

HCL TECHNOLOGIES LTD

Q4 & FY 05-06 Earnings Call

9.00 am (IST), August 21, 2006

Moderator

Good morning ladies and gentlemen, I am Monali, the moderator for this conference. Welcome to HCL Technologies Conference call hosted by SSKI Securities. Mr. Shreyash Devalkar of SSKI Securities is your call leader today. 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. Shreyash Devalkar of SSKI Securities. Thank you and over to you sir.

Shreyash Devalkar

Thank you Monali. On behalf of SSKI Securities, I welcome you all to the HCL Technologies Q4 earnings call. We have with us Mr. Shiv Nadar, Chairman and CEO of HCL Technologies and other members of the senior management of the company. I now hand over the call to the HCL Technologies management. Over to you sir.

Shiv Nadar

Thank you, Good morning friends. I have with me joining in the call is Mr. Vineet Nayar, President, Mr. S.L. Narayanan, Corporate Vice President - Finance, and Mr. Saurav Adhikari, Corporate Vice President – Strategy, Mr. P R Bansal - Vice President and Vikas Jadhav responsible for investor relations. So we have a team of us you know on the call so that they could response to most of what you may need to know. It is a pleasure welcoming you all to the conference call to discuss our performance in the last quarter of the fiscal year. With me on the call who have been there I have already mentioned, as you may be aware, HCL as a brand completed 30 years a few days back. I would like to start of this call to thank all the members of the investing, asset management and broking community there is over the past few years consistently has put faith in us. Thank you very much. The year that has just ended was good in many ways and indeed eventful for HCL. We concluded several landmark deals including what is the believed to be the single largest software services contract, ever awarded by any client anywhere in the world to an India based IT services provider. In addition to Dixon transaction, which is worth about 320 million dollars over the first 4 years, we have announced several other contracts spanning across various horizontals in a wide range of practice domain. This is consistent with the philosophy of working on multi service, multiyear, multimillion dollar deal, which gives a higher predictability and also uses our capability of being in multiple services. Most recent of them was Teradyne this engagement already has been announced. It is in excess of 75 million dollars in all during the last 12 months across service clients and then together with service clients. We have announced contract, I am only talking about the announced contracts that typically 25 million and above would be between

700 and 800 million dollars. This is almost close to the size of the business that we have done just only in large deals. It is an important departure from our past trends, this is organic growth and in the organic growth getting such large deals of business is unusual for almost any company in India. Some of you may have seen the recent article in the Economic Times by Dr. Prahlad in which he postulates the key prerequisites for an aspiring corporation, to put it simply he extorts senior management who always set goals beyond the finite limits of resources and time. I have been particularly fortunate of leading a team of talented executives who have lived up by their jobs. In the recent years, we have used both organic as well as nonorganic measures to augment our capabilities in our existing areas of strength and add new revenue stream to our business. Our exposure to the traditional and mandatory of product engineering what we call technology lead services has now come down very dominant 75%, 4 years ago to less than 24% now. We now have large application and enterprise solutions practice. We actually call the enterprise solutions practice, you know by various names it just driven internally we call it as enterprise consulting and at times this package implementation this towers SAP, Oracle, and other similar practices, they also ramped up beyond the critical mass in BPO and infrastructure management services, two of the major growth drivers of the overall IT resource outsourcing space just to give you a flavor, the IT infrastructure services space when we began 4 years ago was in the neighborhood of 6 or 7% and BPO did not exist okay, now in the year that ended on 30th June these two service offerings, which looked at the future with a huge potential for the future have now occupied pretty..., I mean above 25% less than 30% kind of size in our revenue pie it also completes our service offering to our customers who are wanting to undergo transformation. A very important thing why we have grown in this also we have grown in the infrastructure services, the remote infrastructure management, RIM has a key piece because that India centric or value added is fine, the technology inputs that we can provide is fine, similar to that even the BPO services we have seen the growth. We took into the BPO services being a larger than 50% growth in the India based one so that the profitability stays high, so this had 2 points I thought I would just bring to your notice which may not be visible in the other documents. The run rate of infra business is more than doubled in the last 12 months with the sharp margin expansion and rebalance service mix in view of changing market change in fact many of our recent contracts have been largely helped by increasing stature as a vendor whose capability is stable, a comprehensive suite of service offerings. During the year, we commenced a unique employee first initiative during the year under review with an exquisitely stated corporate objective that the people will take priority over all the stake holders including customers. Under this overall theme, company launched a slew of programs aimed at increasing employee satisfaction. Employee satisfaction to actually essence of employee ownership – user friendly automated appraisal systems, 360 degrees feedback appraisals, you know this is where we are inverting the pyramid. We are getting people to evaluate their bosses, so what _____ and what we will not be able to and they have been able to anticipate changes like initial poles and direct responses from employees reassure us that we are on the correct path. The company believes that its efforts under the employee first agenda will serve us well to make qualitative difference in human resources management. I just wanted to know it is not the human resources management. We have to understand that this is not the business in which the buildings in which we live are the assets or the computers which we work are the real plants and machinery so that's the way it is reflected in the Balance sheet. The asset of this corporation, what came to the door and walked out of the door

