



“HCL Infosystems Q1 FY19 Results Conference Call”

27th July 2018

SPEAKERS: **Mr. Rangaranjan Raghavan, MD**
 Mr. Kapil Kapoor, CFO
 Mr. Bimal Das, President - Enterprise Distribution
 Business
 Mr. Sutikshan Naithani, President - Consumer
 Distribution Business

Moderator: Good day, ladies and gentlemen. I am Harpreet Kapoor, the moderator of this call. Welcome to HCL Infosystems Q1 FY19 Results Audio Conference Call. We will start with the presentation and then follow up with a Q&A session. During the presentation, all participants' lines will be in listen-only mode. This presentation is available in the investor relations section of the company's website.



We would like to begin with a mandatory disclaimer. This call may contain statements concerning our outlook for the future as well as some of our beliefs, future plans and strategies. These forward-looking statements and information are subject to risk and uncertainties that they entail.

We have on the call with us Mr. Rangarajan Raghavan, Managing Director, HCL Infosystems; Mr. Kapil Kapoor, Chief Financial Officer, HCL Infosystems; Mr. Bimal Das, President, Enterprise Distribution Business; Mr. Sutikshan Naithani, President, Consumer Distribution Business. I would like to now hand over the conference to Mr. Rangarajan. Thank you and over to you, sir.

Rangarajan Raghavan:

Thanks, Harpreet. Good afternoon. As we said in the previous call, from FY18 we have been focusing on a few core businesses - distribution and overseas business. An outcome of our endeavour is the sale of HCL Services Limited. Our focus has been on consumer distribution and enterprise distribution and on overseas services, especially in Singapore. With respect to system integration, we have laid stress on execution and collection. For details on the specific result, I now hand it over to Kapil to take you through the financial results.

Kapil Kapoor:

Good afternoon, let me share the highlights of our Q1FY19 results. On the continuing operations side, we had a revenue of 1,137 crore which shows that there has been a decent growth of about 7% sequentially quarter-on-quarter (Q-o-Q). Revenue in Distribution business for Q1 was Rs. 986 crore which again indicates a growth of 9% sequentially. Both enterprise and consumer distribution grew sequentially with enterprise distribution business growing at about 3%, earning a revenue of 457 Crore. Whereas in consumer distribution business, we had a revenue of 529 crore which shows a 14% sequential growth over the previous quarter.

Profit and loss before interest, tax, and exceptional items is about Rs. (7.3) crore in Q1 as compared to Rs. (17.1) crore in Q4, the immediate previous quarter. Domestic services



business has been hived off and categorized as a discontinued operation in our results for this quarter. So, the revenue from discontinued operations was Rs. 31 crore during the quarter, and profit was Rs. 11.7 crore which included a gain of Rs. 9.6 crore from sale of divested businesses.

Let us see slide #6 where we have presented a break-up of consumer and enterprise distribution. As I mentioned, both these businesses have performed better than the immediate preceding quarter. Now, Ranga will take you through each of these businesses in greater detail.

Rangarajan Raghavan:

Thanks Kapil. Kapil has shared the financial numbers. I just want to highlight a few of the things which has worked for us in consumer distribution. Our business model on multi-brand & multi-channel has definitely worked for us, with a yield of about 14% Q-o-Q growth. E-com channel is a focus segment for this business. As we all know, E-com is actually growing well specifically on the consumer segment.

Moving to the enterprise distribution, we have seen Q-o-Q growth which is consistent revenue increase of about 24% Y-o-Y. The existing relationship with various OEMs has expanded. We have announced our focus on emerging digital technologies, particularly security and cloud practices.

Moving to profit numbers from distribution business, as Kapil mentioned, the top-line number was about Rs. 986 crore and the bottom-line about Rs. 0.7 crore.

With regard to the global services, there has been a consistent Q-o-Q and Y-o-Y growth of about 15%. Focus has been on initiatives undertaken in the automation and on adoption of self-healing technologies, thereby investing on capability building in terms of employee training and certification on specific areas.

In terms of global services, the specific reason for the slight drop in the margin is because of the investments in the new



capability which are required for the growth of the new business we have undertaken a few quarters back. The revenue is expected to yield from January next year.

With respect to system integration and solutions, our focus continues to be on the execution of projects and collection of money. During Q1, we collected Rs. 73 crore from one of the large government projects. In terms of the financial results of SI, there has been about Rs. 38 crore revenue and 11 crore loss before interest & tax. This business is largely dependent on the project milestone completion during the quarter. Now we invite you for the Q&A.

Moderator:

Thank you so much, sir. With this, we will open the floor for Q&A interactive session. So, participants, if you wish to ask a question, you may please "0" and then "1" on your telephone keypad and wait for your line to be unmuted. The first question of the day is from Gajesh Abani, an investor. Your line is unmuted.

Gajesh Abani:

Good afternoon, Sir. From the balance sheet of the last six years from December 2012 to March 2018, it is evident that the company has incurred a loss of around 1,663 crore altogether. I just wanted to know how much loss the company is going to incur in the coming years and what went horribly wrong with the company in the last six years. Also, which remedial steps has the company undertaken to get back on the path of profitability?

