"HCL Technologies Limited Q4 FY'20 & Full Year FY'20 Earnings Conference Call for Analysts and Investors"

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MANAGEMENT: **MR. C. VIJAYAKUMAR – PRESIDENT & CHIEF EXECUTIVE OFFICER, HCL TECHNOLOGIES LIMITED**
MR. PRATEEK AGGARWAL -- CHIEF FINANCIAL OFFICER, HCL TECHNOLOGIES LIMITED
MR. APPARAO VV – CHIEF HUMAN RESOURCES OFFICER, HCL TECHNOLOGIES LIMITED
MR. DARREN OBERST – HEAD, PRODUCTS & PLATFORMS, HCL TECHNOLOGIES LIMITED
MR. GH RAO – PRESIDENT (ENGINEERING AND R&D SERVICES – ERS)
MR. SANJAY MENDIRATTA – HEAD, INVESTOR RELATIONS, HCL TECHNOLOGIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the HCL Technologies Limited Q4 & Annual FY'20 Earnings Conference Call. As a reminder, all participant lines will be in listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sanjay Mendiratta – Head, Investor Relations, HCL Technologies Limited. Thank you and over to you sir.

Sanjay Mendiratta: Good evening and good morning, everyone and welcome to HCL Technologies Q4 & Annual FY'20 Discussion. We sincerely apologize for the delayed start to the call.

Today, we have Mr. C. Vijayakumar -- President and Executive Officer, HCL Technologies; Mr. Prateek Aggarwal -- Chief Financial Officer; and Mr. Apparao -- Chief, Human Resources.

I now hand over to Mr. C. Vijayakumar to take it forward. Thank you, sir.

C. Vijayakumar: Thank you, Sanjay. Good morning and good evening to all of you. I trust all of you are well and safe. Today's presentation we have structured into three parts. I will start with a quick kind of overview of the year that went by and the quarter, followed by Prateek who will give a little more drill down of the financials and then I will come back and give you an update on the demand environment and how are we looking at the coming year.

So let me get started with the performance summary for Q4 and Fiscal '20. On the overall response to the global pandemic, we were one of the earliest to kick start the business continuity planning; we started it on 26th of January; after we came to know about the first human-to-human transmission outside China which happened on the 25th of January, within 24 hours, so we had kick started. We as a part of our risk management practices, our chief continuity officer, pandemic officer, all of them were pre-identified as a part of our risk and compliance practices. Now, of course, the three dimensions in which we focused on. Of course the employees was the most important dimension of our COVID response. We took multiple steps to enable all of them to work from home and we did that very early in the game. So, there was very little impact from a supply side during the last quarter. As of today, 96% of our employees work from home. 2.5% work from offices either HCL or global client locations and 1.5% was the supply-driven billing loss. Even this loss has been mitigated significantly beginning this week. Obviously, this is a very unprecedented situation. So there is a significant amount of emphasis on engaging with our employees. We have set up a global pandemic helpline which is manned by doctors and nurses who have been very helpful in providing all the information support and very, very considered advice to our employees and their families. We have also introduced a "Flexible Hour Policy" because we recognize that people working from home have to take into account many, many other aspects in this extraordinary situation. So, this has been very well appreciated by our employees

So, a significant emphasis on digital engagement, whether it is engagement with the teams, engagement which is a little more fun and things like that have been fairly well received by our employees. So, today we are able to implement or work as if we are working from office with that level of interaction… and in fact, there is more interaction now than even when people were working from offices.

In terms of clients, of course, which was again a very important focus. Just to highlight while our internal technology teams transitioned 150,000 employees to work from home model, our employees in the infrastructure business largely enabled over 3.5 million client employees to work from home. This is through multiple means and taking into account multiple security protocols. So it was a phenomenal effort and our clients have been hugely appreciative and have been continuously reaching out and emphasizing how important was the support that we provided and how much we value our relationship.

We also did a survey, which was part of our annual survey, we added another question, "How effective was our response?" 99% of our client respondents rated our response as "Very Effective.".

And then a lot of lot of what we do, whether it is in the healthcare provider segment or supporting utilities, supporting many-many critical segments, we are delivering mission critical services. For example, in Life Sciences and Healthcare, we have had numerous requests to scale up clinical trial environments, a lot of patient-facing applications we have been asked to enhance capacity. In fact, our team set up several hospitals, as a part of three major hospital chains that we support temporary hospitals, with very robust infrastructure that we set up during this time.

Of course, last but not the least, overall, the community has been a focus. HCL Corporation and HCL Tech are very thoughtfully contributing to what we can do to demonstrate or deliver some on-ground meaningful impact, like setting up a "Pandemic Command Center for Noida and Chennai", "Disaster Management Data Analytics Center in Chennai" and similar things like supporting the healthcare workers with the PPE, ventilators to hospitals and many other things.

Just moving on to the numbers per se, as you would have seen, we delivered a good quarter of growth in constant currency was 0.8%. There was possibly a very small impact due to COVID in this. So otherwise, it would have been a little more. Revenues on the actual currency came in at $2.543 billion, which is 11.7% increase year-on-year. Our EBIT was one of the highest in the last five years. We delivered 20.9% EBIT, which is a 63 basis points increase over the last quarter and 174 basis points increase for the last year for the same quarter. And this 0.8% quarter-on-quarter growth came on back of 2.1% QoQ in the Q3 in constant currency terms. Overall revenue in FY20 came in at $9.936 billion, 15.1% growth which translates to 16.7% in constant currency. Our EBIT came in at 19.6%, shade above the higher end of our guidance. Net income came in at $1.5 billion, 7.8% growth over the last year.

If you look at the overall performance trends, I think one thing we are very proud of is, we have delivered consistent performance over the last four years. All the four years, the industry-leading growth, if you look at the top five India heritage providers and the top five global providers on combined about the top-10 providers in the world, we have had the highest growth, highest

CAGR over the last four years as well as the highest growth in the fiscal that went by. All of this growth has happened by maintaining stable operating margins. Cash EPS has also grown quite handsomely over the last four years.