everyday - is people, now, if you are gonna treat them as "the most critical asset" in this business, which they are, then we have to manage differently in sense of ownership, be different, which is what is been exercised by this _____ part as a employee first policy, but the fundamentals of our next growth both rate and place and we are rapidly scaling up our delivery infrastructure and we are keeping _____ strategies in all our delivery locations in Noida, Chennai, and Bangalore. This is the summary most of the financials have been now lying with you over the weekend. I will now hand you over to S.L. to take you through the fiscal.

S.L. Narayanan

Good morning ladies and gentlemen actually I have opened with most of the analysts over the weekend and I just add 1 or 2 aspects for the benefit of those with whom I did not talk basically the queries have revolved around the unnatural reduction in provision for taxation. Basically, the quarter we have been advised by our auditors that in the US GAAP, the fringe benefit taxes have to be taken out of provision for taxation and reclassified along with direct cost and that entry has been passed through the books, so there is a 3 million dollar figure, which has moved out of provision for taxation into that cost and some of you were also keen on knowing what is the expenditure on H1B visa applications that number is little less than 2 million dollars, so taking both these into account, in fact the impacted is being captured in the IT services financial. Our operating margins are actually grown by about 150 basis points, so that is something which you need to factor it and you evaluate the performance of the current quarter and rest of the financials are basically self speaking. We have also not redeemed most of the treasury portfolio, which we normally do at the end of the fiscal year, so the unrecognized gain on this treasury aspects have actually increased by about 12 to 13 crores. We have about 53 crores of interest accrued on investment and this is not been recognized in the P&L and these would come in as an when redemption are expected in the next _____. Other than that we have most of the financials which are absolutely self speaking so I will throw this open for Q&A. We have time till about 10 a.m. and any questions that are lying unanswered__, please feel free to call me or Vikas during the day and we will be happy to follow-up the rest. Over to the moderator of this call. Thank you.

Moderator

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

Ichu

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. This question is from Ms. Mitali Ghosh from Merrill Lynch. Go ahead mam.

Mitali Ghosh

Yeah hi can you hear me.

Shiv Nadar

Yeah Mitali.

Mitali Ghosh

Yeah, so my question was on the you know one is the large contract that you have been winning just in that context you know is there sort of benchmark that you have in mind that you know what is the kind of the portion of the revenues from large contracts you may look at over the next couple of years and what sort of margin implications those could have.

Vineet Nayar

Mitali now this is Vineet here, we do not have our external facing information target of what percentage of revenues will come from large targets but the way we are let me try and explain the logic of the big deals so that we all understand it, this is from the margin perspective. The way we see that is that there is significant pressure on cost across the world and that is the reason for movement of significant IT jobs into India. We believe that cost will continue to be driver for what we call the single service, coding services to be off shore. We believe it is not possible to you know continuously upgrade margins in an increasing cost base of employees and at the same time increasing pressures from customers from re-negotiation, therefore different companies will adopt different models over the medium and long term to be able to sustain their margins. The model which HCL has adopted is the fact that if we approach our customers with the multi service offering where infrastructure and applications both are there and at the same time, offer them prices which are not people based but result based and then following would happen. We will pass on the cost of off shoring of infrastructure management we will pass on the cost savings from application management, there is a significant cost savings which will approve between applications and infrastructure productivity and also we will use our tools processes, methodology, IPs to further enhance productivity and hopefully retain those margins with us and hence increase the margins of the deals as we move forward. In addition because these long terms deals which are 5 to 10 years also give us longer term visibility on the revenues we would be able to make these deals more efficient. As of today, out of the Dixon, Autodesk, Teradyne, AXA and other deals we have done some we have announced and some we have not announced, we are finding that the margins in this fields are identical to the margins in the other businesses so far. Does that answer your question.

Mitali Ghosh

Yeah that does thanks and second question was on and I apologize if you have already spoken about this because I joined the call a little late. On the employee attrition if you could please comment on how that has trended in the quarter and you know what you planned to do in terms of improving the retention.

