"HCL Infosystems Quarterly Investor Conference Call"

April 27th, 2015

SPEAKERS: **Mr. Premkumar Sheshadri, Executive Vice Chairman and Managing Director, HCL Infosystems**
Mr. S.G. Murali, Group Chief Financial Officer, HCL Infosystems Ltd.
Mr. Biswanath Bhattacharya, Chief Executive, HCL Services Ltd.
Mr. Sandeep Kanwar, Chief Executive, HCL Infotech Ltd.

Moderator: Welcome to the Third Quarter FY14-15 Earnings Audio Conference Call of HCL Infosystems. Throughout this representation, all participants' lines would be in listen-only mode. There would be a presentation followed by a Q &A session. We would like to begin with a mandatory disclaimer. This call may contain forward-looking information including statements concerning our outlook for the future as well as some of our other statements of beliefs, future plans and strategies. These forward-looking statements and information are subject to risk and uncertainties that they entail.

We have amongst us, Mr. Premkumar Sheshadri, Executive Vice Chairman and Managing Director, HCL Infosystems; Mr. S.G. Murali, Group Chief Financial Officer, HCL Infosystems Ltd.; Mr. Biswanath Bhattacharya, Chief Executive, HCL Services Ltd.; and Mr. Sandeep Kanwar, Chief Executive, HCL Infotech Ltd.

The conference would be now handed over to Mr. Premkumar Seshadri.

Premkumar Seshadri: A very good afternoon to you, it's a real pleasure to have you with us and welcome to our Earnings Conference. We have amongst us Mr. Sandeep Kanwar who drives our System Integration business and the erstwhile CFO of the company, who has taken on this new role. We also have two other leaders who would be addressing you for the first time, Mr. S.G Murali, who has come onboard as the Group CFO. He is just 25 days old in the company, and is all set to take up this very critical function. Also with us is the Chief Executive of HCL Services, Mr. Biswanath Bhattachrya. We now flip over from here to the broad organization structure. Our discussion is going to centre on our Distribution Business, the Services Business, the Learning Business and the SI Business; these are our four core entities. Besides these, we have our past legacy, PC and Mobility business, which we will discuss as we move forward.

Moving onto Slide 3 of our presentation, which essentially talks about the highlights of the Q3 FY14-15, – we are glad to inform you all that our Enterprise Distribution grew sequentially at 49% and on an year-on-year basis it could be pecked at 26%. The Services business grew sequentially at 9% and on a year-on-year basis it grew at 30%, out of which the Enterprise Services business has grown sequentially at 11% whereas on a year-on-year basis it stood at 21%. The Consumer Services business which has been growing steadily over the last year or so grew sequentially at 2% and on a year-on-year basis it stood at a solid 110% growth. Our consolidated revenue was lower at Rs. 1376 Crores for Q3 against Rs. 1450 Crores in Q2. The key cause for the decline was the same as in previous quarters, but what really brought that about and the impact it had on the overall profitability of the company is a matter that we will touch upon between Murali and me as we go further into this conference.

The profit and loss before tax, marginally improved from Rs. 49.6 Crores negative last quarter to Rs. 45.3 Crores negative. As a low light of the business, our finance cost net of interest income, was at Rs. 29.8 Crores. Our Distribution revenue fell by almost Rs. 150 Crores, largely due to the telecom product rationalization that we are currently going through.

On the System Integration business, the PBIT fell by Rs. 19 Crores, due to our project mix and continued variability that we had touched upon in our last investor call, essentially contributing at various levels during different points in time, depending on the percentage completion of the projects and so on. The business rationalization cost during Q3 also contributed to almost a negative of Rs. 15 Crores in the quarter in consideration.

The Enterprise Distribution business crossed the Rs. 100 Crore per month mark in March 2015. The Telecom Distribution business which was essentially around General Trade and Organized Trade in rural India, moved on to becoming a key channel from an online channel rollout perspective. This happened at the end of the last quarter. So the revenue accrual for the same would happen in this quarter. Enterprise services business had significant uptake in order book and key large account customer wins in this quarter.

