you.

Diviya

Yeah exactly.

S. L. Narayanan

I think infrastructure is at 58% YoY growth and 114% EBIT YoY growth, I think they are where they should be, I think if they grow any faster they would not be able to manage growth, that is where I see them growing. What was your second question?

Diviya

This 30% revenue target that you are talking about, if at all if you had to split it between BPO and infrastructure and software services, what would be the individual basis growth for each of these components?

S. L. Narayanan

I do not think we are looking at that way as Ranjith said BPO is a step function growth, you know a large transactions turns and suddenly you know we would grow by 18% QoQ and then we will consolidate. Infrastructure right now is growing significantly largely because it is on the smaller base and it is winning a lot of business. From a long term strategic direction, what we have given is all these combined, some will grow faster, some slower in some quarters, something will happen. That is approximately the range in which we will be next year.

Diviya

Over a long term, which of these do you see growing faster. Give me as, you know, a ballpark kind of growth you are looking at for each of these?

S. L. Narayanan

I think, what we have said is that the emerging services, which is infrastructure, BPO and ECS the enterprise consulting will outgrow pure application services in our growth charter.

Shiv Nadar

Can I answer and give you one more dimension. See if you had asked this question 5 years ago, which of the areas in which the service offerings would be there, and where it could increase, we had at that time infrastructure which was what if I recall 30 million in size and the technology business was 230-240 million in sign and all applications and SAP implementation and those services put together that was about another 40 million or so in size. Now if you want to ask me to predict the next 5 years, I would see that there would not be any longer, just only 5 service lines. We have created pretty close to 20 different solution offerings, because you are comparing it basically on horizontals where as we would go on solution offering basis part, which is what is good for the company, so try and look at it that way, those who came for the analyst conference in February had an opportunity to look at these new service offerings which are in a package form and the people who are actually implementing them also were there to answer questions. If you wish, we would be happy to share that with you anytime you would like.

Diviya

One last question, I missed what you said about contribution from Europe increasing due to project start, could you repeat that for me please?

S. L. Narayanan

European revenues have grown from 21% to 25%, so if we to take those numbers on last quarter's numbers of 234 million and take the current quarter run rate of 251, it is almost 28% sequential growth in terms of dollar.

Diviya

Right, thank you so much.

Sandeep Shah

Sir one more question about this share price charge of $19 million, which we will be accounting in the fourth quarter, how much the impact will be there on the EBITDA margin for the fourth quarter?

S. L. Narayanan

It will be below line.

Sandeep Shah

It will be below line?

S. L. Narayanan

Yeah, because this is a non-cash charge. We would be disclosing this as in Performa accounts below line, but under US GAAP accounts, it will get merged into compensation cost.

Sandeep Shah

So under the US GAAP, the margins will decline in Q4?

S. L. Narayanan

Yes.

Sandeep Shah

Okay, and you are saying that this is a recurring charge, so it will be accounted in the US GAAP in FY07 also?

S. L. Narayanan

Yeah, but what is happening in most companies in the US is everybody is using Performa accounts, the way to put this under the US GAAP accounts people are going to ask for this number and then they will have to strip it off and look at cash flows. Because, almost the entire financial community wants to look at operating income and not the reported net income.

Sandeep Shah

Thank you.

Moderator

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

Girish Pai

Yeah Hi. Sir, you mentioned about value-based pricing and transaction-based pricing, in your existing BPO, IMS, and IT services business, how much would these constitute at this point in time and where do you think the percentage of this is going to be say two-three years down the road and what impact will this have on your margins?

S. L. Narayanan

You know, right now it is not a significant number to talk about. Therefore, we are not sharing that number with you. This is a strategic goal. We have defined that all new bids we will try and convert them into value-based pricing in some form or the other. These definitely will have an impact on margins and the margins will increase based on the strategy, however, I think that will only counter the negative margin impact coming for a negotiation of existing contract. I do not think in our industry there is scope for increasing margins. I think, whatever margins increase we achieved through such strategies we will have to either we deploy in higher SG&A for marketing invest or it will take care of increased pressures on existing contracts, which are commodity, which will come up for renegotiation or bidding.