Vineet Nayar

I think Shiv made that comment in his opening remarks that the transformation journey which we started 12 months ago, employee was the centerpiece to this journey and we at HCL believe that if we have to transform ourselves from where we are to a value based leadership platform then employees are going to play a significant role, we believe there will no __more business, more customer that less employees and therefore handling the company which is very employee centric is by far the most important agenda of this transformation. We have launched some very significant changes in our HR policies which are being compliment the world over not for the fact it is old but also the fact that they are simply departure to policies being adopted by others and hence give us the significant strategic advantage over other competitors across the globe. The results of this is that over the financial year last year to this year our overall attrition in application business has gone down by 4% it will take the GFM or GFM attrition board greater than 1 year employees who have spent more than 1 year will was 13% it has gone up to 14% which is fine because the fact that we review processes in April, May, June and some of the people do not get what they think we should get so that is the reason for high in April, May, and June. The infrastructure attrition has come down from 9% to 6.8% so there is a significant down turn in the infrastructure which is hovering on a single digit attrition number and the BPO attrition has gone up from 12.6% to 17.7% for this quarter, which I think is cyclic. So that is the attrition numbers for you.

Mitali Ghosh

So just I missed the one the 13 to 14% of which area?

Vineet Nayar

Application business is 13 to 14%. Infrastructure is 9 to 6.8%.

Mitali Ghosh

Okay and BPO I got that and all of these exclude attrition in the first 1 year of joining.

Vineet Nayar

Yes that is correct.

Mitali Ghosh

And okay fine so 14% that you said that has come down by 4% over the year is that right.

Vineet Nayar

No, no I was talking about the overall attrition including everybody; including the freshers also compared to last year had come down by 4%.

Mitali Ghosh

Okay, okay and what number would that be.

Vineet Nayar

I don't have it but SL can share that.

Mitali Ghosh

Sure, sure and just one last thing on attrition for the quarter what have the trends seem like because this I think these are all annual numbers you gave right.

Vineet Nayar

Okay let me repeat that again for GFM quarter this application attrition was 13%.

Mitali Ghosh

Okay, okay I understood that so these are the all the quarters.

Vineet Nayar

These are all for the quarter.

Mitali Ghosh

Okay, okay and one final question on the ESOP charge for this coming year is that an estimate that you have.

S L Narayanan

It will be around same levels at what we have you know taken this quarter and we have about somewhere between 16 to 20 million.

Mitali Ghosh

Okay for the year.

S L Narayanan

To precise number because it is as you know is binomial expression which depends on various mathematics.

Mitali Ghosh

Sure, sure, okay, thanks a lot.

S L Narayanan

This will be somewhere between 16 to 20 million.

Shiv Nadar

See if you recall, we think in the month of January in our investors call an estimation of \$19 million and actual computation came down to 15.2. It's a non cash charge that we have to compute as we go along so afterwards we have not issued the large number of share it should be more or less around the same level and if there are major price movements which may take place in the year and it could go up beyond where we are.

Mitali Ghosh

Sure, sure. Thanks a lot and all the best.

Ichu

Thank you Ms. Gosh. Anyone with question please press 01. please press 01 to ask a question. Please press 01 to ask a question. At this moment there are no further questions from participants connected at SingTel. I would like to hand over the proceedings back to Monali. Monali.

Moderator

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 is Mr. Sameer Goyal of Alchemy Shares.

Sameer Goyal

Yeah, hi, good morning gentlemen. Question pertains to infrastructure business there has been a significant improvement in margins which showed overall margins my believe is that it is more to do with cost front as on revenue front because the revenue seems to be moving in line with employees could you explain me what are the cost initiatives taken here and what are the dynamics of the business going forward.

Vineet Nayar

No it is not nothing to do with cost, it is changing revenue mix what is happening is that the global business is going pretty well. The multi service deals which we are doing are far great margins than the previous businesses, which is standalone services which we were doing and that is the reason for margin expansion, so I do not think there is any significant cost reduction initiative in an infrastructure business by and these are all resultant of good quality of revenues.

Sameer Goyal

What will the strategy going forward actually in terms of margins largely.

Vineet Nayar

I think the strategy going forward would be that infrastructure is going to be the lead in acquiring multi services deals and if you see Dixons, Autodesk , Teradyne and other deals which we have announced these are all infrastructure led multi service deals where application and application transformation comes in. The strategy will continue to be the same and that is what will be keep driving the margins for infrastructure business.

Sameer Goyal

Okay, fine, thanks a lot and best of luck.

Shiv Nadar

Thank you.

Sameer Goyal

Thank you.

Moderator

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

Priya Rohira

Yeah, hi, good morning to all of you all, while we got a flavor in terms of you know the strategy on large deals, but if we were to take an inventory for FY07 where we have more clarity what percentage of revenue is coming from these deals. My second question relates to you know you mentioned that IMS is good entry point looking at the deals which you have won would it be fair to assume that you know the deals are more IMS or BPO as an entry point in terms of your service offerings.

