HCL TECHNOLOGIES

Annual Results Conference Call

August 23, 2005

Moderator

Good afternoon ladies and gentleman. I am Rohini, the moderator for this conference. Welcome to HCL 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 international participants connected to SingTel. After that, question and answer session will be conducted for participants in India. I would like to hand over to HCL management. Thank you and over to HCL.

Shiv Nadar

Thank you. Good afternoon and welcome to the HCL Technologies Annual Results Conference Call. I have with me today Vineet Nayar, President HCL Technologies, Ranjit Narasimhan, who heads the HCL's BPO Business, and S.L. Narayanan, Corporate Vice President, Finance. In the next few minutes, along with my team, I will talk to you about not only our financial results, but the deeper strategic changes we have unleashed within the organization to reinvent ourselves. We have in the last few months taken significant steps to create a unique position for ourselves in the industry. The success of these initiatives is evident in our robust growth and increasing satisfaction at the customer, employee, and stakeholder level. These strategic initiatives are closely linked to our financial performance and therefore I will now use two broad themes to lay the ground for the call; first is strategic one and the second the financial.

Let me start with the strategic initiatives. HCL is on the cusp of series transformation. In the last few years, we have quietly gone about our job transforming the company, often unnoticed. Though HCL is a three-decade old enterprise and HCL Technologies is ranked amongst the big five of Indian IT service companies, we are in fact the youngest of the block. Our journey began as recently as 1999 with our IPO. In just six years, we have grown multifold in our stature, size, and most importantly impact. We could achieve this growth only because we clinched on the right strategy and stayed focused on long-term goals. Let me touch upon some of the key drivers of our growth. First, amongst all the IT companies, I think we have the best balance service portfolio. We have created depth across four broad segments, product engineering and technology services, applications, infrastructure, and BPO. Today, we rank #1 in infrastructure, #2 in product engineering and technology services, #3 in BPO, and #5 in application. Each business is now on profitable growth track and our goal of creating leadership within each business has taken shape. We are positioned extremely well in the emerging segments of BPO and infrastructure services. In fact, our IT infrastructure management practice leads the industry by a wide margin. Similarly in BPO, our share of non-voice business is close to 30% and growing. Today, we do cutting edge work for global customers and product engineering and technology services domain. A remarkable feature that has been featured in recent Business Week article. Our application business which was developed with both organic and nonorganic means is today a creditable #5 in near three years' time. The technology specialization and innovative solutions have enabled us to create multiple touch points covering every aspect of a typical CIO budget. Today, we have landmark deals in the pipeline in virtually all our key business areas and we shall be announcing them shortly as we move them to closure. Second, over the years we have invested heavily for growth. Our physical infrastructure now boasts a world-class facility and we have three more new campuses in the making; one in Noida, the second one in Bangalore, and the third in Chennai. We presently employ 24,000 people spread from across six cities. Our HR practices not only focus on strengthening technical skills, but also shaping leaders of the future. Third, HCL strategy of non-organic growth has provided huge payoffs. Over early part of 2005, the acquisition of stakes out of six subsidiaries has been significant contributors to our growth. There are two stars of which we are particularly proud of. The first is HCL CMS or SOL DSL, which today is a business in excess of 100 million of revenues. CMS stands for Capital Market Services. The other is the British Telecom JV, which not only gave us global footprint, but also resulted in the largest BPO orders in the Indian industry of $160 million. HCL was also recognized by Northern Ireland Government for creating employment for over 1800 nationals at the time when India was being pilloried for job losses in the west. Such global transactions and value creations have few parallels within Indian firms. The future will see such significant collaborations and definitely HCL will continue to be most agile and dominant player in the coming sweepstakes. Now, the fourth point is our innovation and farsightedness to track emerging trends. I believe that the IT industry is in for a huge transformation. From a demand-based industry, we will soon render into a supply-based industry where huge thrust would be required for demand creation. To prepare ourselves from this inflexion point, we have created considerable traction in newer territories that offer attractive domains. We see new trends in service delivery that will call for turnkey solutions including output-based pricing contacts that will also be based on blended shore manning. The complexity of related risk dynamics will call for an execution rigor radically different from traditional models. I see as developing tools and techniques to model, assess, and manage different types of risks as we migrate large parcels of work from companies that are keen to restructure their P&L; not only P&L in their very manner of functioning. More over with the basic building blocks in place, we are focusing our energies on the sales and marketing structure. A major corporate branding initiative is under way and some of you may have noticed how we are the rising a media presence and mind share. We also went through a substantial management renewal by adding seasoned industry professionals across the globe. The initiatives improved our win rates particularly in the end-user applications and solutions space. You will be delighted to know that we have completed multiple deals in the quarter which across verticals in the application side. One of this is an $85 million contract over a period of five years with a bank in Western Europe, and yes the fifth and most important driver for our growth is people empowered, infused with the interest, with infused with the inherent HCL DNA. If there is something that separates HCL from others, it is our spirit of entrepreneurship, a burning desire to ensure customer satisfaction, youthfulness in our gait, and the guts to do things which carry risk but deliver commensurate reward as well.

This was captured in our fearless advertising campaign that we tried to communicate the fact that HCL has courage and the guts to reinvent itself. Our focus on unifying and developing a brand will be single minded in step with our business goals. So I think strategically, we are positioned right at the forefront of transformation that will indeed bring pleasant surprises for us in the coming year.