If you look at the Q4 highlights per se from a business perspective, Q4 was the highest booking quarter in fiscal '20, significant increase over Q3. We signed 14 transformational deals. A big part of these 14-deals were signed sometime in January and early February. But while the momentum was a little slow towards the end of March, but we did sign a few deals in March as well. So pretty much whatever we had, which we expected to close, 90% of them we closed in Q4.

Overall, year has been very good; 53 transformational deals and the overall pipeline also looks good as we stand today. The biggest contributor to growth in Q4 was Mode-2, which grew 7.1% on back of strong demand for some of our digital propositions and cloud offerings.

We announced a deal with Stanley Black & Decker, which is a very large deal involving over 1,000 people across different parts of the world. And this is a very strategic engagement where all infrastructure, application, and the application modernization and their enterprise packages like SAP, all of that is getting outsourced to us and we won this against a large Indian provider and a top global provider.

Infra business has seen a robust uptick across the year, primarily driven by fluid workplace solutions. Fluid workplace is an offering in our digital workplace solutions, primarily it provides a flexible working infrastructure and this demand has gone through the roof in March and it will continue. A lot of our existing customers, even where we are not servicing them on the infrastructure side are looking at us to be supporting them on this front.

Another very significant aspect is HCL Software business continued its operational momentum. In fact, this is the third quarter and we are actually 10-months after consummation of the acquisition. We have reasonable data points to believe that we are doing exceedingly well in this business.

We also looked at expanding our countries, I mean, offshore was largely India so far, but we are expanding into Sri Lanka and Vietnam. Sri Lanka is a country where we have already made a global delivery center operational and we believe this will also help us basically debalance our overall offshore presence. So this is part of a slightly larger strategy that we have embarked on over the last few years.

With that, I will hand it over to Prateek and then I will come back for talking about the future. Over to you, Prateek.

Prateek Aggarwal: Thank you, CVK. Just taking some of the numbers forward, repeating the first line, revenue growth in constant currency, very handsome, 13.5% year-on-year growth for the quarter and for the full year at 16.7%. And just giving you the breakup of the organic versus inorganic. So, for the year 10.7% is where we finally landed up. The last guidance we had given you at the end of previous quarter was a range of 10.5% to 11%. So happy to be back in the middle of that range as also the same for the overall revenue growth. Guidance given was 16.5% to 17% and we are back in the middle again. In this quarter also, out of the 13.5%, 6% of it was driven by organic growth, the balance 7.5% coming from the inorganic growth which was largely the acquisition of products from IBM which we concluded at the end of June last year.

The EBIT percentage for the quarter was at 20.9%, which is 63 basis points increase over the previous quarter and 174 basis points over the same quarter last year. That just reflects the solid cost improvement initiatives that have been taken in the company. You will remember, both March quarter and June quarter of 2019 where some of the lower margins that we saw, and from that level to move to a margin level of almost 21% this quarter, shows you what can be delivered on this base. For the year as a whole, it was 19.6% EBIT, remarkably, completely the same or three basis points ahead of 19.6% that we delivered last year. Some of you might remember that the last year number was actually 19.5% at the time that we announced it. That number has increased to 19.6%, because of new accounting standard that we have adopted this year, and we were sort of restated the 19.5% of FY'19 to be now at 19.6%. That is just a small accounting change about which line the interest component of the gratuity cost needs to be shown. It was earlier shown in all the lines above the EBIT and now it has moved to the other income line. It has no impact whatsoever on either the profit before tax or the profit after tax, it is just in between the lines change. So I just wanted to clarify that in case some of you might have questions around it. So 19.6% is where we were last year full year and full financial year this year also we are at 19.6%.

Going below, the tax rate has increased. We were at about 19.7% last year and now we are at 20.1%. There are some one-time benefits we got in this quarter. If you remember last quarter when I shared detailed quarter-by-quarter numbers, we were at 22%, but there were some benefits we got this quarter which took it down to about 20.9%, which is what gave us the full year net income of 15.6% and for the quarter it was at 17% helped by all the factors that I talked about before.

For the full year also the earnings per share the reported number, the fully diluted number is Rs.40.80, double the number of shares obviously which is a good increase of 10.8% on a year-on-year basis and the cash EPS number that we take from the cash flow, which we is going to come to in the next page, is at Rs.52.8 per share which has gone up huge 26.3%

With that, I will move on to the cash flow page on the next. These numbers are there with you. Unfortunately, it is a long statement, not very visible on the slide here. But if you just make it a bit larger, then you can see the three key numbers that I want to talk about on this page… instead of focusing on all the four columns, just focus on the second column with the blue band. And cash profit is the number that we used to generate what we call the cash EPS. Cash profit was $2011.8million or $2 billion to put it in a round number and that is the number when divided by the fully diluted number of shares, generates that 52.8 per share. That same number was at $1.637 billion the last year, so that is an increase of close to $400 million during the year.

The second blue box there is what is the (OCF) the operating cash flow. And that also has improved to a level of close to 1.75 billion. So, that also is a handsome increase of $400 million from $1.34 billion the previous year.

And if I take the next line item, which is purchase of property and equipment which is CAPEX, you can see 1,743 minus 214.6 gives you a round number of about $1.5 billion as the free cash flow for the year. All of these numbers 2 billion, 1.75 billion, or the 1.5 billion very handsome growth over the previous year in numbers which we are very happy to report.

On the right hand side of this page, given the kinds of COVID and crisis and all those kind of synonyms, cash is king and at the end of March, we are happy to report gross cash of about 2 billion plus, $2031.9 million to be precise, and a net cash of 1.36 billion. Obviously, there is 800 million that we need to pay out to IBM at the end of June. So even after that payout, the 2 billion gross cash would be still 1.2 million which is still a healthy number, quite pleased with these numbers, happy to share them with you.