Vineet Nayar

First is let me answer this second question as of now we have not done any BPO infrastructure and application deals together so all these deals are infrastructure and application. We are hoping to do a BPO infrastructure and application which is what our dream deal is, but so far we have not announced any deal of that kind therefore all these deals are infrastructure and application. On most of these deals the infrastructure and application, it is infrastructure led but application dominated, so don't get it wrong in the fact that the infrastructure revenues dominate the deals no it is always the application revenues which dominate the deal, but the cost savings are originating out of infrastructure, the reason in all these deals what is common is that the final 2 or 3 vendors was HCL plus the global five, was largely because of our dominance in the infrastructure services business. The question of what percentage would largely constitute for next year you know I am not willing to share that information right now, but I would you know, it is suffice to say that, let me give you some other statistics which points you towards that direction.

Priya Rohira

Sure.

Vineet Nayar

We said that we want to surrender small customers because we had too many small customers and we had said right in the beginning that if we are not significant in strategy to our customers then we will withdraw from those accounts, because my personal belief is that there is lots of business out there and if we focus quality of business we will get it right from a long term point of view if you see the statistics of number of customers of HCL Technology greater than 5 million dollars there is a 40% improvement in number of customers greater than 5 million dollars and that itself will explain a lot to what is happening.

Priya Rohira

Sure, just two data points from my side in terms of you know the enterprise services revenues in this quarter was somewhat muted compared to the company average was it with respect to completion of certain projects and you know awaiting commencement of some other projects.

Vineet Nayar

Yeah enterprise consulting is some place where I am very bullish and don't go by these numbers, I mean when I talked to you next quarter will make you smile.

Priya Rohira

Sure, just 2 more questions from my side. In the infrastructure services what percentage of revenues is now export driven and on the BPO side if you could give some flavor you know what are the trends going forward and how the client concentration is there now.

Vineet Nayar

Let S.L. answer the BPO question.

S.L. Narayanan

BPO will continue to grow because you are aware in the last couple of quarters, we have completed major recruitment program for the large western European deal that we announced in the December quarter. So from here on, we will see a gradual ramp up of both the sequential top line growth as well as steady, you know going back of the margin which had a different margin sometime in March and we have seen fairly noticeable improvement in operating margins in June as we had prognostic ____into April that is basically because of an improvement in utilization and we hope that the same trend would continue. We are also looking at initiatives to improve the shift utilization because largely during the day time the facilities are not being used. The

intent would be to get back office processing work which can be deployed during the day time hours so that will be the strategy going forward.

Priya Rohira

Okay and the last question on the percentage of revenues from infrastructure from export side.

Shiv Nadar

I will just summarize what SL. Said this is Shiv.

Priya Rohira

Okay.

Shiv Nadar

Basically the strategy being followed by the BPO business is now Mitali Ghosh on the newer deals towards out put pricing and not just the effort based pricing that is the underlying strategy. Second underlying strategy is that between Ireland and India grow India keep where Ireland where it is because there the profit expansion is difficult so correspondingly India probably will grow you know 40 or 50%, so overall growth to be brought within 27 and 30% but the profit growth should be kept at 30% that is the goals with which they are moving.

Vineet Nayar

On the export amount of material business infrastructure has also reached the milestone we have crossed 500 crores of business in this particular year. Material business is about 150 to 175 crores out of the 500 crores.

Priya Rohira

Thanks very much and wish you all the best.

Moderator

Thank you very much mam. Next in line is Ms. Subhashni from ASK Raymond James.

Vishal

Hi, this is Vishal. My question was on the tax front this quarter is about 1% of PBT level compared to more than 10% last quarter could you explain what is going on there.

S.L. Narayanan

Yeah basically what has happened is it is a combination of 3 factors one is the reclassification of the fringe benefit tax which was earlier disclosed as part of provision for income tax under US GAAP the view is if there is a tax, which has an nexus with an expense and not with income it should be added along with the expense from where it relates and therefore \$3 million has been debited to provision for taxation sorry credited to provision for taxation and added in direct cost. The other one is of about 6 crores in all of provisions no longer required because these were kept as provided for till assessment proceedings were completed so on completion of the assessment and on acceptance of our views before the assessing officers about 6 crores has been released and then little less than about \$300,000 is impact of short term capital gains tax provided in the first 9 months reversed on investment of capital gains exemption bonds and that investment happened in June, so roughly about \$4.5 million is the impact of these transactions with 3 million of FBT, about a million of tax refund and about 300 K of short term capital tax. Otherwise the normalized effective tax rate should be around 10% although during the year we will see a mild creeping up of the effective tax rate you would probably go up to about 12% by the last quarter of this year.