Let me now move to the financial theme, which I mentioned earlier, which is inextricably linked to the strategic one. It is here where you will stake your research, analysis, and funds on HCL Technologies. First in line is our services portfolio strategy. We have aptly demonstrated over the last several quarters that we can grow all our business lines profitably. It is important to look at the business over a continuum. Most revenues and EBITDA have grown. Over the last eight quarters, our run rate is up by 90% and EBITDA is up 130%, which is a 400 BPS improvement. I had mentioned in October 2004 that we will grow our EBITDA by 50% during 2004-05, and we have demonstrated and delivered on that promise. Second, HCL Technologies now has a robust balance sheet, it always had one. Our networth is $871 million. We have $457 million still in cash and cash flow of $137 million in the last 12 months giving us a solidity not only to invest and aggressively grow our organic business, but also to pursue nonorganic growth. We have also been following a high dividend pay out policy in an effort to reward our shareholders and paid out a total of $113 million during the last fiscal.

In conclusion, why should the HCL stock be interesting for you. Firstly, because at HCL our prime objective is to enhance the shareholder value while striving to keep a strong balance sheet. Our dividend policy is a manifestation of this principle. In the present economic and competitive scenario, we believe that only those organizations will survive that have the capability to reinvent themselves at every inflection point and maintain operation efficiency. We at HCL have prevailed over the past three decades only because we had the organizational character to embrace change and revisit our strategic plan and each crossroad. Over the last few years, we have rationalized our cost structure propelled with JVs on a fast track and integrated the PSO operations of HCL Infosystems to unleash significant synergy that increased profitability. Before I hand you over to SL and then for questions directed at my team and me, I would like to mention that we intend to shortly invite you to a investor and analyst meet where you will meet our leadership and operating team who shall walk you through the powerful force that they have unleashed to transform HCL. Your faith in HCL, I assure, shall be reciprocated by our performance and commitment to work for our stakeholders. Now over to SL.

S. L. Narayanan

Yeah, thank you Mr. Nadar. I will keep my speech very short and brief. I would like to inform all the analysts on this call that the pricing situation is stable and the other financial numbers that all of you would be interested in is the kind of covers that we are holding at the moment. We continue to be extremely conservative in our approach on management of forex. We have about $355 million of hedges which covers in effect the net flows over the next 12 months, and as I had mentioned on a previous occasion, we follow the edge contracts accounting method as a result of which the gains that we realize on completion of the contract is recognized in the quarter in which the contracts expire, so it is about $5.2 million of forex gains on a mark to mark basis for future contracts as of June 30, 2005, which has not been recognized in these accounts. Otherwise you would have seen all the numbers and the release, the margins have been stable on a year-on-year basis; on the last 12 months, there has been almost 2.2 percentage point improvement in EBITDA margins. Our opex as a percentage of revenues has fallen by a full percentage point. The gross margin is up by a full percentage point, so with that I will conclude and I throw this open for a Q&A.

Moderator

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

Moderator

Thank you Rohini. We will now begin the Q&A session for participants connected to the SingTel Bridge. Please press 01 to ask the question. The first question is from Mr. Prateek Gupta from City Group Singapore. Over to you sir.

Prateek Gupta

Hello. I was just wondering if you can elaborate a bit more on these various deals you have mentioned in the press, something like 10 deals with $100 million, sorry 10 customers with $100 million each in revenues in about three to four years' time and annual revenue growth of 30 to 40%, could you give us some more color on this? There has been some talk in the press about two to three of these customers but could you just give us some color on what kind of deals are these total outsourcing contracts, which service lines are likely to be growing the fastest, and also in terms of the margins, typically we tend to see with large deals, margins come under pressure, so could you give us an outlook on the margins as well please?

Vineet

Okay, this is Vineet here. I will try and attempt this question. There are too many questions combined in one, but let me try and give a perspective of what we are trying to do. If you really see the last five years what we have done is we have opened more fronts through emerging services. We have added infrastructure services to our portfolio. We have added BPO services to our portfolio. We have added multiple verticals, aerospace verticals did exist, the semi verticals has been added, the life sciences vertical has been added, and we have consolidated our position in package application. We have added a lot more services to our technology services area in concept to manufacturing space. So in the last five years, what we have been trying to do is to try and increase services and increase more touch points at a customer end so that we can be more significant to the customer than most of our colleagues in the industry including the global major. Now that formed a critical strategy of HCL. If you really articulate it well in what we are articulating now in the blue ocean strategy, we believe at HCL that the red ocean is where there is no unique differentiation in services, which is largely application development services and hence that will become a red ocean; too much competition, margins will go down, prices will go down and therefore there is need for us to create enough revenues from blue ocean, which is uncontested market spaces. Those uncontested market spaces HCL has tried to create through three strategies. Number one by having more emerging services that I talked about. Number two by having equity stakes, joint ventures, mergers and acquisitions, and nonorganic strategies to be able to reach that market spaces, and number three is by focusing on output-based pricing rather than effort-based pricing. Each one of these three strategies are in different state of roll out and have resulted into different gains. Now the impact of all these going together is now what we are seeing is HCL is engaging in larger parts of customer IT budgets and hence participating in larger deals and that is the reason HCL focus is going forward to try and increase what we do for few customers rather the increase in number of customers. So the comment which was made in the press conference a few hours back was to do with the way to measure back would be that you will see more $100 million clients with HCL predominantly because we will work with large customers, do more with them, and increase their value with fewer customers rather than work with larger customers. So whether it is 10 or 5 or 20, it is hypothetical. I think the statement which was made is that in coming years' time you will see HCL to be in the leadership position of dealing with $100 million plus customers. So therefore there is no specific guidance being given, it is just accumulation of our strategy and the result of the strategy would be that you will see HCL playing in larger big biz. The question with reference to impact of margin on large deals, I believe it is not true that large deals are less profitable than small deals. I think large deals have lower SG&A; predominantly you sign 10-year contracts. Number two is since large deals are hit through services lines and they are not homogenous service lines, hence comparison is difficult with competitors. Number three because large deals fall into the blue ocean, which are largely uncontested, we are largely contesting with the big guys who may not be as competitive as you are. Therefore price is not necessarily lower in large deals. We have seen a lot of deals with the prices much better. Our focus is to create uncontested market spaces and we believe this is one of the ways to be able to mitigate the risk of a red ocean or commoditization of the ADM services, which is bound to happen in the coming years time.