Moving on to some more color in terms of client categories and all the other breakups in the subsequent slides. The left hand side of the slide really shows the great increase that we have had in the top of the ladder which is $100 million plus category of clients and that has actually grown by 50%, so 10 clients who are giving us business more than $100 million has grown to 15 and so on and so forth down the ladder you can see 50 million plus has also increased to 30 and so as 10 million plus increased to 171. So happy to report these numbers.

On the right hand side, looking at the client contribution, there are two things that I would reflect here -- One is the more systematic trend as we grow larger, typically the top-5, top-10 and top-20 clients contribution would tend to come down. The second factor, which is unique kind of factor is the revenues that we used to get through IBM before the acquisition, some of those products as you will remember, were there in the IP partnership revenue also. So as those revenues move to direct billing to our clients, that stops going through IBM and therefore the IBM number in that sense is coming down. So that is something I just wanted to clarify.

Also, to give you the margin walk before I go into more details of the modes and segments, just wanted to complete the picture on the margin walk. It is really simple margin walk, just three factors. FOREX is the larger. So foreign exchange movements, particularly the rupee movement is the one that gave us the maximum benefit. So out of 63 basis points, 53 basis points actually comes from that, so the balance is really just about 10 basis points. And there are two factors within that. There is the amortization cost which did go up basically in the P&P segment, as you know, as we move into more and more billing to direct versus coming through IBM, that amortization cost keeps going up. So that went up by about $3 million for the quarter and that was a hit of about 12 basis points. And the balance 22 basis points improvement is really the productivity that got generated largely the ITBS segment. P&P as you know was basically flat. So ITBS generated the maximum productivity during this quarter on a quarter-on-quarter basis which was partly offset by ERS but overall it gave us 22 basis points at the company level.

Moving on to the next page, if can just look at, this is the quarterly picture, on the top is the segment wise breakup, and at the bottom is the mode wise breakup. I will focus on the segment wise as you can see the growth in the segments was largely in the ITBS segment this time. R&D degrew a bit, 1.8%. This was also the segment which took some hit because of the COVID factor because some of the work that we do is working in laboratories for the customers, so that portion took a little bit of hit, so that was a decline of 1.8% and P&P was basically flat.

And looking at the margins, you can see 19.1% is the good margin that we got in ITBS, which I spoke about in terms of productivity just a few minutes back.

And ERS, in that sense, the revenue also impacted their margins, so the margins in the ERS segment came down. Products and Platforms just like revenue has been very flat. Even their EBIT margins have been very flat; so 32.9% and 32.8% as flat as it can be.

In terms of the breakup of the modes, Mode-1, Mode-2, Mode-3, as the table on the bottom shows, the increase is basically been in the Mode-2 which is all the DNA and IoT and cloud and cyber security areas. There was some degrowth in Mode-3, but Mode-2 was the one that really grew the business this quarter, and Mode-1 was on the flattish side, a slight decline there.

Moving to the same breakup for the full year as well. So the mix is the first one in terms of segments, close to 72% in the IT & Business Services, close to 17% touching now in terms of ERS and 11.5% in terms of Products and Platforms. And in terms of margins, as you can see, both ITBS and ERS are sort of around at 18%, 19% mark and the growth of both has been almost the same at 12.7%, 12.8%.

Looking at the Mode 1-2-3, the growth has largely been driven by Mode-2 and Mode-3, as you can see 45% in Mode-3, also helped by the acquisition there, as well as Mode-2 growing at 27.6. Between these two, they now constitute 33% of the revenue mix and growing at about 35%-odd.

Moving on to the next page, this gives the breakup by geos and verticals. Instead of focusing on all the five columns, I will focus on the last column which is FY'20 over FY'19 and that really reflects the last 12-months of financial year FY'20 over FY'19. So that is the 16.7 and the breakup is given right there, pretty evenly distributed across the geographies. You can see both Europe and ROW grew beyond 18%, and the Americas also grew by 16%.

And as far as verticals is concerned, Manufacturing grew the fastest and handsome (+20%) growth coming both in Retail, CPG and TME as well as mixed services. Technology and services looks a little low here at 2.3%, but remember it is partly because of the same IBM revenues moving out from being sold through IBM now flowing into the respective verticals. So that 2.3% is in that sense depressed because of that. If you look at the first two columns in the same row technology and services you can see the growth is on a year-on-year basis 38.7%, 35.8% depending on whether you are looking at the quarter or the full year. So that of course reflects the old methodology, which is putting all the IBM revenues here, so you can see that is a very handsome growth actually.

So that is the notable thing here in this page. Financial Services also grew 11.1%, and L&H also at 13%. So happy that all the verticals really contributed in a big way with double-digit growth on a full year-to-full year basis.

CVK, I will just hand it over back to you for a few thoughts on how are we looking ahead.

C. Vijayakumar: Thank you, Prateek. So, I want to do this in three parts; one is to look at what are the short-term business drivers and what are the new opportunities and what are the execution priorities for us as we kind of work on FY'21.

In terms of short-term business drivers, as I mentioned earlier, the supply side has stabilized for the fluid working model from home and from office model. Still there are some minor factors which are at play, like access to labs and some visa constraints when people have to move from one engagement to another. Most of the aspects related to access to labs has got sorted out as of this week, I think we are pretty much 100% operational between either work from home or work from office. So, supply side is stabilized. We do a lot of virtual onboarding. But there are some specific situations where certain background checks have to be done and things like that which are slightly getting delayed, but it is a very insignificant impact.