Vishal

Thanks a lot.

Moderator

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

Sandeep Shah

Yeah sir if you look at the IT services as per the US GAAP we have registered 8% growth and as per the efforts which have been build it is a 4% volume growth, so the balance the 8% growth is despite the increase in the off shore revenue percentage, so what I mean to ask is there any increase in the billing rate?

Vineet Nayar

You know in the beginning of the year we had said that it was a 4 prong transformation initiative employee was one, customer consolidation and enhancement of value was another, the third was operational efficiency and when we bench marked with our colleagues in the industry we found that in the IT services area we were inefficient in a lot of areas, so we chose for I think close to about 76 initiatives in the whole transformation out of which there was a significant focus on cost out initiative and increased efficiency that had to do with utilization and with pricing _____negotiation you know FTP projects being monitored better so you are seeing the gains of the efficiencies coming in from that so for example the utilization between the quarter of July, August, and September and the quarter of April, May, and June is 6% higher for off shore revenues 6% and what we did was the whatever savings accrued out of these savings from operational efficiency deployed that into a SG&A so our SG&A you will see a significant increase in SG&A and we have an 83% increase in

sales people, 83%, and we have a 63% increase in HR and finance people who are supporting employees. So we took out money from efficiency saving and we deployed in what I called good SG&A which is the sustaining for company from a long term basis.

Sandeep Shah

But sir the volume growth is just 4% so how do the revenue growth at 8% on a US dollar number.

S L Narayanan

No but its also a question of mix you know where you have you know high cost resources working if there is a shift in favor of utilization which is more pronounced in both kind of businesses you can still have that. If there is a 6% increase in utilization that means 6% of the people who are not build are _____.

Sandeep Shah

And sir coming to the growth rates, the infrastructure management has more than 60% growth in FY06 so we believe that this growth rate is sustainable going forward.

Vineet Nayar

I do not want to comment about what growth rates we will sustain in the future all I am saying is that we have created a unique differentiated strategy and I think that will hold HCL in good stud over the next few years.

S L Narayanan

Another way of looking at it is if you look at the last 3 fiscal years our top line has grown at a compounded 33% and our operating profits at EBIDTA has grown at a compounded 41%. So I mean if you ask me if this is what we will sustain in Q1 and Q2, the answer is wait and watch and if you ask me is there a reasonable chance of maintaining this for the next 3 to 4 years, the answer is a resounding yes because all the macro drivers are in place. We have all the investments that the ground level to be able to deliver what the market is requiring from India and the rest is execution, execution, and execution.

Sandeep Shah

And sir just the as we just long late so can I know the salary hikes.

Vineet Nayar

The salary hikes you know as we are the company we believe that the employees should be compensated more than adequately and the salary hikes are consistent with them that is varied from 3% for non performers to average performers and gone up to 45% for great performers. The average salary hikes, I don't think we have disclosed that publicly but post that salary hike our cost per employee has remained the same

till 30th of June and effective 1st July our employees come up for salary hike which are the 85% of the employees and the balance 15% of the managers come up for salary hike on 1st of October and people who joined us for less than 1 year which is in almost 30% of the employee base come up for salary as an when they complete the years, so this is what the data as of now is.

Sandeep Shah

Okay, okay, thanks very much.

Moderator

Thank you very much sir. Next in line is Mr. Anantha Narayanan from JM Morgan Stanley.

Anantha Narayanan

Yeah thanks and good morning everyone. Shiv you mentioned in the opening remarks that the quantum of large deals that we have announced in the recent past has been a fairly significant departure from past trends. Now while I understand that the margins in these large deals will be the same as overall average margins over the period of the contract it is likely that there could at the lower margin level may be in the initial year or so consequently should we expect some pressure from a near terms perspective on account of all these recent large deals announcements.

S.L. Narayanan

Anantha this is moving you know there are too many moving part here. The entire business is predicated on 2 or 3 new businesses that we are starting on day 1 your premise is right but then even if you take the very large deals like Dixons it starts off at a certain level sure there is going to be lot of upfront for there is going to be lot of expense on new diligence on paying legal consultants, insurance consultants, people flying back and forth but this gets you know completely taken in the wash because even if you take deal of a Dixon size it is an average of \$80 million a year per quarter normalized should be \$20 million but the very first quarter it will not be a big number and the cost would be naturally high but then that number itself as a proportion of the total menu of cost is never going to be so significant as to completely derail the P&L. So the answer to your question, is it is not going to have any material perceptible difference in the way we are going to having the P&L quarter-on-quarter and consequences of not doing this is going to be far worse, because what we are doing today is actually securing a very predictable and visible line of revenue stream and that is the way we are going to go.