Shiv Nadar

Can I add some color there?

Prateek Gupta

Sure.

Shiv Nadar

Amongst the 100 millions plus deals which have been signed, it is already given in this note that there is one which is with a bank in Western Europe which alone is roughly 100 million of size. There are other deals in infrastructure services and BPO services, which have been signed, which are again pretty close to 100 million in size. All of them are between Europe and US, okay. Coming to where were these 10 guys from more than $100 million that will come. Three years ago, we could not see any. Last year, we created one. Now with the orders and new contracts in hand, the second will be there in this year 2006. The third one we have been intimated, that means 7 more to go. We have shortlisted a list of 17 organizations, out of them 7 will happen, but we cannot say whether this 7 will happen from the 17 or a couple of outsiders may come up and come up to 100 million each, both are fully possible. Have I answered your question?

Prateek Gupta

Yes, thanks very much. So basically what you are implying is the revenue growth outlook is very strong, but we shouldn't really necessarily expect a decline in margins at least in the short term as well, is that a fair statement?

Narayanan

Yes, it absolutely a correct statement.

Prateek Gupta

Okay, and second was just a very quick question on the BPO business, that didn't seem to grow much this quarter; were there some issues over there?

Narayanan

This quarter we were focusing on consolidation and expansion of margins and you would see that this quarter there has been a significant expansion of margins and increase in EBITDA. If you see a year-on-year growth, it has been extremely high growth; some of the revenues could have spilled over to other quarters. If you see year-on-year growth, we had grown 81% during the year.

Prateek Gupta

Okay, and just one last question what is the attrition rate in your BPO business right now?

Narayanan

It is currently much lower than the industry and it is about 4% per month.

Prateek Gupta

You typically exclude your less than one year employees, right?

Shiv Nadar

No we don't. If you exclude one year, it is in single digit on an annualized basis, because less than one third of the employees will be more than one year force because of the expansion.

Narayanan

In fact Prateek, the real attrition rate that you should be looking at for BPO is for employees who have put in one year or plus because typically what happens is the first three months, it is the toughest time, because suddenly these kids come and they find that there life is not looking as good as they thought. So, the highest attrition happens around the third or fourth month and the people who ride over the 12-month hump, they tend to become BPO veteran. So the real attrition that you should be looking at for the BPO business is with reference to people who have completed full 12 months and that number if I recall right it is about 8%.

Shiv Nadar

Its about 11.6%.

Prateek Gupta

Okay, thank you very much. All the best.

Moderator

Thank you sir. Participants connected to the SingTel Bridge may press 01 to ask the question. Please press 01 to ask the question. At this moment, there are no further questions from participants at SingTel. I would like to hand over the proceedings back to Rohini. Over to you Rohini.

Moderator

Thank you. We will now begin the Q&A interactive session for India participants. Participants who wish to ask questions, please press *1 on your telephone keypad. On pressing *1, participants will get a chance to present their question on a first-in-line basis. To ask a question, please press *1 now. First in line, we have Mr. Mahesh Vaze from Brick Securities.

Mahesh

Hello sir. Congratulations on the good numbers. BPO direct costs have come down sequentially by about 8.5 crores or so. Your revenues are flat, typically in such scenarios, you see some sort of escalation in the cost, what exactly happened here?

Narayanan

Mahesh actually we had a one-time impact of reversal of some costs, so you should consider a little bit of caution while looking at these numbers, but the balance part of that is on account of an improvement in the mix in favor of offshore.

Mahesh

Okay, so what exactly is happening? Is some business moving from Northern Ireland to Delhi or what do you mean by mix change?

Narayanan

Yes, it constantly happens because as we stabilize operations in Northern Ireland, it migrates after some maturity is reached to Noida, so that's a dynamic process that keeping happening fully, but there have also been some one-time impacts of reversal of costs.

Mahesh

Secondly, also wanted to understand, see your BPO revenues have not grown and we have seen numbers from some of the other companies also where the BPO part of the business does not seem to be growing. Also we have heard a lot of negative and we have seen a lot of negative about the whole BPO industry. Do you see growth getting impacted; I am talking more of a five to six quarter prospective? Are we at a point where one should be looking at lower growth? If one looks at your growth, then from the first quarter 04 onwards you have consistently grown at double-digit rate, okay, and this time around its flat, so are we at a juncture where one should lower the expectation for future from the BPO business?

Narayanan

Mahesh, I think we have always maintained that there is some quarter to quarter lumpiness. At the same time last year, I saw that there was hell of a lot of apprehension on the sequential growth rate in software services and today as we present these numbers to you, there is a 9.5% sequential growth rate which has come roaring back. So I think its only the interpreted strength of this company that it has truly diversified the revenue drivers that at a time when BPO is stabilizing, software is rocking; same time last year, we were growing at a 20% quarter-on-quarter on BPO and almost everybody was feeling so apprehensive about our sequential growth rate in software and what you have seen in the most recent quarter is completely put those doubts at rest.