In terms of demand side, what we have done is we have looked at all the key things that the customers are asking for and we have a good grip of what these ask from the customers are -- One is, of course, very straightforward. There are a lot of customers where we do volume-based billing based on number of employees or number of servers or applications that we support. Some customers have put a lot of their employees on furloughs. So, to that extent there will be a reduction in volume-based billing, which is a pretty straightforward contractual thing that will kick in.

Discretionary spend itself in segments which are B2B or B2C discretionary spend is not being deferred, but segments which are pure B2B, there is some deferral of discretionary spend.

Some new projects, which is what we call as EN Business, new business from existing customers, so obviously customers have put some of that on hold, I mean, they have not canceled them in most parts, but they have kind of temporarily delayed some of the work.

And there is a little bit of price discount. There are some customers who are very strong businesses, very strong brands, but current situation has kind of significantly impacted their business. So they are asking for price discounts. Most of the times the discounts are very temporary either for one quarter or at most for two quarters. We have not seen anyone wanting to fundamentally renegotiate any of our long-term contracts.

There are payment term extensions from 30 days to 90 days depending on the customers, maybe a small segment of customers are also looking at payment term extensions.

We have done a very detailed analysis of our portfolio by industry and service line. While we report seven verticals to the market, internally, we track close to 40 sub-verticals across these seven verticals. And then we classified them as top impacted verticals and low impact verticals and the top insulated verticals. As you can see, the top impacted is largely in manufacturing and if we really break that down into sub-verticals, it will be automobile and aerospace. These are the two sub verticals which we see big impact.

"Entertainment" Definitely, we have big parks that we support entertainment parks, we do some work for companies which are supporting the casinos and things like that. So those are impacted.

And the non-essential retail is another segment which is impacted. I would say these are the top impacted verticals.

We see Financial Services and Telecom has no impact verticals. Financial Services per se, I mean, there is an expectation that this could get impacted in a significant way. But in all our conversation with all of our top customers in Financial Services, we are seeing very minimal impact. There are a lot of customers for whom we are doing significant amount of scale digital kind of programs. And they are all enabling more digital banking and digital channels for our customers. So that continues to be a big priority for them. And we are also seeing a trend of vendor consolidation here as well. Some of them will play out in the long-term, but in the short-term, there are a lot of small vendors who could not deliver, and that work is getting consolidated in ones and twos in Financial Services, and we are getting some good share of that.

Similarly, Telecom continues to be very strong. So the impact is low.

And the Life Sciences, I mean, is fairly insulated. I mean, we look at Life Sciences and Healthcare in four parts. One is Pharmaceuticals, Payers providers and Medical Devices. Pharmaceuticals is strong. Payers? Right now we have not seen an impact, but maybe we will see some impact as things go ahead.

"Healthcare" Of course, there is a lot of work that we are doing now. But almost all the hospitals are under significant stress because their profitability is seriously taken a negative term because they are all focused on COVID, elective surgeries are very less. So that is one thing. And because elective surgeries are less, some medical device companies are also impacted. But overall as a portfolio, Life Sciences and Healthcare which contributes to maybe 12% of our revenue, we think it is fairly intact.

Technology Services as well, which is pretty large vertical for us. We believe there is going to be continued momentum in that vertical.

As I said earlier, there is good demand in some weak verticals like oil and gas could be weak but there is some good momentum in some run the business consolidation work as well as there is weak demand and perceived stronger verticals like telecom is expected to be strong, but there are some client-specific issues because of which there could be some impact in the coming quarter.

In all this, the way we are looking at is our first priority is to enable every client in all possible ways because the demands are varied. And all the customers are very large brands, very reputed brands. And we believe their businesses are all absolutely sustainable businesses and long-term businesses. So, in the short-term investments that we will make will be rewarded in the medium-term and long-term. And this hypothesis has always worked for us be it in the 2008 or other scenarios. And I think that this is a playbook which we will continue to work on.

So, FY'21 itself will evolve quarter-to-quarter. There are multiple scenarios that are playing out. One scenario is we will see a decline in Q1, Q2 it will stabilize and Q3 and Q4 which is H2, we will see some growth. That is the most likely scenario that we are working on. But there could also be a situation where there is the resurgence of virus in the next few weeks or months, in which case the stabilization may happen in Q2 and there could be some dip in Q3. That is some kind of a worst case scenario, but we are still preparing for something like that as well.

So, mostly, the dynamics is going to be driven by business portfolio and the relevance of our propositions. And we feel pretty strong about how they will play out in the mid to long term.

Moving on, I want to cover a few medium-term propositions which are really seeing good traction. First is fluid digital workplace. This was a proposition which was fully ready. We had very good client references. So we have gone on a hyper marketing, digital marketing of this proposition to all our clients. There is significant interest largely in our existing clients. In Infra clients, most of them we do this, but in the non-infra customers, we see good demand for this. Of course, I mean, it is very well known by now that digital transformation itself is going to accelerate what was expected to happen in two years or three, five years is all going to happen in the next couple of years, maybe in a few quarters. So the biggest element here is everything, the customer interactions are all going to be driven around zero touch through digital channels, monetizing the content. Brand loyalties are reducing, so customer loyalty programs, all of that is where we are seeing stronger strength that we have, and we think that is a good market pick up of this. Cloud consumption we think will double primarily, because people do want to avoid CAPEX and they prefer an OPEX route, that's one reason. Obviously, the flexibility that cloud offers, even though the total cost of ownership could be a little higher, we think this will kind of accelerate. But however, a lot of cloud consumption doubling will happen because of significant amount of new applications, like gaming, telemedicine, virtual tourism which some of our clients are already thinking of and conceptualizing some programs. Cyber security is going to be an absolutely top of the mind, kind of proposition, especially in this kind of working environment which is very fluid. We also see some emerging opportunities in engineering services. 5G itself is going to make a lot of virtual everything possible. So that's going to drive some amount of testing, sustenance, validation, and compliance related spends through IoT and other things. And the overall service providers' scale and strength will, in areas like workplace, security, cloud migration, and strong partnership with the cloud providers and scale digital proposition, I think will gain and we're very, very strongly placed in every one of these propositions.