Girish Pai

Okay. My second question is on competition from MNC on your IMS side, I mean, have the IMS offering in the offshore area reached a certain credible level with customers?

S. L. Narayanan

I think so, largely because if you take, there are two very interesting points about IMS. One is if you take the financial services industry, we have close to about seven of the largest banks working for us and only one of them does software development with us. The balance do not do software development with us and they do it with some of our other colleagues in the industry which shows the robustness of the IMS model. The fact that six of them outsource IMS shows the robustness of the model. So, IMS model is quite proven, I do not think there is any single customer at this juncture asking whether IMS can be done remotely. I do not think there is any customer which is talking about a fixed credibility in this market space and the win ratios with IMS is achieving is actually they are winning close to sever out of ten deals.

Girish Pai

No, basically I wanted to know more about your competition, your MNC competition in IMS area, have their offshore offerings reached certain credible state?

S. L. Narayanan

Their offering yes. I think their offering has reached a credible stage and they are credible competitors. The answer is yes.

Girish Pai

Okay. My third question is, there is a talk in the media that TCS is probably going to win a very large Deutsche Bank order and it is with operations. I just wanted to know whether you bid for that order or you did not want to take it up, any thoughts on that?

S. L. Narayanan

There was a large bank, which did a large vendor consolidation and did a bidding for that for which there was blood bath on pricing, which HCL did not win and did not want to win, which has gone into our best information to TCS which is fairly large contract, which is not Deutsche Bank and which is gone at a blended pricing of some $20, that we are aware of. Other than that that we have heard in the market place and we do know because we know the customer and we worked hard to the process till the pricing became what they became. Other than that, we are not aware of any other deal and if there were such a deal, we are sure we would have participated.

Girish Pai

Okay, one last question was on your enterprise consulting business. It seems to have declined quarter-on-quarter basis. Is there any issues there?

S. L. Narayanan

No, there is no issue. That business is very robust. You would see it fact on fact next quarter. It is just a matter of some onsite moving offshore.

Girish Pai

Okay thank you.

Moderator

Thank you very much sir. Next is Mr. Trideep Bhattacharya from UBS.

Trideep Bhattacharya

Yeah Hi, good evening gentlemen. My question was on software services business, like you know the growth has been up and down across last two or three quarters. On the back of some of the large contracts that we are signing, when will we see, like you know, maybe the software services business moving on to a slightly higher growth trajectory?

S. L. Narayanan

First, it has only been up. It has not been on down. We went up by 4.6% in first quarter, 5.2 in second quarter, and 5.3 in third quarter, and in fourth quarter it will be not down.

Trideep Bhattacharya

Okay, sorry I was not talking about the decline, but I am talking about the rate of growth?

S. L. Narayanan

Okay, rate of growth is also increasing. I think, you know, our biggest challenge as I explained earlier is in the application side where we are going through portfolio rationalization, reorienting our strategy. The big deals we have cracked are largely going to kick in next year. There is either due diligence going on right now, or they are in the process of contracting or they are in the process of transitioning. So, you are going to see the impact of most of these deals next year. I had already indicated to you that Dixon's you are going to see it coming in now but Autodesk and the other deals you are going to see next year. So that is where we are and as you indicated, we are running under the value principal at about 6.5% growth per quarter. That is where we are. I would rephrase it. If I take 30% and put it per quarter, it is 6.5 and I do not believe that this 6.5 per quarter will exist. In some quarter, it will be 6, some quarter it will be 7, some quarter it will be 5.5, some quarter it will be 8. So, just bear with us. These are quarter valuations which are, you know, we do not run the business in such a linear fashion, and one other aspects of applications which I would like to bring to your attention and I do not know how we are going to deflect this in our reporting, is that most of the applications deals that we are winning now are combined with infra, so going forward, we will request you to look at the growth rates of the two combined, because all the transformation deals we are winning are combined deals as it is becoming increasingly difficult to split the revenue between the two service lines, but we keep attempting that, but when we ask you look at our growth rates, we would like to look at those growth rates combined.

Trideep Bhattacharya

In this earlier part of the conference call, I think S. L. Narayanan talked about one of the item, do you mind repeating it, I can catch it sorry of asking the same question again?