Mahesh

My question was more on the industry?

Narayanan

I am coming to that. I think what we have is a dynamic organization, its a very live thing, so we will have this quarter to quarter lumpiness and I would encourage you once again at the cost of repetition, look at these trend lines over a 12-month period and I don't think you will have any apprehensions. Just to also add as Mr. Nadar said the pipeline and the deal flow in BPO is looking absolutely exciting.

Ranjit

If you see over a longer period of time, you would see that, year on year the growth has 81% at the top line and we have built a very strong momentum of growth both in the top line as well as the profitability and going forward we see that momentum to be continuing.

Mahesh

No sir, I fully appreciate it, the only thing I wanted to understand was it was not something that was unique to you in this quarter, so I was just wondering whether the sector as a whole is in for a lower growth trajectory?

Narayanan

I think the rest of the companies probably are going through some amount of vibrations which I am hearing from quite a few of the companies, but they are all execution related or caused out of execution, and I suppose that does make a difference. Anyone, when you are talking about BPO, you are taking over the core operations of a company. If that stops, the organization stops. So anyone who has got any flaw in delivery, it can happen to organizations which have purely software organizations because software if it gets delivered by 15 days late, the client does not collapse, whereas in operation, business processes, if it anywhere gets impacted, the customer gets very severely impacted. So it may have something to do with the company culture because we come from manufacturing background, we probably won't let this happen, in turn robustness maybe strong. Those who are not strong will lose.

Mahesh

On the infrastructure services side, what would be the contribution of exports in this quarterly figure?

Shiv Nadar

That would be about $25 million out of the $70 million in this financial year.

Mahesh

Okay, and for the quarter what would the amount be, approximate proportion?

Shiv Nadar

I will get SL to come back to you. That will be a higher percentage than what I have said.

Mahesh

Okay, so basically the growth is being driven by exports?

Narayanan

That is correct. All growth of profits and margins and revenues is coming out of exports. We are trying to reduce our dependence on hardware, which I think a strategy we articulated two years ago. The domestic revenues will go down, the global revenues will go up.

Mahesh

One last thing sir. We have had a great year. We have been growing both revenues and profits really well and we are now trying to up our profile by an aggressive ad campaign, so is it prelude to some sort of overseas listing at some point in time, is that something that you are considering at this point in time?

Narayanan

No, this is unconnected and we are not considering this at this particular point of time.

Mahesh

Okay, but sir given your history of inorganic strategy, you are one of the few companies in India who have had a meaningful inorganic strategy, wouldn't that be a tool which will further give you many more options?

Narayanan

It definitely will be because we have understood this, we have assimilated it, and now we would be doing it for two purposes. One purpose will be to enhance our capability in niche domains. These niche domains could be many, highly technical areas as far as certain spaces which are bread and butter where we simply need the additional capacity or capability that's one, and second we would be straight away going and acquiring some areas where output-related pricing is already being executed. There we would possibly buy for sheer legitimacy purposes. These are two areas in which our acquisitions are due.

Mahesh

Okay fine, thanks a lot and all the best.

Narayanan

Thank you.

Moderator

Thank you very much sir. Next in line, we have Mr. Manoj Singla from JP Morgan.

Manoj

Hello, good afternoon sir. Congratulations on excellent quarter. My first question actually goes back to the BPO business. I just wanted to understand that you have obviously shown a big increase in margin and you said some of it was one time, if you look at various operating methods like shift per seat like the voice-based business, how are they tracking, and do you think that there is still some scope to increase the margin there?

Narayanan

Yeah, margins have been improving on an ongoing basis. For last eight quarters, they have been increasing consistently and we are taking a lot of steps including increase in shift utilization to enhance the margins.

Shiv Nadar

Manoj I think the upsides are certainly there even more from where we are now, because I think the big opportunity is when we will have the day time hours also filled in because currently our shift utilization is perhaps just one shift. Maybe in the near future, we will have some kind of supply chain administration opportunities coming in, and at the moment, we are taking a long hard look at what are the opportunities and how best to maximize. There is a temptation to actually fill up those seats even now as we have certain deals which are there, but surely in the near future, we will have some kind of opportunities whereby we will take the shift utilization perhaps to 1.6 or even above and that gross margin will pretty much drop down to the bottom line as net income because there is very little capex addition that you will need, so the leverage on net income through better shift utilization during the day time hours will be phenomenal.

Manoj

Sure, and sir again looking at the growth sides while I agree that the slow down in growth could be more a quarterly phenomenon, but this year you have grown your BPO business at 70% plus and just the sheer size of the business now, it is 70% larger than last year, do you think that on an yearly basis you would expect growth to come down?

Ranjit

May I answer that question. See overall the growth projections that we they given is between 30% and 40%. Now obviously, if BPO is going to grow at 70%, someone has to grow less than 30 or 40, that it is unlikely to happen. So you are going to see a more uniform growth across the service offerings. So, will BPO go down in terms of growth, likely; will the rest go up, we have said between 30% and 40%, so likely.

Manoj

Sure. One last question from my side. If you look at the R&D side of the business and if you look at that contribution to the overall revenues that seems to be coming down over the three-four quarter horizon?