Moving on, if you want to look at some medium-term market opportunities, I think the biggest inflection point is going to be in the healthcare industry. Basically, scaling up of all the telemedicine, virtual consultation, all of that is going to be the big teens in the providers. In the in the payer segment, obviously, most of them, if you look at the U.S. landscape, most of them have significant legacy landscapes and their costs are completely out of proportion, so there is going to be a lot of simplification and modernization which is absolutely the must for their survival. So we think that will pick up. Telecom and technology is also going to kind of be strong verticals, market opportunities, whether it is cloud adoption driving further demand for telecom infrastructure, for 5G led solutions and some of the topics that I talked about earlier. Similarly, retail, consumer services, travel and hospitality, primarily these businesses will have to completely redefine themselves. And a lot of this redefinition will happen through some new technologies, which is like digital engagement, IoT conversational AI, etc. Financial services, that digital channel is going to kind of significantly accelerate, so that is going to drive certain new ways of working, more automation and more modernization.

We are also looking at certain strategic decisions led by certain opportunities for providers with a strong track record and execution capabilities. If I were to call out three things here, there are good carve-out opportunities of captives, there are product carve-out opportunities, professional services, outsourcing by software companies and vendor consolidation, these are some good opportunities. This vendor consolidation is not the ones and twos that I talked about, but fairly large chunks of revenue which is typically boutique digital firms who are delivering work for some of the banks and others, we think there is a good opportunity. Not only banks, even in other retailers and U.S. companies, we think there is a good opportunity. There is going to be a significant cost cut mandate across various industries which will increase the penetration of outsourcing business in under penetrated markets and some clients. Another trend that we are seeing, already a couple of large RFPs are out is geo rebalancing of the global delivery model. Some of the large clients have significant presence in India either by through service providers or through captives. But there is definitely a big urgent push to do a little bit more rebalancing. That's something which is playing out as well.

With this backdrop I will just summaries it by saying what are our execution priorities. Obviously, the first focus is client commitments, absolutely we want to deliver everything and make sure our clients continue to be very delighted with what we are doing. So this is really the base capability that we want to continue to execute very well on. All the transitions, while we signed the 13th transformational deals last quarter, none of them are on hold, everything is already under transition. So we have come up with a no-touch transition or zero touch transition. And one client who got signed after the India lockdown, we signed the contract, we are already transitioned, we are already live. So some of the large deals would go live in the next quarter, which is July, August, September quarter. So, so far this is very successful in whatever engagements that are happening. Renewables are all on track, we are tracking the renewals in a very granular level, every project which is expiring we are trying to find out what can be done to make sure customers can either renew those programs or how we can reutilize some of the bright talent that we have in these engagements.

I talked about emerging opportunities, so we have launched propositions around these opportunities, and we would continue to push this very hard. Because my expectation is, our pipeline by end of next quarter should look significantly different from what the pipeline that we had when we started the quarter. In terms of managing the costs and profitability, there is significant focus in very, very granularly managing utilization productivity, and billing. So pretty much there are daily standard calls across different divisions and it's being managed very well. People cost, I mean, we absolutely don't want to make any impact to our employee experience, no changes in the benefits. There will be some impact on variable pay, which is going to play out based on the performance of the businesses. However, there is significant opportunities in non-travel cost, most of them are pretty much straightforward, travel, marketing. And in the infra business, we have a significant chunk of third party services which are also dependent on volumes, so they would naturally scale down when the revenue scales down in these areas.

We will also leverage or enhance our focus on global delivery centers, because we think that its going to be, while offshoring will continue but there will be some more emphasis on bringing some work within the geographies, so we will continue to strengthen our geography footprints, and also de risk the overall country concentration. This compliance is among the highest focus areas at this time. While so much work is getting done remotely, we are reeducating, recertifying all our employees to be fully familiar with all the requirements that we have to meet with. So we are doing everything to enable and empower our employees to deliver to the client expectations.

I think that brings us to the end of this presentation. We also have several members of HCL leadership team on the call. And now we can take questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Ankur Rudra from JP Morgan. Please go ahead.

Ankur Rudra: Thanks for the very detailed commentary, CVK. Just if you could elaborate on, I understand the reason why you may not want to give a guidance this time, but how would you quantify or qualify your visibility on the order book you have entering into this year versus maybe a year ago? And how does that can help you get visibility on controlling the business going forward?

C. Vijayakumar: So, Ankur, thank you. I hope you are doing well. And from an order book perspective, the order book is significantly higher than what it was when we exited FY19 versus FY20, it's significantly gone up. But you would know that order book has multiple aspects, new deals won, renewals and some business which is lost. So we report this as a part of our remaining performance obligations. And I am sure you can look at it, I think there is at least a 12% increase in our orders book on a like-to-like comparison. Though there are some exclusions there like royalty revenues and revenues which are based on some variable parameters are excluded. But on a like-to-like basis, we think our order book is significantly higher this year compared to last year. And even further if I want to look at the pipeline, compared to what it was in the end of December to the end of March, there is a reduction in pipeline, primarily because every quarter we get a good chunk of new deals going into the pipeline. Towards the second half of the quarter, that new deal pipeline has slightly come down. However, we are tracking this on an everyday basis. If you look at what happened in the last five weeks, maybe if I were to divide that into the first two weeks of the quarter, and the second three weeks of the AMJ quarter, in the second three weeks, we are seeing a good increase in pipeline, there are many deals which are coming up. So I would think the pipeline now rather than 31st March is much better than what it was at the end of December.

Ankur Rudra: And CVK, is that mainly on these areas you mentioned around digital transformations, fluid workplace as opposed to the broader broad based pipeline earlier? So you probably more concentration of the conversation happening now?