In the System Integration business, our focus area is on execution which is essentially making sure we reduce our backlog. An important milestone in one of the key projects in the SI domain is
UIDAI where we are the Managed Service Provider and today we are proud to share that almost 800 million Indians are covered.

In our Financial Inclusion business, which was a very fledgling business for us, the business scaled up to almost about 20,000 activations per day. It's a very interesting run rate that we have been able to arrive at, in the last quarter. The PC and Mobility Hardware business which is almost phased out now is definitely a highlight, given the legacy that we were carrying for quite some time now.

With regard to key recognitions, we were awarded as the best retailer of the year, in Mobile and Telecom service category at Asia Retail Congress. We continue to pursue our investments in this space, both from a technology point of view as well as in the context of operational excellence which has translated into such recognitions. One of the key aspects of our Services was to look at how the marketplace and the key analysts in the Technology space value us. In the Multi-vendor Technology support and Integrated Management services space, we won the Dataquest Award and were positioned in the Champions quadrant, which is definitely a great start to our campaign - one of the focus businesses and growth businesses of the future.

For achieving Excellence in implementation and use of technology, with reference to the Mobile and Telecom space - The OCEAN Portal won the Dataquest Award for being one of the best in business benefits in Enterprise applications. And today, one could state rather proudly, that in the context of a comprehensive distribution network we have technology capabilities not only like an ERP at the backend, but also a solid front-end technology like OCEAN involving mobile devices, social media and mobile application. In my opinion, it seems to be a great integration and a key strength as well as intellectual property for the company.

Our financial inclusion business was awarded for best access to Banking and Financial services, for our Smart Card Technology at the e-Gov BFSI Leadership Summit.

With those broad highlights, to walk you through the rest of the presentation, it's now over to our CFO, Mr. S G Murali.

SG Murali: Thanks, Prem and good afternoon to all of you. Let us now walk you through the snapshot of the Financials for this quarter. The revenue for the quarter was at Rs. 1376 Crores against Rs. 1450 Crores for the last quarter. For PBT, we are at Rs. (45) Crores compared to Rs. (49.6) Crores for the last quarter. Finance costs for the quarter, net of interest income is at Rs. 29.8 Crores. The provisions that we have taken into consideration for the quarter are at Rs. 15 Crores. The business had sold off a couple of properties which resulted in a short-term gain of roughly around Rs. 4.9 Crores. The Financials for the quarter from a PBT level are marginally better, when compared to the previous quarter. And now going into a little more detail about the Distribution business, there has been a drop in revenue, quarter-on-quarter because of the change in the portfolio mix. Some of the products are undergoing refreshment, and the change in the mix, has resulted in the drop of the revenue for the Distribution business, with the drop from about Rs. 905 Crores in Q2 to Rs. 755 Crores in Q3. On the Enterprise business front, I must say it is an exception. In the Consumer business, we have seen a drop in revenue but despite that, we have been able to sustain the profitability, PBIT is very close to where we were in the last quarter. PBIT for Services business was at negative Rs. 4.3 Crores in the last quarter whereas, in this quarter we are close to becoming positive. We are at negative Rs. 0.4 Crores.

In the Learning business, where we had a negative of Rs. 5.3 Crores in the last quarter, we are now at Rs. 2.5 Crores for the current quarter. Hence both the businesses – Services and Learning – continue to show positive signs, while Distribution continues to sustain profitability despite movement in revenues. Overall, PBIT improved from negative Rs. 18.4 Crores in the last quarter to negative Rs. 15.5 Crores in the current quarter. On the PBT level, we are at Rs. 45.3 Crores in the current quarter, compared to Rs. 49.6 Crores in the last quarter.