Narayanan

The overall growth, see we are at $764 million. If we take a 35% growth, between 30 and 40 if you take midway through, the growth will be about $250 million or so, right, $250-280 million is the range of growth and it has to fall in five buckets, which is R&D services, application consulting, enterprise consulting both of which are application businesses, BPO, and infrastructure. When you divide this into five, if the total is going to be 30, there will be redistribution if BPO business comes down, something else is going to go up, but that's something which will be continuous and that's the benefit of our company.

Manoj

Sure.

Moderator

Mr. Manoj, Hello sir. You are through with your question?

Manoj

Yeah, thank you.

Moderator

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

Ajay

Hi, Good afternoon and congratulations on a good quarter. My first question was again on the BPO business. I was just wondering if you could discuss the non-voice part of the business, what proportion it is and what kind of work are we doing there?

Narayanan

Currently, non-voice contributes about 30% of our revenue, but going forward we expect an increase in this percentage to happen. We do a variety of non-voice business. We do a lot of procurement jobs, cash we need to procure, and we also do mortgage services. We do a lot of F&A work, and going forward we expect a significant increase in the contribution from the non-voice business.

Ajay

Okay, next question was, we discussed output-based pricing compared to input, rather than input based, I was just wondering if you could discuss what percentage of our current business or revenues are from on output-based and where do we expect to see that in a couple of years?

Narayanan

Sorry, could you repeat the question please?

Ajay

Yeah, we were discussing output-based pricing earlier in the call. I was just wondering if you can discuss what percentage of this current business or current revenues are based on output-based pricing rather than input-based as of now and where would we see this ballpark in a couple of years from now on?

Narayanan

So, what we are doing is that as a strategy we have, as we articulated, driving output-based pricing, we are right now driving it as an internal strategy, we are not articulating revenue splits in that area for strategic reasons. We will give you some examples when we have the investor meet shortly on what are we talking about when we are converting some fixed-price effort we have, contracts into output-based contracts. Only after it reaches a significant number and momentum and our uniqueness in this area is predicted would we start sharing revenue splits in this area until that time our revenue splits will continue to be in the form and shape which we are giving.

Ajay

Fair enough. Just one last question from my side. You mentioned moving towards larger clients. I was just wondering if over the next one year would we see our actual number of clients come off, is that the extent of the focus that we are looking at, would we see total number of clients come down or we looking at only a few client addition kind of over the year?

Shiv Nadar

We would definitely see some client rationalization which will take place because unless it is critical work and where the growth is not definite, we would persuade those clients to relocate work with others.

Ajay

Okay, thanks a lot.

Moderator

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

Sameer

Hi, congratulation on a good set of numbers. My question relates to again output-based pricing. Could you give us our experience so far both in terms of billing rates and in terms of client attraction? How are we seeing this model going forward?

Narayanan

You stated this goal repeatedly in the press conference, and at the moment, we are at the point in which we are proving the case and we are gaining and gathering experience. It is the same thing like what the emerging businesses were three years ago. Now they have become bread and butter and part and parcel of our company. The number of areas in which we are working is high. It is currently giving an output which is roughly twice as what we would normally get, if that can give you an indication whereas the scope would be that it can go 6 times as much.

Sameer

Okay, good. The other thing was that you talked a lot on developing new tools and techniques and some new service domains you are keeping a thrust on, could you elaborate a little bit more on that, which are the new services you are looking at?

Narayanan

See there are two things which we are trying here. First is there is significant upping of investment in IP creations by dedicating people towards it. We believe that IP has to strategically to be used in three areas, one in trying to increase the amount of automation involved in service delivery and increasing productivity of people. The second is in terms of using reusable codes in a larger percentage. Let me go back, the basic premise which HCL is working on is increasing operational efficiency as Shiv talked about and bring about competitive advantage in operational efficiency, bring about new services and bring about a competitive advantage in the service offering we deliver to the customer and how we deliver to the customer. The automation investment and the tool investment is on one side going to help us drive efficiency and drive more per person than using tools and automation which is something which all global companies are trying to invest in to fight the Indian outsourcing, so we have to make that investment more aggressively than they are making to be able to enhance productivity. On the services side, we believe investment in service-based tools is the key to success. The entire remote infrastructure management business is thanks to the investment we have made in IP, in the tools and technologies which is driving that entire industry, without that investment which we started 3-4 years ago, this whole industry would not have been possible. We see similar four different opportunities in services space where we are making investments, which will drive again new blue ocean services strategies and that something as our revenues beyond $50 million in each one of those spaces we will keep announcing them, but we will keep investing in service products to be able to drive new service offerings, because we are committed to the blue ocean uncontested market space strategy.

Sameer

Okay, and last question was just a data point actually. Could you give us the attrition in the software services business?

Narayanan

The attrition in the software is about 12.6%.

Sameer

Okay, thanks a lot and best of luck.

Moderator

Thank you very much Sir. Next in line, we have Mr. Pankaj Kapoor from ABN-AMRO. Mr. Pankaj, Hello Mr. Pankaj. We take our next question from Mr. Shekar Singh of ICICI Securities.

Shekar Singh

Hi, congratulations on a very good set of numbers. I just wanted to know like if I look at your EBITDA margins and they have done very well in the last four quarters. Can we expect some more margin improvement in the coming quarters, and if so, what will be the main levers for it?

Narayanan

I think Shekar they will be stable.

Shekar Singh

Stable, okay. Secondly, as far as your revenues are concerned on the BPO side, have reached a maximum run rate over there or is it like still scope for improvement or if the contract size itself has expanded?