C. Vijayakumar: Yes. I mean, of course, one is definitely on some of the new propositions. But I think there are at least three or four consolidation opportunities as well, which has showed up in our existing customers where we are reasonably in good situation.

Ankur Rudra: Thank you. Just one follow-up from me. You obviously ended the year with very strong cash flows and cash EPS. However, if one looks at the overall payout ratio for FY20, it's clearly a lot lower because there wasn't a buyback this time or a special dividend to compensate for that. Just want to understand, is there an intention to lower payouts maybe to conserve cash for more acquisition M&A in the short-term? And how would you think about capital allocation policy in the medium to long-term?

C. Vijayakumar: Prateek, you may want to take that.

Prateek Aggarwal: Sure, CVK. So, Ankur, the payout ratio as we have mentioned, I think in several one-on-one meetings with the investors and potential investors as well, for the moment we are sticking to the Rs. 2 per share, which actually is on double the base of number of shares post the 1:1 bonus issue that we did at the end of December. As you can imagine, these are turbulent times and we don't want to sort of fritter away the cash at this point in time because, one, we have the IBM payout to be done. So even though $2 billion is there in gross cash, that does come down to $1.2 billion post that payout which is due at 30th of June. And also because these are the times we like to keep investing in business, both organically as well as inorganically as we tied through these troubled times. And this is not the time we thought appropriate to sort of go for a big bang payout.

Moderator: Thank you. The next question is from the line of Sandeep Shah from CIMB India. Please go ahead.

Sandeep Shah: Sir, just show based on your commentary, it looks like you are saying the Q4 order book being highest in the last four quarters. And most of these deals have under transition as a whole. So is it fair to say that Q1 may see a decline in the revenue, and the decline in the revenue could be lower than the industry which we perceive as close to 5% to 6% QoQ dip? Is it a fair assumption to make?

C. Vijayakumar: Sandeep, honestly, I don't want to hazard a guess on what our Q1 will be. So there are so many unknowns and I would not say anything on Q1. I told you what the factors which are driving the demand side and what are the factors which are driving the supply side. And a lot of deals that we won in Q4, most likely the revenues will start flowing in only from Q2, and I want to leave it there, Sandeep.

Sandeep Shah: Okay. And just the second question in terms of the margin in the PNP business. So I think it's really handsome at 30%, 33% which has been stable last three quarters. Is it fair to say that in a rupee scenario of 75, 76, this kind of margin is likely to continue even in FY21, despite there could be some amount of nature in terms of renewal of license? And how to look the renewal of the license in the products and platform business, especially in a COVID scenario? Will it also see a similar kind of a business pressure or you believe there could be higher or lower pressure than the same?

C. Vijayakumar: Yes, so maybe we will answer this in two parts. I will let Darren comment on the revenue and what is the kind of impact due to COVID on the PNP business, a large part of it is in software. And Prateek can kind of cover the commentary on the margins. Darren, over to you.

Darren Oberst: Yes, thank you. What we have experienced over the last couple of months is that we have continued to see a strong velocity in volume on renewals. So to date, we have seen very little impact from the COVID point of view. To some degree that's a reflection of the criticality of these product, the fact that the customer base is very distributed globally and by industry. And it's also even where there are some headwinds, it's countered by some areas where many of these technologies are even more critical. So even in industries like retail or in hospitality, which again are relatively small segments of our total customer base, for those customers, areas like doing e-commerce, with our commerce software, areas of collaboration and communication with partners with their employees, critical areas around security, all of these are areas where they are either sustaining investments or in some areas increasing investments. So, so far, I think the way that we are seeing it, we have good confidence that from a renewal point of view, again, we are going to continue to see good velocity, good volume and pretty good stability from the raw pricing point of view as well.

Sandeep Shah: Okay. And if you can answer or Prateek can answer regarding the sustainability of the margins in the product and platforms, because there could be further upside considering the current spot rate or 75, 76, where we believe that in this kind of business rupee depreciation should largely flow through to EBIT margins.

Prateek Aggarwal: Sandeep, let me take that. So, yes, exchange rate did help us kind of maintain that same 32.9 32.8 kind of margins this quarter. And that certainly flows through. But, as we know in this business and as we have referred to even in the commentary upfront, the amortization would continue to go up till the time we are completely on 100% HCL paper invoices, rather than going through IBM, which will take a while. So amortization is the cost that continues to go up in this business quarter-on-quarter. We also continue to invest a little more incrementally on the sales and marketing side, both marketing of the products and the sales force that is selling there. So therefore, those costs will sort of continue to creep up. We are happy to see the incremental revenue on a year-on-year basis, because that's the right way to calculate that. This quarter it is more than $160 million plus incremental revenue. So the guidance that we had given you at the time of signing the deal, 625 going up to 650 in playing out the way we expected it to. And that's definitely helping us maintaining the margins. But as we have always said, right from the beginning, the guided margin for this business is more like 30% plus is what we have said, in the initial few quarters, first three quarters that we have been running this business now, we have delivered a little higher. But the guidance on a medium to longer-term basis would continue to be around that 30% plus.

Sandeep Shah: If I can squeeze the last one, in terms of how to look at engineering R&D business, because that contributes 16%, 17% of your business. So in a COVID scenario being a project based business, it will have a slightly higher pressure and that also coincides with the exposure to manufacturing sector, if I am not wrong.

Prateek Aggarwal: CVK, would you like to take it or GH? Sorry, I was on mute.

GH Rao: Yes, I will take it CVK. Engineering and R&D services, we have two segments. One segment is based on online and mostly telecom which is not impacted by COVID, in fact, we don't see much of a difference in demand scenario pre-COVID to post-COVID. However, as you mentioned, there are segments which are exposed to manufacturing where we have both the supply side as well as the demand side issues at this point of time. The supply side is mostly because we have to do some work necessarily from the lab or customer sites in manufacturing. So, that probably is coming to some control now, however, the supply chains for our customers got disrupted, we do still have some demand side issues in this part of the business, especially segments like aerospace and automotive, manufacturing areas we do have some pressure.