S. L. Narayanan

Sorry?

Trideep Bhattacharya

I was saying that earlier in the call, I think S. L. Narayanan talked about the some of the orders which went up this quarter might not be there in the next quarter, I did not catch it??

S. L. Narayanan

In fact, basically, you know on BPO we have explained the impact of certain start up costs on the large projects that we commence, and we also made a point on the effective tax rate going up from 10% to 12.5% this quarter because of certain additional provisioning that we have created. The effective tax rate should come back down the next quarter.

Trideep Bhattacharya

Okay. That is last and best of luck.

S. L. Narayanan

Thanks.

Moderator

Are you through with your questions sir?

Trideep Bhattacharya

Yes.

Moderator

Thank you very much. Next is Mr. Pankaj Kapoor from ABN AMRO.

Pankaj Kapoor

Yeah Hi. My question is on the infrastructure business. Can you give me the breakup of revenues between products and services and between the domestic side and the global side?

Shiv Nadar

I think, I answer that a couple of minutes ago. I do not have that data right now, but I think it is approximately 50:50 between global and domestic and it is about 30:70, 30 product and 70 services that is my estimate as of now, but S. L. Narayanan can get back to you with specific numbers, but they will be more or less around this level.

Pankaj Kapoor

Sure, and second is on the hiring front. We are looking at about 60% of our hiring to be coming from fresher side. Can you give a sense of the campus offers that have been made so far in the year?

Shiv Nadar

I do not have the number right now, but we have not only made campus offers for this, we had also made it for the next year, as you know, before it is becoming very competitive, so we have also made the campus offers for joining in 2007.

S. L. Narayanan

I hope you all know, now in engineering colleges the offers are made when the students go into the fourth year itself, and a lot of the training or orientation gets done during the fourth year, during the weekends.

Pankaj Kapoor

Okay, just one last question on the support manpower side, the numbers have been growing for the last two-three quarters. I understand that is because of maybe because of the large deals that we have been pursuing, so where do you see this share of support manpower, which I believe includes sales also going forward and how should we be reading this?

S. L. Narayanan

I think you should be reading this correctly the way you are reading it that we are saving cost from operating efficiencies and deploying them in support. We, you know, from the number of sales people we have today, we intend to add 60 more sales people from now to the next six months, so you will see an increase in support cost, support manpower further, but we intend to largely fund it out of increasing operational efficiency.

Pankaj Kapoor

Okay, so do you expect the SG&A as a percentage of revenue being static at around current level or do you expect this to increase because of this?

S. L. Narayanan

No, it is static around the current nine month average level.

Pankaj Kapoor

Okay fair enough. Thanks a lot and all the best.

Moderator

Thank you very much sir. Next is Mr. Surendra Goyal from SSKI Securities.

Surendra Goyal

Yeah Hi. In infrastructure services, the export proportion is growing up and services proportion is also improving, so what can be the statistic margins here maybe in a couple of years' time?

S. L. Narayanan

You know, this is the question which Shiv used to ask me, BPO is on the right hand side and software is on left hand side, so I will leave that up in confidence. I think, it should move up. I will tell you what we are doing on infrastructure, so that you understand. We are not focusing on margins at all. This is one industry, which we conceptualized, we pioneered, we dominate, and our focus for the current one year, which is next 15 months, is only to dominate. We want to win everything which moves in this space. We want to dominate it so much that the business comes automatically to us like it come automatically to a lot of application software players because they were first in the market. So, I am less concerned about the margins and more concerned about winning business. Having said that, the margin attractiveness of this deal is significantly larger than applications. It is a very interesting fact, which are noticing in applications is that if you start with a 100 revenue, by the time you finish the year it comes down to about 50 and you have to win back to 50 through new projects and take it back to 100, where as in infrastructure you start with 100 and you remain almost at 100 or maybe at 95. That means the SG&A to get incremental business in the application is going to be significantly larger than in infrastructure. Now, these are all indications that on the longterm basis, the margins on infrastructure should be identical to application or maybe a little bit up or little bit down. That is a longterm basis, but in the next 15 months we are very clear that whatever we are going to take out we are going to invest back because we want to win everything which moves in that space.