Shiv Nadar

There is a still lot of scope for enhancement of the volumes. We are having a very fruitful tie up with British Telecom and they are extremely happy with our services delivered, and going forward we see a lot of scope for expansion of the revenues from them.

Shekar Singh

Okay. Thirdly like if you can just tell us what is the status on the product engineering business, how does the growth looking like, and which are the key verticals where the growth is coming from in the product engineering space?

Shiv Nadar

Fortunately after a long wait, the product engineering business is back on track. It looks like the investment is back in product engineering especially what we have seen in the last two quarters. Interestingly, the aerospace is dominating, the life sciences in technology is dominating, telecom is dominating. These are the three verticals which are dominating. They are also seeing a huge amount of traction suddenly coming up in the last quarter in this semiconductor industry, which is also coming back into making more and more investment in this area. From a service line perspective, we are seeing concept to manufacture getting a lot of traction where people want us to take larger ownership of results. We are also seeing people wanting us to take a lot of ownership in doing product conceptualization through development. So the conceptualization business responsibility more and more customers want us to take which is also driving growth. So these are some of the areas where we are seeing growth in the technology space. I don't know if you had an opportunity of seeing the McKinsey NASSCOM report; as per that report and if you were to go by that data, the application development market as per them is growing at 17%, so there is plateauing happening there as per them, and the technology space is now suddenly jumped off and is going to grow by 55%. Infrastructure management as per them is growing at about 200% plus and BPO about 60-70%, and same is true with the packaged application space. With that kind of background on the industry, if you see our application development is only 25% of our whole revenue, balance 38% is in technology space and the infrastructure and BPO constitute 22%, so we are on the right side of the growth industry so that's something positive.

Shekar Singh

Okay, sir lastly a small question to SL. If you can just let us know the unrealized profits from your treasury investments, they seem to be very low, so on $400 $4 million and the treasury unrealized profits of close to $5 million, so should we be expecting some more increases over there going forward?

Narayanan

Actually, this keeps the tracking based on a completed 12-month cycle, so last year we had most of the portfolio maturing around June and September. Its something which you have to see over at least 2 years to get a reasonably good fix on what should be the correct number when you look evaluation of the treasury portfolio, and also the last year the number that you have there which is $36 million includes about $8 million which was reclassified from FY03 to FY04, so the $36 million is unnaturally high and to the current years number of $22 million if you add the $6.7 million, you get a number of $28 million which then you have to look at the portfolio and evaluate what is the performance.

Shekar Singh

So net-net, for model purposes, should we expect return somewhere close to $28-29 million.

Narayanan

If $450 million at 5% is $22.5 million in other income, we have made about $28 million on a full-year basis. So if you look at the current portfolio, our portfolio is largely on account of liquid funds and short-term floaters. We are making at best about 5.6 to 5.7% pretax, so you could possibly modulate on the basis of 1.4% pretax per quarter.

Shekar Singh

Thanks a lot sir and best of luck.

Moderator

Thank you very much sir. Next in line, we have Mr. Trideep from UBS.

Trideep

Good evening gentlemen and congratulations on your results. Could you please tell us a little bit about how the Boeing contract and the NEC JV is kind of progressing, and also in the large contracts that you talked about, are the revenues front loaded or like how exactly will the revenues flow through in the next year or so, if you could throw some light on the same, that will be great?

Shiv Nadar

First, I think the Boeing contract is going pretty well. One of the positives about the Boeing contract is whenever you become extremely valuable for your customers by doing jobs which are very strategic and important to them, the customer takes care of your growth, so that is one of the reason which is driving HCL towards being to be in services which are more strategic and more valuable and more core and significant for the customers than not to be significant. The NEC joint venture, we are still awaiting the regulatory clearances. As you aware, NEC ODC is already working and growing. The regulatory clearances between Japan and India is in process. We have different dates on when this will happen. I don’t think it will happen this quarter, but I think the formal JV would start next quarter, but the revenues from the ODC continue. The second question with reference to the larger transactions and how would the revenues be loaded, I think you hit the nail on the head the transactions are extremely large where the knowledge transfer and the due diligence phase is not paid by the customer. If you really remember, if you have tracked the way the infrastructure services has grown, the way the infrastructure service grew is we came to you and said that the customer is not going to pay for transaction and that will be amortized over the period of the contract and in case the customer terminates the contract, he will pay for it, so it survives termination. Most large deals are structured that way and especially when the large deals the way we are structuring it and we have discussed output-based pricing a little, for example, if an insurance company deal which we are structuring, we are structuring on a per policy price, so what would happen is that the front loading revenues will not accrue immediately. The knowledge transfer phase and the transition phase will have zero revenue but will have cost identical to the infrastructure services business, and after that the contract will continue for annuity, either 5 years or 10 years with only termination for cause, no convenience.

Trideep

Just a followup, how may people will you apparently have on Boeing, is it possible to share?

Shiv Nadar

I do not know if our contract allows that share. If it does the investor relation department will share it with you. They will check the contract.

Trideep

I see, okay, thanks and best of luck.

Narayanan

Thank you.

Moderator

Thank you very much sir. Next in line, we have Mr. Pramod Gupta from HSBC Securities.

Pramod

Hello, congratulations on a good quarter. Just a couple of questions I have. One what is happening in the existing large relationships that we have, it seems to me like the top accounts are not growing as rapidly as some of the other accounts are?