Vineet Nayar

Yeah Anantha I just want to S.L. while on a long term basis this is true of what S.L. has explained on a quarter-on-quarter basis whenever we win a large deal you may see a marginal variation because the way I am hearing this conversation is while the margin of up by 50 basis point and why the margin down the 50 basis points so if that is the point we are talking about, then yes, you will see from quarter-to-quarter some

variation as we win more deals, but on a overall basis I don't see any material changes happening.

Anantha Narayanan

Thanks that clarifies and obviously I don't think so you are too concerned about quarterly small fluctuations but we just want to be sure that we should be expecting such fluctuation and just secondly S.L. you could just run also this rational of changing the accounting policy on a forward covers.

Vineet Nayar

Anantha I just want to make one clarification to your see as of now we have not done this but it is quite possible that tomorrow if we get an opportunity where theoretically speaking lets say CISCO comes up and says that can you develop a new IP TV for us and we will give you 50% of the revenues generated those kind of deals we also pursuing, where we link our revenues to our customers so as and when that happen we will let you know.

S.L. Narayanan

Yeah on the FOREX accounting, Anantha, basically you know I must take you back in time about 2 years back when we started looking at significant forward contracts book, the view was either you could mark all exposures to market at the reporting date or follow what is called the Hedges contracts accounting method. Basically, we take the impact of plus or a minus arising out of the FOREX contracts only in respect of contracts whole maturities have concluded during the quarter for which accounts are drawn out and we don't take an accounting treatment of the future contracts and put the number into the period for which the P&L is disclosed and this is something which has been consistent with US GAAP and a lot of companies world wide adopted somewhere during the year there has been a lot of literature which is coming out of accounting journals, SEC bulletins and also some of the agencies that issue accounting standards and related staff accounting bulletins and therefore we took the view that we should also be moving to mark-to-market so what you are seeing in the P&L the \$3.6 million is the impact of hedged accounting continued for the current quarter so that it is consistent with numbers that we have disclosed in the preceding quarters and in consistent with the same accounting policy and then below line we have disclosed the effect of change in the accounting policy with respect to the contract expiring post 1st of July. So that is the why, we have disclosed and this is basically to move more in line with what is been recommended by you know auditors and other experts saying that you will be better of with this method.

Shiv Nadar

Can I give your another flavor to this. We have been following this over the last 4 years, the purpose of following this is was in 70% of a cash outflow is in Rupee denominated so we must secure it for 12 months going forward. This is the basis on which we even started covering foreign exchange. So beginning at sometime in November 2002, during this entire period we have disclosed this as our gain and if add

it all up till 30th June it will add up to be -2 million dollars now if you count the revenue during this period then it is happened it is about it is an excess of 2-1/2 billion. So it is a very small portion of the risk that you take for a very large amount of definitiveness that you bring in to the business, now what is a change of mark-to-market that is coming up one is pronouncement that have been made and 2 when we look at our own peer we found that TCS per to our knowledge TCS and Wipro are following the same hedge accounting that we are following, whereas Infosys, Cognizant for a short period of time when they covered and Satyam are following mark-to-market. Anything that is followed consistently will yield the same average. Again this charge that we have taken really speaking is relating to a future period because that is the time in which it will really accrue. At that time you know if I were to look at the last 4 years and what has happened we quite well may come up and say that you know they always yesterday not yesterday last week the crude oil dropped \$5 per barrel. It was very _____, not expected by anybody now it drops another \$5 you know this entire amount may get returned back, we are used to it and that is what has happened in the last previous 4 years but this 20 million charge that we have taken may well come back into profit place during the next 12 months itself

S L Narayanan

In fact Anantha, precisely to avoid such kind of a swing that we were feeling that hedge accounting was a better way to do it because it only focuses on the contract that have matured during the quarter but on a deeper study of the literature it seems that this the way that SEC would want to go.

Anantha Narayanan

Thank you sir and what is the outstanding contracts and have at this point of time.

Shiv Nadar

We have coverage till next August.

Anantha Narayanan

And what will be the quantum.

S L Narayanan

\$580 million of which 120 is cross currency, the balance is US dollars.

Anantha Narayanan

Thank you.

Moderator

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

Trideep Bhattacharya

Good morning to the management. One question on account of salary increase has been in equally in the next quarter it should be budget for a meaningful margin drop initially and then been recovered for over the course of the year or it is going to be flattish across the quarters.