Surendra Goyal

Okay. Thanks a lot.

Moderator

Thank you very much sir. Next is Mr. Ajay Mathrani from DSP Merrill Lynch.

Ajay Mathrani

Yeah Hi, thanks. The first question is on value and output based deals. Now, you know, the current proportion is low, but in the deals that we are bidding for in what proportion of deals would we be able to get, you know, value or and output-based conversation into it. Is it 10%, 20%, or almost all our deals that, actually the incremental deals, that we are able to get the same?

S. L. Narayanan

In the infrastructure side, it is a very large portion. We are almost at in excess of 40; in application side wherever it is linked with infrastructure total IT outsourcing, it is about 20; in standalone application side it is zero; in technology side it is again in the new bids which are coming up which is about 10-15, so its moving average has been, it is still early days of a new concept. So, I think it will be difficult to nail down a percentage and put it in an excel model.

Ajay Mathrani

Sure, no I was just looking at broadbased to see where it is getting adopted and ….?

S. L. Narayanan

Wise safe pricing has been adopted that is a done deal. BPO also output based pricing is a done deal. It is an accepted model. In technology, royalty based payment is just about started; and in application, it is behind everything else.

Ajay Mathrani

Fair enough, so what is the response being said, you know, where other vendors are bidding on traditional DNN or fixed price and say we would go in and bid on output or say value based pricing, is that always met with an encouraging response or is the opinion on it still divided?

S. L. Narayanan

I think, what is very encouraging is that whether the customer buys that or not he sees that as a differentiator. So, the answer is in 100% of the cases, it is positive, but not necessarily results into a buying pattern of that kind, but the customer appreciates that with HCL, he has an option where as with somebody else he may not have the option.

Ajay Mathrani

Okay, moving on, would we have figures on, how many visas do we have now and how many people are say onsite as of now kind of any numbers on that what is our visa coverage?

S. L. Narayanan

Our visa coverage is a big area of focus and that is something the cost which you should watch for next quarter and that is going on a daily treadmill as to how much H1 we can apply. It is a moving figure, I do not want to share that number with you, but yes I mean next quarter there is all about who applies how many H1 visas. So, it is a race to the finish line next quarter. All of us are out in the market and moving everybody. Whoever moves is saying, you know, I will apply H1 for you, why do not you come in. So, it is quite a fish market out there right now, so do not ask me for numbers, but if you have some numbers please share them with me.

Ajay Mathrani

Okay. Yeah, this is the followup from one of my earlier questions on large deals. Now the schedules that you mentioned earlier, you know in terms of when you would expect them to ramp up, so was wondering has there been any change from the time the deals are signed. Have you seen some acceleration or deceleration there?

S. L. Narayanan

Yes, there has been changes. In large deals automatically there are changes. There has been no acceleration in any deals, but there has been, you know one or one and a half month slippage in two of them.

Ajay Mathrani

Okay fair enough. One last followup. Blended pricing deal that you mentioned is up $20 this is the pricing that you are mentioning, what did the pricing start at?

Male speaker

The pricing started at $32.5 is where we were, I mean, we looked quite foolish, I know that.

Ajay Mathrani

Okay, thanks a lot and thank you.

S. L. Narayanan

We will take one last question because, I think, some of us have to go for other engagements.

Moderator

Thank you very much sir. The last question is from Mr. Abhay Shrivastava from Birla Sun Life.

Abhay Shrivastava

Good evening sir. This is just in relation to that contract which you signed with WaveSat recently, I just wanted to know the potential of that deal and when will the revenues start coming in?

S. L. Narayanan

I think, it is not a significant deal, which is going to impact revenues. It is one of the deals where the customer is willing to share the name. You know, today we have fewer customers wanting to share their name. The bigger ones which we sign, the customers are willing to share their name, so WaveSat is not going to have a significant impact on revenues or profits.

Abhay Shrivastava

Okay fine thank you sir.

Moderator

Thank you very much sir. At this moment, I would like to handover the floor back to Mr. Shiv Nadar for final remarks.

Shiv Nadar

I want to thank all of you for joining us in this conference call and if there are any further questions, please send to us and we will be happy to answer you. 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.