Narayanan

Okay, I think that observation maybe correct. That observation is largely because we were focused on, last full year, we were focused on new client acquisition, new name acquisition, the unfortunate part of our business is I can't share the names with you, but if you take the top, in the last quarter the number of wins we have of people who are doing application development with some other colleagues of ours in the industry and who are doing emerging services and technology, infrastructure, or BPO with us is significantly growing, so there is a customer churn which is happening, so we were focused on that initiative and we will continue focusing on that initiative. It is next quarter onwards we have turned our attention into those 17 customers which Shiv talk about. There we want to significantly invest in them and grow alternate lines of services in existing customers, because there are profit centuries anyway, so that intention will go into them and therefore you will see some changes in those numbers happening as you move forward; however, I think Shiv articulated it and I would like to reemphasize there are certain sets of customers that we will drop, I think we have too many customers who are giving us too little revenue, so they will have to decide whether they want to give us more or they have to find some alternate service provider.

Pramod

Second thing that I was wanting to ask is about the share count number. This quarter again we have seen some kind of a dilution and if you could just brief us on that?

Narayanan

See that is basically because a lot of people have exercised their options.

Pramod

Okay and what about the fully diluted share count as of date today?

Narayanan

It is 319 million shares.

Pramod

And finally I just had one request basically we have really grown big and we have done excellent job in the last three years, but our disclosures are not improving in the sense that we still do not give schedules to the quarterly performance numbers, also our result comes pretty late and I will suggest we should do something about that also.

Narayanan

Point taken. Point absolutely valid and taken.

Pramod

Thanks, thanks a lot and all the best.

Moderator

Thank you very much sir. Next in line we have Mr. Anantha Narayan from JM Morgan Stanley.

Anantha

Thanks and good afternoon everyone. Just a follow-up on BPO business, you all mentioned that the non-voice part should grow significantly going forward, is there any sort of optimal mix that you have in mind over a long term timeframe?

Narayanan

See, in BPO typically the value chain is that in the bottom of the value chain we have transcription-based services and then we have voice-based and then you have transaction-based, and then you have knowledge-based service. As the industry matures and we definitely move up the value chain, and over a period of time, the percentage of voice-based business will come down. We will see greater percentage of transaction-based services and further down, the percentage of knowledge-based services will go up.

Anantha

Right, is there a sort of percentage that you have in mind over a 3- or 5-year time frame?

Ranjeet

No its an ongoing process. I mean on ongoing bases the percentage of voice-based will keep coming down and the percentage of knowledge-based services will keep going up.

Vineet

Anantha we are not willing to commit to a percentage, but what I think he is trying to say is that our focus is towards non-voice base, so I don't want a theoretical maximum is on how much we can do non-voice based. See you must understand that a couple of things which is different from the BPO which Ranjeet is trying to explain. BPO is a business of large deals that's what we are focused on, so when the large deal comes in, it is very difficult to predict what the ratios would be. Our focus is in getting large deals, our focus is in getting integrated deals with BPO, infrastructure, and software all put together, our focus is in BPO to try and focus on non-voice based, but it is difficult to predict percentages. Our wish statement is that the voice should be very little as little as possible.

Anantha

Thanks Vineet, and just one final question. I think SL alluded to this during his opening comments about the quarterly volatility that you see in some of the business lines, is there anything that is structurally very different in HCL Technologies business model relative to peers that should create higher volatility?

Shiv Nadar

I think a brilliant question, and you know I have been struggling to find that answer and I think I will give you a hypothesis. I understand HCL very well. I don't understand the rest of the businesses. Unfortunately when we talk in this detail if I look at the total split of the HCL business as a percentage and I did that and I did everybody else's percentage, I find HCL quite unique in the mix of its businesses, if application development business is only 24% of its total service, out of 24% the application maintenance will be a certain percentage, right, I don't have that number, so there will be some project-based work out of 24% and there will be some annuity business which is maintenance business. Then the technology development business which is purely project-based is 38%, there is very limited maintenance work, so the profitability on technology work is higher, but there is limited less maintenance work there compared to the application, that constitutes 38-39% of our business. Then you go to BPO, which is purely reckoning in nature, that's a positive from a revenue predictability point of view, which is 12% of revenue. The only problem with BPO is because the base is small and the large contracts significantly impact the revenues and hence the cyclicity of the revenue. So we are on the $100 million base of revenue and the moment the contract comes in, it is in the deal range of $20-30 million, it significantly impacts the revenue and the deals comes in, the transformation takes place and impacts the revenue, and the same thing gets impacted to the balance of the revenue, which is infrastructure, which has an Indian component where the JAS quarter is the lowest and the April, May, June quarter which is the highest, which is the Indian side of the business because the cyclicity of the Indian business, and the infrastructure business again where the base is low and the large contract announced will significantly impact the results predominantly because you start with onsite services and you bring them offshore, it impacts the quarter by quarter. So my understanding of the way it is, is because of the lower base which we are, which is $763 million versus a million plus for others and a lower base of ADM, the quarter-on-quarter numbers keep fluctuating instead of being consistent; however, we did a projection of what does the 2006-07 number look like and what does 2007-08 number look like, and I will encourage it do it this maths and I definitely can't share my excel sheet with you, but if you look at the four lines of business of HCL or five lines of businesses of HCL, look at the relative growth and ignore the current year, the current year holistically will grow, and look at what is the ratio of the businesses in the next two years, I think on quarterly stabilization should start happening about 12 months from now and I think it is an important thing which we at HCL are focused on. I do not think it will happen in the next 12 months, but I think something, which we are attempting to do in the 12 months after that. Does that answer your question Anantha?