Moderator: Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: I had just one question, CVK. You ended the year so strongly and the margins have also done extremely well. But my question is that, while you are saying that Q1 will see such a sharp negative impact, because we are seeing broadly in Q1 things have started returning to normal. And secondly, you will have a big tailwind probably from the cloud work which will get in the current situation. On the top of that, you have a very strong deal exposure in the current year. So, I just want to understand that whether our production side can give us more severe pain than we can anticipate, because primarily sales may not happen at the same pace due to the current situation? Or do you think there is something more uncertain because of which you don't want to commit anything? Number one

Number two, on the margin front as well, while I understand that there will be some cost pressures, do you think are we able to manage our operations in a way, because there would be obviously some potential savings as well that we can maintain our margins at current level. So, just want to understand. I am not asking for any particular guidance, and thanks for taking my question again.

C. Vijayakumar: Thank you, Sandeep. A lot of questions all combined into yours one question. See, first of all, let me clarify, as Darren just explained, PNP business will see very minimal impact due to COVID, that's what we have seen so far, all our analysis indicates we will have very minimal impact in the PNP business due to COVID. Coming to why are we seeing negative in the q1? I think a lot of deals that we closed in Q4 are likely to translate to some revenue in Q2 of this fiscal. So, Q1 will largely be kind of preparing for transitions and getting transitions kicked off. And as I explained in terms of constraint, largely we have overcome all these supply side constraints. And you will see that I talked about several demand side headwinds in certain verticals, whether it is volume based billing or customer discounts, especially in the verticals that I pointed out. So, that is where the uncertainty is. And in a lot of things are moving around, so we don't want to make a commitment on what our Q1 will be or the full year will be. But overall, Sandeep, the way you should look at this is, we are coming into this crisis from a position of strength. We have grown very well over the last four years, our organic momentum has accelerated over the last three years, hitting a peak this year of almost 11% organic growth, which is the highest in the industry. A lot of investments that we have made in our Mode 2 offerings, whether it is digital, fiber, cloud, IoT, all of them are yielding very good results, even this quarter you would see that has gone up by 7% sequentially, year-on-year it has gone up by 30% odd. So that momentum is what we invested for. And we think that is something which is going to be very helpful. So, we are entering this phase with a lot of strength. So maybe there is a quarter or two of uncertainty, but we do believe there will be all the short-term and medium-term and the propositions and the industry trends will start looking very good as we get into H2, provided there is no resurgence of this virus and the current kind of tapering continues. I would leave it there, Sandeep.

Moderator: Thank you. The next question is from the line of Sumit Jain from Goldman Sachs. Please go ahead.

Sumit Jain: Congrats on good execution. So a couple of questions. Firstly I had for Prateek, where I think, Prateek, you mentioned that you are on your target for $625 million to $650 million revenue business from the acquired IBM Products. So we just want to understand, I think based on my calculation, you are currently earning at $400 million to $450 million kind of range for the first nine months. So are we expecting a significant uptick in Q4 in the PNP business? Maybe because of seasonality or higher acceptance for the products.

Prateek Aggarwal: So, Sumit, thank you for that question, because it does give me the opportunity to clarify. What I was talking about was the run rate of incremental. That's the 160 number that I talked about. And I will just multiply this by 4 to come to 640. And that is what I was talking about. What we started off as of slow start in September quarter is something which remains, I am not sort of trying to make that up in the next quarter or anything like that. What I am talking about is that the business has, for the second quarter running, been able to generate the kind of incremental revenue that we expected it to. And that we are kind of back on track, stabilized and gunning for more is the hope that we have.

Sumit Jain: Right. And just a follow-up question, I guess, since you are now running these for several quarters now and I think the collaboration kind of tools are seeing incremental demand in the market and work from home arrangements. So what kind of acceptance level are you seeing for some of these products, from the new deal wins or new clients are getting in the market?

Prateek Aggarwal: Darren, do you want to take that? It's mostly around HCL Software.

Darren Oberst: I mean, if I am understanding your question, it's about winning new customers in the market? Okay, so look, our first objective when we sort of took over these products 10 months ago, was first really stabilizing and energizing existing customer base with huge volumes, transactional volumes and renewals. So that was goal number one. The second goal then was modernizing the products. And what we announced towards the end of JFM in March, were major new releases of several of the products. So over the course of the last year, we largely achieved our goals from a product release and roadmap point of view, with major new releases of DX, Domino, App Scan, Big Fix, we just released a new product called Volt, which is a new low code capability to bring to all of those Domino customers. We had a major new release of Unica, we have several other major new releases coming later this quarter. So that was part two, was really reenergize, really bring a lot of innovation and high end features to those products. And then step three, which I think is what you are alluding to is, drive new growth. Once we have stabilized the customer base, once we have invested in innovation and the products, go expand the market reach. So we have been tracking actually our new customer footprints over the course of the first three quarters. And it's about 150 across the product set, and across every single one of our products we are winning new customers. The products where we have the most new customer footprint adoption, as we expect are in the security area, so products like Big Fix and App Scan. But we are winning new customer footprints across our entire portfolio. We are also seeing a lot of new license growth, again, across multiple geographies and across multiple products. So I think to date, we have really emphasized the first couple of blocks of that strategy. I think what you will hear more and more from us throughout FY21 are those proof points and validations in terms of new customer adoption, and growth that we are seeing across our products.

Sumit Jain: Got it. Thanks, Darren, for that clarity. And maybe one more question if I can squeeze for CVK in terms of the infra management business there, clearly you are seeing a lot of demand for the cloud migration and enabling your client employees to move to work from home. So, how you are seeing that tailwind working against the headwind of pricing pressure in your legacy side of the business? If you can give some clarity.