S L Narayanan

Trideep, I don't think we should get into such precise number crunching. We have just laid all the cards on the table and Vineet has explained the impact of increases that will happen during the year and how but it is going to impact you know people of a certain designation and senior management which will happen post October, I think we have stayed away from this game giving any kind of precise color of flavor for quarter specific character, suffice it will say that we are confident that the P&L the way it is presented at the end of June in terms of pure margin construct is not going to be very different in the next year. On a much larger base of operation for the full year and so lets leave it at that and please don't expect us to give any kind of forward looking statement hence forth.

Trideep Bhattacharya

Fair enough and just to understand this salary increase part properly the maturity of that which will come in the September quarter is that fair to assume September and December quarter?

S L Narayanan

Yeah see the middle management and below the increases will be effective 1st of July, middle management and above with the post 1st of October and good part of the head count where it is constituted by people who are less than 1 year old the increases will happen as an when they complete 12 months in the company and are confirmed.

Trideep Bhattacharya

Okay, thanks and best of luck.

Shiv Nadar

Thanks.

Moderator

Thank you very much sir. Next in line is Mr. Hitesh Zaveri from Edelweiss Securities.

Hitesh Zaveri

Yeah, hi, my question is with regard to the mix in the infrastructure management business you did mention that of the many of the large deals that you commenced last

year the mix in the last quarter was such that I am at a higher proportion could you throw some light on this number Vineet if you could and #2 how will it plan out in the current financial year.

Vineet Nayar

I am sorry I did not understand your question. Percentage of infrastructure business is already there we have declared it.

Hitesh Zaveri

What I am asking is the percentage of infrastructure business within that how much is coming from the large deal and you mentioned that the large deals you know are causing increasing growth in the infrastructure management business which has helped the margin as well.

Vineet Nayar

Yeah the number and the percentage of revenues coming from large deals for infrastructure management in my view is not enough that is the only guidance I can give you if not needs to be more, other than that I cannot give into specifics.

Hitesh Zaveri

Sure, I mean at the same time you know the order book that you mentioned you know it is a \$700 to \$800 million so what next 2 to 3 years and within that the next 12 to 18 months is it fair to assume that whatever percentage of the you know IM business that comes from large deals could actually be doubling or something from here.

S L Narayanan

Hitesh let me just give you a clue on how to you know model your P&L going forward. See we did not have anything coming from overseas customers till the end of calendar year 2003. The first big deal was AMD and after that we have gone on a very, very aggressive customer recruitment streak and we have something like close to 25 solid customers for whom we deliver the infra business and even at that time I had shared with some of you that the strategy has been to put a foot in the door and then once we gain salience in the market place keep increasing prices because we believe that we are delivering some exceptional value to our customers, so as the acceptance has gone up and as the share of overseas services in the overall IMS pie has increased, the margins have steadily expanded and I can tell you that our positioning in the market place being what it is today we also have some better pricing power on these services and therefore it is reasonable to assume that this business will keep showing improving margins at least for the next 12 months beyond this specific numbers I don't think we should give any numbers now.

Hitesh Zaveri

Sure I appreciate it. My second question is about the fortune 500 customers I saw a number in your release earlier say roughly about 66 fortune 500 customers that you

have out of the total you know among the large scale players, the other scale players that I look at the numbers are you know in the range of 120 to 150, 250 or so in fact in some of the cases where there are relationship with fortune 500 in that context does HCL tech look at this kind of relationship differently.

Vineet Nayar

Yes, but there is one point which I want to add to the previous statement which S.L. has made and then answer this question I think this question is a very important question. First is while S.L. was talking about the trends like compensation which is going to be pressure on margins and we also articulated what will help increase the margins and you must all understand that we as a stated policy would like to continue investing in our SG&A and we are not here for the next year or the next quarter and we are here for the long term so as part of the transformation journey you will watch and you have already seen a significant increase in SG&A so whatever savings we will bring in from margins or from operation efficiency we intent to deploy that into the SG&A to build long term sustainable advantage for HCL and with reference to the second question which you had what was your second question.

Hitesh Zaveri

Yeah it was about the fortune number of fortune 500 that you have when you look at this relationship differently compared to the some of your peers.

Vineet Nayar

Yeah so we see three trends, trend #1 is most of the fortune 500 customers are setting up their own captive units especially the banking industry #1 and trend #1 and trend #2 if we have to do total IT out sourcing it is not going to happen in the fortune 500 categories and trend #3 fortune 500 have already got existing relationships with existing vendors and you know we either participate to a new service line where infrastructure management has been very successful or we participate in their vendor consolidation so unless that happens you know fortune 500 is not necessarily the target space for HCL so the way you mean to look at and you know at our business and may be that everybody else businesses what is the growth in 5 million dollar per annum plus customers and for us that standard fix has gone up by 40% that means the number of customers in the 5 million plus category for HCL has gone up by 40% compared to last year for us that is a figure which is more relevant going forward than the number of fortune 500 customers we have.