The fall in the Consumer Distribution revenue, is largely due to the ongoing portfolio refreshment that is happening across various Consumer products. Enterprise Distribution has clocked Rs. 100 Crores revenue for the first time which puts this business completely in a different threshold. It has shown promising growth which helps us in the scaling up of the business as it appears to be sustainable. For SI & Solutions, the PBIT, before Provisions and Exception of Q2, we were at Rs. 17.7 Crores positive as against the present Rs. 7.3 Crores negative. The variance has largely been linked to the various projects which are coming up as revenue recognition from time to time. The projects and the margins associated with some of these projects, change from quarter to quarter and that is the result of the large movement in the SI and &Solutions business.

Now we move on to slide 6, in the Distribution business, The revenue on Enterprise showed massive growth by about 49% over the last quarter, an almost 100% growth in March, compared to the average revenue of the previous month. The partner-led model is responsible for contributing to this increase. At this point in time, 50% of the Enterprise businesses is now being done through the channel partner. Efforts are on to increase this percentage further. The expanded reach in terms of channel ecosystem expansion has gone up from about 183 to 560. Additionally, several strong Global brands have been signed up and all this has contributed to the positive momentum in this space.

In Consumer business, for Windows-based devices, we have seen a very significant growth of 20%. However, this growth could not outpace the decline in the entry-level feature phone segment. The entry segment has been subdued. We have seen the transition happening from the entry segment into feature and smart, where better handsets with better price points, are actually getting populated. Overall, the handset prices have also been dropping, not only for us but across the industry. So that is one of the reasons for the fallen revenue as well. And one good news is that in the Online Channel which is the fastest growing space, there has been a lot of progress in the last quarter. We have completed the roll out and the revenue accruals have started in the month of April. Overall, the Consumer Distribution revenues have dropped from Rs. 905 Crores to Rs. 755 Crores in the current quarter. The online platform can also be leveraged for the emerging opportunities, which exists in the Consumer Electronics and Home Appliances space in future.

In Slide 8, the revenue for the quarter is at Rs. 939 against Rs. 1028 for the last quarter. The profit before provisions for doubtful debts, impairments and write-offs is at Rs. 17.4 Crores, more or less similar to the level we had witnessed in the last quarter. And at the PBIT level, the profit is at Rs. 16.6 Crores against Rs. 18 Crores. Despite the drop in revenues, we have been able to sustain the profitability due to various improvement measures in this area.

On Slide 9, the Services business, we witnessed growth across all businesses related to Domestic, Overseas and Consumer Services. Across these segments, we have seen growth during the last quarter. In the Enterprise services order booking there was 140% growth, this will not be visible in the next quarter but will keep getting accrued over a period of time. The investments which were made both in terms of the spread, as well as the offerings to the customers have actually started yielding results, and hence, we have seen a significant growth in the order book in the current quarter. As usual, signing up and adding large Global OEMs is something which is progressing well. Several key customer contracts have been won in the last quarter. This is an area where the business has shown significant improvement, in terms of operational delivery capability. We have also been recognized for our efforts on various forums and platforms.

The overall revenue for the Services business went up from Rs. 223 Crores to Rs. 244 Crores in the current quarter. And in the Enterprise Services, the revenue has grown from Rs. 184 to Rs. 204 in the current quarter.

In Slide 10, the consolidated revenue for the Services business for this quarter is at Rs. 244 Crores as against Rs. 223 Crores of revenue in the last quarter, and the PBIT for the business has moved from minus Rs. 4.3 Crores to very close to neutral, a negative Rs. 0.4 Crores. One of the challenges which we are facing in this business is the high margin warranty revenues, which were accruing from our past HCL-branded hardware products which is now seeing a decline, since we have discontinued these products for the last couple of years. This is one of the revenue streams which has dropped and there has been additional investments which we are making to improve both our market capability for the business, this will result in profitability, which is not reflected immediately.