C. Vijayakumar: Yes, sure. I mean, infra business, I mean, overall if you look at ITBS, we have delivered significant growth, close to 12.8%, pretty much all of that is organic growth. So, infra business overall momentum is good. Of course, there are some dynamics around pricing and renewal pressure and things like that, but most of them are stabilized, I would say, and there is significant opportunities in the new areas. So, I think in the medium to long-term, I do feel very positive about how we will continue to do on the infra business, including all the cloud migration opportunities where we now have very strong partnership with all the hyper scalars. There are many accounts where we are proactively looking at cloud migration. And mostly for a lot of new applications we become the app modernization partner and the cloud migration kind of tags along. And that's how we are looking at this business, Sumit.

Moderator: Thank you. The next question is from the line of Sudheer Guntupalli from Motilal Oswal. Please go ahead.

Sudheer Guntupalli: My first question in terms of Mode 2 margins, I think during the quarter it seems to have shown a good amount of an uptick. And in one of the prior quarters, we have also highlighted that we are exiting some offerings or ramping down some offerings in this business in Mode 2. So, where do we see the steady state margins in this segment?

C. Vijayakumar: Sudheer, there is certain kind of one-offs in this quarter, so that is where you will see a slightly larger increase in margins in this quarter. But structurally we believe these margins will gradually improve, so I think from a year perspective we came in at 15.2%, possibly last year was much lower. So, we will see this gradually improving but nothing dramatic, because this business is an area where we are continuing to invest. And kind of as I said earlier, the cost margins are high, but investments and practice and all of that is what is bringing the EBIT numbers lower than the company level. So you will see some kind of marginal increase as the quarters pass by, or more from a year-on-year perspective. But I wouldn't read too much into significant increase in margins in the Q4. So I hope that answers your question.

Sudheer Guntupalli: Sure, sir. And any colour on the nature of this one-off and adjusting for that what could have been the actually margin?

C. Vijayakumar: I think you should just look at the yearly margin, Sudheer, that would be the right representative margin of the business.

Sudheer Guntupalli: Sure. My last question is to Prateek. In terms of the impending large payment towards IBM for the acquisition of their products, did we explore the option where we requested deferral of payment, given the force majeure kind of a situation? That seems to be the trend of the day that most of the companies tend to conserve as much cash as possible on the balance sheet, or are we comfortable on making this payment on a timely basis?

Prateek Aggarwal: Right. Sudheer, Thank you for that. I think the answer is very simple, we don't see the need to request a deferral or anything of that sort. I think we have $2 billion of gross cash on the balance sheet is a healthy number. We have done, of course, all the stress testing for various quarters in the future and come up with, even in the worst case scenarios, we continue to have good gross and net cash. So there was no need to basically look at something like that.

Moderator: Thank you. The next question is from the line of Ashwini Mehta from Ambit Capital. Please go ahead.

Ashwini Mehta: CVK, two questions. One is in terms of the products and platforms business, where are we in terms of transferring contracts from IBM onto HCL Tech, either in terms of revenue or overall customers?

C. Vijayakumar: It's largely on track. I mean, every quarter there are some renewal books which come where we need to go back and renew with the customers, so largely on track. But as we had explained earlier, a big part of it will get over when we finish one full year, but there will be a long tail which may run into the second and third year. So it's on track.

Ashwini Mehta: Okay. So most likely in the next the next two to three quarters, a substantial portion should be transferred on to HCL. The second question was that, historically we have talked about that cannibalization of data center services due to cloud migration should reduce as deals post FY16 were largely cloud led. Now with cloud migration accelerating further, would this change be still additive to our IMS revenues on a net basis?

C. Vijayakumar: Yes. See, there are two factors, right, so cloud migration will accelerate, which is given. But the market that we can go after is also increasing because a lot of mid-sized customers are moving everything to cloud as an option. So, the new business, and number of deals that we signed in the last couple of years are all in cloud kind of solutions as well, in the midsize customers. So I think it is only going to be added to the business. That's the way I look at it, because there will be a lot of service revenues. In some cases where we are hosting a product on cloud, maybe it will include the consumption as well. So net, net, I think it will be positive for us.

Ashwini Mehta: And just the last one if I can squeeze, so in terms of captive carve outs, any particular verticals that you have seen higher trend in terms of people looking for captive carve outs, or it is much more broad based?

C. Vijayakumar: It's more broad based from what we are seeing. I mean, it's not that everybody is saying we want to carve out a captive, it's more a proactive pitch to some of our customers to really build a value proposition of our ability to run this better and service them better. So this one is something which we are largely looking at in our existing clients, some of them who have captives we are looking at that as an opportunity. It's still early stages on the captive carve out. We think there is a strong proposition and there is some interest. But we have to see how this will play out.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now have the conference over to Mr. C. Vijayakumar for closing comments.

C. Vijayakumar: Thank you. And in closing, I want to once again reiterate that we have kind of a very good year, and we have really delivered industry leading growth for the last four years, while maintaining our profitability. Our strategy of organic and inorganic growth has definitely paid rich dividends. Most of the inorganic acquisitions that we have done, have delivered very good results, we feel very positive about it. And we are entering the space with a position of strength. We have a stable leadership team, we have good momentum in the business, barring the current disruption. And all of our investments in IP lead opportunities and all the Mode 2 opportunities and the new propositions that will come much more strongly, much more relevant in this scenario, all of that we are well placed.

So as a company, I feel very confident, even though the circumstances are very unique and special now, our capabilities, our business mix, our strong client relationships and the financial strength will see us through the space. I feel extremely confident that we will emerge stronger than ever from this crisis. So with that, I want to conclude the call. All of you stay safe and stay well. Thank you for joining the call today.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of HCL Technologies Limited, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.