Shiv Nadar

I want to address this question differently would you know where the largest company which is let's say on fortune 500, the 500 first company their revenues side.

Hitesh Zaveri

Well it varies but you mean the absolute number of revenue from the top account.

Shiv Nadar

500 first fortune number.

Hitesh Zaveri

Well I believe the revenue will be higher than 100 million dollars from say GE-TCS relationship.

Vineet Nayar

Okay, the 500 first name in fortune 500 which is only America facing is \$3.1 billion so if we take from fortune 500 to fortune 1000 we would be having on an average somewhere around 2 billion or so and they are all very good sizes for us to go and derive very profitable transformation business from. The fortune 500 to 1000 are under threat from the fortune 500 companies and that is where HCL with this multiple service offering becomes the most suitable vendor and they are going to go away okay the fortune 500 to 1000 or the ones which want to come in the fortune 500 so we are the once who would be the transformation agent that is our chosen strategy. I just want you to understand.

Hitesh Zaveri

Sure.

Hitesh Zaveri

Yeah.

S L Narayanan

This is to the moderator we have time for just 1 last question because we have some other engagements coming up at 10 o' clock.

Moderator

Sure sir.

Vineet Nayar

If there are any answered questions Vikas and I will take them off line.

Moderator

Okay we will take a last question now that is Mr. Neeraj Dalal from Capital Market.

Shiv Nadar

Hello.

Moderator

Mr. Neeraj Dalal, okay we will take the next question that is Mr. Girish Bhai from East India Securities.

Girish Bhai

Yeah, hi, I just wanted to comment on the overall demand environment now compared to say 3 months back especially in the US where we have seen some slow down in GDP are you seeing any lengthening sale cycle in the greatest scrutiny of spending or pushing back of projects or something like that.

Vineet Nayar

No we are not seeing any such trend, we are seeing the appetite for IT services from Indian companies to be quite strong and the market seems to be as hot as ever and the long term opportunities of market looks short term, medium terms, and long terms opportunity and the market space looks very attractive for us.

Girish Bhai

Okay my second question is on your large project pricing does the pricing remain constant to trend upwards is there any case for the prices to move down if ever say you have a recession in the US something like that in these large projects.

Vineet Nayar

I think contractually no but in an eventuality with the customer is under threat from a competitive point of view would HCL stand up and support the customer, the answer is yes, so I don't know under what eventuality right now the contract does not provide for any such eventuality but we are going to stand up for however we can to make our customer competitive.

Girish Bhai

Okay one last question on pricing, how does it look now compared to you know 3 months back is it stable to upward the rising as you have been saying we have been hearing from the company.

Shiv Nadar

I will answer this question this is Shiv Nadar. See we have already answered that whenever the price increase opportunity arises, the margin increase which comes because of that we really pride in opex because our goal is to increase our pace of growth what is our pace of growth between 2000 and 2002 we look an inorganic approach and acquired some companies, 2002 to 2006 the last 4 years starting at \$415 million we have been growing in the last 4 years without any meaningful nonorganic addition, this is taken us to \$976 million giving a 33% compounded annual growth is it sustainable over the next 4 years I am not saying 33% I would not give any guidance at all, but a past is at a reasonable reflection of the future to come it will

be 30% and that about something which I had mentioned last year itself and the same question came on EBIDTA and during the same 4 year period starting at 78.33 million in 2002-03 we have ended this year at 216.37 and this reflects about 40% which is high and now we have started redeploying some of this margins into meaningful opex so growth similar to revenue percentages is reasonable. Net income from \$64.79 million will come up to 172.48 million dollars over the 4 years and this is normalized and the one time capital again took place through the sale of Perot stake and this kind of things that has been removed from this and yet it shows a 38.6% CAGR, is it sustainable as I mentioned again if EBIDTA at some percentage gives you an implied in improving SG&A and enhancing SG&A it will track the EBIDTA growth and this is the guidance which we had provided last year and we are more or less lived up to the guidance during the course of the current year and we hope to do so in the future years. Gentlemen thank you very much for joining us in the morning and we thought the first opportunity that we get after the announcement was made to get thro to you and some of you joined the call at 9 o' clock thank you very much. Good, bye.

Moderator

Thank you very much sir. We would like to apologize for any inconvenience faced by participants while trying to dial in for this call. Mr. Shreyash Devalkar.

Shreyash Devalkar

Thanks to the HCL management and to all the participants.

Shiv Nadar

Thank you Shreyash. Good day to you.

Shreyash Devalkar

Thanks.

Moderator

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

NOTE:

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