Slide No. 11, is about our SI Business (System Integration). Our primary focus remains on execution of current Order Pipeline and that is progressing well. Where there was a backlog of Rs. 1723 Crores in the previous quarter, with our team efforts we have been able to bring it down to Rs. 1614 Crores. Some new orders were received during the quarter and these have been executed in the same quarter. At the same time Aadhaar enrolment has been running smoothly. Finally, we are witnessing that the PC and the Mobility business is actually reaching its fag end, just a quarter and we should be able to get over with this business. So with regard to the revenue for the SI business, we are at Rs. 215 Crores as compared to Rs. 202 Crores which include all the segments such as System Integration, Enterprise, Hardware Solutions and PC.

Slide No. 12, is about the revenue for the quarter which is at Rs. 215 Crores. The PBIT is at negative Rs. 18.1 Crores as compared to a negative of Rs. 18.9 Crores in the previous quarter. If we look at Solutions space we are at a positive as compared in last quarter stands at Rs. 9.1 Crores. Now this stands at a negative of Rs. 10.2 Crores , whereas PC business and the Mobility business the loss which was at Rs. 28 Crores in the last quarter, largely on account of the provisions in impairment which took place in the last quarter, have come down to Rs. 7.9 Crores in the current quarter. A Minus of Rs. 7.9 Crores Net – net - revenue come down from Rs. 1450 Crores to Rs. 1376 Crores , while PBT has improved from minus Rs. 49.62 Crores to Rs. 45.3 Crores . These were the inputs from my side and now I would hand it over back to Prem to carry on with the discussion.

Premkumar Seshadri: Thank you Murali, this brings to a closure of our presentation and the data facts. It is now turn for the Moderator to take over the proceedings for the Q & A session.

Priya: Thank you and good evening to the Management team. There are a couple of questions from my side. Could you please give a brief understanding to your experience from the online channel roll out? It's gone live from April; it's been almost a month now.

So how has the order pick-up been, has it seen some qualitative numbers in terms of the cities reached or the logistics that go with it?

The second question is on the same distribution segment. How about margins compared in online channel compared to the current scenario and how would this help us in improving the margins? That's on the Distribution side. On the Services side, is it possible for you to entail the order book in quantitative terms, in terms of what has been the current size and the customer response? Whichever you think is more feasible?

Lastly, if you could share in terms of the phase out of the PC and Mobility business which had a PBIT of around negative Rs. 8 Crores this quarter. Do we see this going to a zero in the next quarter, so the profitability could be better? And more as a data point, what is the receivable dates for this quarter?

Premkumar Sheshadri: Let me try and shed some understanding on the Online Channel rollout first. It is largely for the telecom product lineup which you must be aware of. It is now approximately 3 weeks since the business started. The reach is quite widespread across the country. We do have a rural bias in some cases, but we have a significant amount of traction in the metros and the key cities. This gives you one perspective;

But from a volume uptake point of view we can only relate it to how we had internally planned. We had analyzed the last few quarters of online traction, especially in the OND quarter which had the festival season, starting from the "Pooja period" right up to Diwali and a little bit over to the New Year and it was an outlier in terms of volume uptake. In terms of the bigger picture in case you had access to the IDC report which basically talks about the total telecom output, you would see that distinctly there has been a change since that point, in terms of the overall uptake in the market. So a good part of our drop, of about Rs. 150 Crores in the quarter, could be attributed directly to some product rationalization. I definitely see the overall sentiments in terms of large purchases that happened in the OND quarter to give some sort of headwinds, which impacted the JFM quarter. So from our perspective we did our estimate more on the JFM quarter and accordingly put together our business tasks for online traction. In 24 days since we went live we are live almost with all the key providers. Now with all of them onboard, I would say it is still early in the day to say, still we are more or less at about 60% to 70% of what we planned to do.

Priya: Do we sell all the brands here or is it only the ones which are on the Distribution site?

Premkumar Sheshadri: We only sell what is there on the Distribution site.