Anantha

Yes that's helpful Vineet, thanks a lot.

Moderator

Thank you very much sir. Next in line, we have Mr. Hitesh Zaveri from Edelweiss Capital. Mr. Hitesh. Hello sir.

Narayanan

He is not there. You can go to the next in line.

Moderator

Yeah sure. Next in line, we have Mr. Rabin Ghosh from Crisil Market Wire.

Rabin

Hello, congratulation on a great set of numbers. I have this question on what is the impact of FBT in Q1?

Narayanan

Hi. Rabin SL.

Rabin

Hi SL.

Narayanan

1.9 crores.

Rabin

Can you repeat that again please?

Narayanan

1.9 crores.

Rabin

Also could you throw some light on the hiring plans for the rest of the year?

Vineet

The hiring plan for the rest of the years is, there is a just in time hiring.

Rabin

So you are not willing to share any numbers?

Shiv Nadar

I know what you are trying; I think you are trying to politely ask for an actual guidance. I think Vineet has through that question.

Rabin

Also sir could you just throw some light on your capex plan. You did give us your capex for the past year. What would be the capex plan for this year? I understand your Chennai campus would be under construction in this financial?

Shiv Nadar

It will take some time, it will be coming up in phases, but it is reasonable to expect at least $70 million outlay on capex this year.

Rabin

Largely for your Chennai…?

Shiv Nadar

Facilities creation everywhere.

Rabin

Also could you throw some light on your blended billing rate?

Shiv Nadar

We don't have a blended billing rate, but

Shiv Nadar

I would like to make a statement out here, that's one of the reasons we are spending longer than normally we do. I think somewhere some of these matrices, which we are reporting will undergo a change. By the time we come to next quarter, we will evolve different matrices to create this more aligned to realistic business model which we are chasing. One of the reasons that we want to do an investor meeting sometime is to walk you through our model and hence what the right parameters to look at it including whether the bill rate is relevant or bill rate is not relevant. So I don't have an answer for you right now on this, but I do want to discuss this whole issue of onsite, offshore, offshore centric, onsite centric, it confuses a shit out of me, but we will do something on this area and come back to you with some more meaningful data rather than all the data which is there in the release right now.

Rabin

I look forward to meeting with all of you during the analyst meet.

Shiv Nadar

Thank you. Any other questions waiting?

Moderator

Sir, there is one more question from Mr. Dipen Shah of Kotak.

Dipen

I think the most of the questions have been answered, just one data point, has there been any impact on your salary increases this quarter?

Narayanan

Yes, there have been some salary increases in April. There will be more salary increases in July, and our geo salary increases are in October. Our India is split into two, some part increases in April and some part increases in July, so the real increase in salary is really coming up in July and in October.

Dipen

Right, any light as to what could be the salary increases or any estimates?

Narayanan

On salary increases? It would be enough to make our employees very happy and not that much to make our shareholders sorry.

Dipen

Right then, thanks very much.

Moderator

Thank you very much sir. We have Mr. Pankaj Kapoor from ABN-AMRO.

Pankaj

Hi, thanks for taking the call. My question relates the infrastructure management services business. Can you give me some sense of how much is the services business in this and how much would be the equipment sales?

Narayanan

I think our projection if you take $100 million in the infrastructure management space, we would be about $40 million in equipment and about $60 million in services.

Pankaj

Okay, and how do you see this mix changing going forward and especially in the services business to the question which you spoke earlier on in terms of exports increasing. Can you give us some sense of what kind of business will come in and how do you see this growing in terms of the number of deals which are going to come in, the kind of deals that you are pursuing, the size basically, the vertical that you are looking at?

Shiv Nadar

See either that is a loaded question or it is an innocent question. If it is a loaded question, you know too much about what has happened in HCL. If it is an innocent question, then you are very lucky. Yes, the kind of deals which we are getting are going to be very interesting, remote infrastructure management area is something very very interesting that is happening. If you allow me I would like to postpone answering that question, give me just about 45 days more and I will come back to you with a very interesting answer. You must understand there is a huge competitive advantage we have built up and the reason that we are not talking about some things which have already done is largely because we want, as the word you use, we want to bank it and then talk about it.

Pankaj

Sure, fair enough, I think you are keeping it for the analyst meet, I believe.

Narayanan

I remember the last conversation we had Pankaj in our conference room, I think you are almost with a single-minded focus pursuing that.

Pankaj

Okay, sir. Thank you very much and all the best.

Narayanan

Thank you.

Moderator

Thank you very much sir. At this moment, there are no further questions from participants. I would like to hand over the floor back to HCL management for final remarks.

Shiv Nadar

Thanks to all people on call and for any further questions, you can call either me or Sujoy Ghosh. Thanks very much.

Vineet

I just want to make a concluding remark. I don't know if anybody is still left on the call. I do know that a lot of you have expressed interest in having a chat with me and SL and team have been taking to me, both me and Ranjeet are completely focused on driving the revenues up and our priorities right now are focused towards getting the new strategy and business model rolled out and that has what has occupied us for the last 3-4 months because of which we have not been able to meet you as often as we would liked to. I think things are going to change because the things that we wanted to do in the last four months have started falling into place, so give us about 30-40 days and then we will be very available to you, and I think from a investor relationship point of view, I think we will be back on stream as being one of the best class company in this space also. With that, on behalf of Shiv, Ranjeet, SL, and myself, thank you for being with us and thank you for your support, bye.

Moderator

Ladies and Gentleman. Thank you for choosing WebEx Conferencing Service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you and have a nice day.