Priya: So, in other words if you are measuring in 100 units, you're getting around 60 units to 70 units, am I correct?

Premkumar Sheshadri: You are correct in saying so, if the plan was for 100 units, we would be anywhere between 60 units and 70 units. This is early days and we have just one product and we have only recently come onboard. You must view the online channel in two perspectives. Firstly, there is the Online pure distribution channel and secondly Online as a market place. So, both of these have different nuances in terms of what it does, because in some places you really want to control it also as you just do not want the product to go overboard.

Priya: Sure, that was quite helpful. Thanks.

Premkumar Sheshadri: On the PC and Mobility front, as Murali stated, we are at the tail end of that business - we are at the smallest part of the tail. We would not be able to give you a quantified number. From a point of view of stock remaining with us, we are almost over.

Priya: Sure. What about the order book in the Enterprise Services and customer wins?

Premkumar Sheshadri: The revenue is at Rs. 244 Crores last quarter. It is not possible to give you a specific number though I know that for your model you would look at what translates into revenue. But I can tell you that in the context of the growth from the previous quarter, it can be said that the order book has increased approximately by about 140-150% growth. To give you a sense of what it takes, depending upon when the order has actually got right through the calendar year or right through the financial year, it would be safe to expect that out of the total order booking value which is the TCV (total contract value), 30% to 40% of it can be billed in the same year. The balance may trickle in 2 or 3 years time. Normally, we do not pick up contracts beyond 3 years; a significant part of it will be sub 3 years. So that's broadly the context of these contracts. So I have shared the two data points that can help you build the model - an understanding of the growth in the order booking and how this translates itself into billing.

Priya: Sir, looking at this from the point of view that Services being a key focus and as this business increases, margins certainly do have to scale up. The top line, growth has to be really phenomenal and wanted to understand this perspective.

Premkumar Sheshadri: Well, Biswanath can respond to this query.

Biswanath Bhattacharya: Thank you, Prem. First of all, you must have seen that the Service business is growing and also for Q3 from order booking point of view, the growth was more than 140 – 150% and we have plans to achieve growth in the Services business. From a big scale perspective, we are not there yet in the market. Hence, in Q2 and in the couple of months after that we were getting ready to drive in this market - we have our own Enterprise and Channel team. At the same time, on the value creation front, we have created some offerings. So you'll see some momentum in the Services business during our next call.

Premkumar Sheshadri: Each of these businesses had a certain timelag, when it gets into a growth phase and has been through an inflection point. Our Services business is focused on to get revenue momentum in terms of growth rate of order booking and has been achieved. One important point in our Services business was that it was associated with maintenance contracts of our own HCL PC and Mobility hardware which does not exist presently. In the previous years, this business segment was automatically renewed. So in spite of this transition, we have registered growth, built competences and are making investments in the context of tech support centers and allied business. So, thereby our plan for this business is to look at significant revenue increase and we are moving in that direction.

Priya: How do you see the addressable market for Services? Are we just trying to get an understanding of what could be our aspiration to build up, may be a particular billion dollar entity in Services.

Premkumar Sheshadri: A perspective about addressing a billion dollar industry is definitely there and the Services leadership team is working on it. The team has a very clear roadmap. So, from an addressable marketplace we would have to break down the whole industry number, all inclusive of what it represents i.e. about 35 to 40 billion dollars in size. In fact, it could be more, but taking that piece which is addressable from our point of view of the market, I think that a billion dollar over a few years, is definitely possible.

And just to give you an understanding of our captive hardware, we were at a much higher number at a certain point of time in this industry. With the new changes coming in the providers are extremely excited. One of key things that has happened in the industry is that each of the OEM principals have suddenly realized, that the only organization in the country which can actually support them across the country, and is in a position to offer service and has been in this business for long is HCL. We are an automatic signee to any one of these OEMs. We are doing this step by step, after doing the right analysis and making sure that we are able to take on what we can chew. But our significant presence in tier 2 and 3 towns over and above the metro towns and tier 1 towns lends us a distinct plus in this growth strategy. So from the present point of view, we are well positioned in the addressable market place. If we look at the last 6 months, we are extremely well positioned today in terms of investments and in the context of capability and competency. We are definitely well entrenched as a brand, because of our large Enterprise presence even before we became an independent entity. And lastly, in the Service delivery capability our investments are paying off and we are trying to achieve Gold Standards in what we do. We are definitely in a position to address the large market and your context of a billion dollar target is definitely in the minds of the leadership team.

Priya: Thanks. That was helpful. I have one more question, what is the margin and business from the channel partners. What advantages do we have because of these channel partners? Is it likely to become a growing pie for us? Do we see margin upliftment coming in from this side?

Premkumar Sheshadri: There are two advantages from the channel business. This is slightly different from the traditional channel business that you would have been tracking akin to few of our peers in the distribution space. This business is entirely driven by the Value Added Distribution Channel and the capability that we bring to the table adds a lot more value to the Channel and also in terms of the solution context being offered to the customer eventually. Hence, given this context, we believe that our margins will definitely be better than the traditional distribution perspective. Typically from a context of credit risk and so on, it would bring in an absolute layer of insurance that would help us to look at this marketplace.

SG Murali: Regarding the query on DSO, we have multiple businesses within our business. The DSO is generally less than 30 days, or very close to 30 days. The Services business, ranges anywhere between 30 to 45 days and the project days receivables goes anywhere between 60 to 90 days. At this point in time, the weighted average of all of this is at about 45 to 46 days.

In the System Integration business, the process time is longer. Some customers take much longer because of their procedural requirements and approvals. The weighted average of this business is about 45 days.

Priya: Thank you so much. That was helpful.

Sheetak Kumar Shah: Good evening Sir, What is your strategy for the Learning Business?

Premkumar Sheshadri: The traditional Learning business was a very large lease rental based, asset heavy and content-loaded business which we have re-portfolioed now. The business is largely content based. And in the context of content, we have brought a three dimensional change to the business which is in progress. We have made some good investments in the past few quarters in the business and this will continue. The first dimension is on how the existing content is improved across languages, across different types of boards and across different countries.

The second dimension is in the context of how content is being used and what we are doing in this space. Presently the content is used either by tutors, self or by the cloud-based beaming into the schools and homes. The third dimension is about creating multiple channels. Presently, the channel is linked directly to the schools and it will move on in context of direct to home, as well as direct to devices.
A three-dimensional change has happened in content and this is a continuous process. So, as far as the business from schools is concerned, we are now extremely asset light. A good amount of traction is associated with pure content purchase. We are now getting a good amount of traction in terms of replacement for both Content and Services i.e. for K12.

The second part of the business i.e. the CDC, which was essentially focused on Entry and Mid-level Certification Programs is now migrating into multiple sectors like Health Care or other adjacencies like banking. Hence, this business is also going through the same three-dimensional view in terms of change in content - syllabus we are focusing on, change in the consumption channels consisting of largely online and lastly in terms of the channels. As you would be aware, our present reach in the marketplace is in association with Franchise Channels. Therefore, these businesses, especially the learning business, presently, we are in an investing mode over the next few quarters and you will also see it reaching its inflection point very shortly.

Sheetak Kumar Shah: Ok. Currenty, our businesses rationalization cost, going forward will this continue or are we at the fag end of it?

Premkumar Sheshadri: We should wait for a quarter or so before giving you an emphatic answer, because as you know, multiple of our businesses are going through a much larger focus in retention and a good number of our businesses have already been addressed well.

Sheetak Kumar Shah: Okay. Thank you sir.

Premkumar Sheshadri: Thank you all for having joined us in the call. In case you have questions, please feel free to write to sumeet.ahluwalia@hcl.com. Thank you and have a great evening.