Management:

We are not permitted by Board to give any forward-looking numbers. But as revealed in our preceding calls and evident from the related transcripts, over the last one and a half or two years the company has been trying to rationalize the businesses where it has not been able to scale up. We have been fairly successful in doing so with the closure of divestment in the domestic enterprise services business. The objective was to focus on certain key businesses where we see growth and profitability. And now we are hoping that going forward with these three key growth businesses will help us get back into profitability and help us improve the performance of the company.



- Gajesh Abani:** I have another question. What is the margin in both the enterprise business and consumer distribution business?
- Management:** See, in distribution businesses, typically the margins are in single digit. So, that is the case with our distribution business too.
- Gajesh Abani:** Even in enterprise distribution business the margin is in single digit?
- Management:** Yes. The margin is at single digit because we are not selling our product or our brand. We are distributing the products and solutions of other OEMs. It is slightly better than consumer distribution in terms of absolute comparison though being in single digit. This is the industry norm. It's no different with other distributors who are into enterprise IT products and solutions. You will see that they also have similar range of margin. In the overseas services, definitely we have much better gross margins which are upward of 20% and that business also is growing well.
- Gajesh Abani:** So does that mean it will keep on growing strictly at the rate of maybe 10%? You have not mentioned any growth rate. But in the last four years, it has remained around that.
- Management:** Historically, it has been quite a steady business for us and has been growing at about 10% to 15%. Going forward, we are doing our bit there to see what best we can get out of that market and adjacent space.
- Gajesh Abani:** What is the path to profitability in terms of the entire company?
- Management:** That's what I explained to you a while ago. Having rationalized the businesses we have focussed on three key businesses where we believe that the growth and profitability for the company lies.
- Gajesh Abani:** And how much is the net debt right now?
- Management:** Net debt would be in the range of about Rs. 700 to Rs. 750 crore.



- Gajesh Abani:** Against that are there any receivables?
- Management:** Of course, there are receivables in our systems integration business and in our distribution business.
- Gajesh Abani:** Once you recover the receivables in terms of system integration business, that debt can be zero?
- Management:** Yes. Along with systems integration business, we have certain other receivables. Debt cannot be zero because there is a capital requirement in distribution business as well as in consumer and enterprises though it is not very high.
- Gajesh Abani:** And, whatever money that you have raised, that is, around 495 crores, has that been used to repay the debts?
- Management:** Yes.
- Gajesh Abani:** After that, you raised another NCD?
- Management:** Haven't raised an NCD as yet. We have taken up approval from the Board to raise the NCD in order to convert some of our short-term loans into slightly longer ones.
- Gajesh Abani:** Okay. If you can just elaborate, what went horribly wrong with the company in the last six years? I have some data. In 2010, the market cap was around 1,100 crore, which is still the same. In the same management, HCL Tech market cap was around 20,000 which is now 1,40,000 crore. I am not comparing but merely saying both the companies are under the promoter. What went horribly wrong with this particular company? Has the promoter lost focus on this company? If you can explain something and put some light on that?
- Management:** It's not that the promoter does not have focus. Promoter is a shareholder, and he continues to be one. If you want to go year by year in historical numbers and understand in detail, I suggest you can have an offline call with our IR person. He will be able to run you through each year financials and how things changed in the company over the last six years.



- Gajesh Abani:** My point was just to get a view whether the promoter has some kind of vision for this company or is he disinterested in this company. As you have said correctly, they have put in a lot of money.
- Management:** I think I have answered that question already.
- Gajesh Abani:** Right, sir. Thank you.
- Moderator:** Sir, the next question we have from Dilip Sahu, an individual investor. Your line is unmuted.
- Dilip Sahu:** Just wanted to get a sense of the international business. What is the breakup of Middle East and Singapore business in terms of both topline and profitability?
- Management:** Ninety percent of the business is Singapore global business; The Middle East business is too small. In terms of the margin contribution also, the business in the Middle East is more or less break-even or making a marginal loss. And most of the margins you see in the financial results are coming from Singapore.
- Dilip Sahu:** Okay. I read somewhere that you are planning to divest Middle East business. Is it still on or is it called off?
- Management:** Absolutely. See, the Middle East divestment is still on. The earlier investor has backed out and then we could actually go ahead with that particular deal that time. We did actually make the announcement way back in April. And we are looking for a new investor. At the right time, we will come back and make the announcement.
- Dilip Sahu:** Okay. Just wanted to get a feel of the SI business backlog. I think the backlog remains at 650 to 750 crore for the last three quarters, and we built around 25 crore to 55 crore? But it is still at 85 crore. Is there something I am missing out?
- Management:** In SI business, all our large orders, barring one or two, are on their absolutely last leg. Either we have completed the



implementation on build phase or we are just about to do it in a quarter or two. Once we are able to complete the implementation or build phase, then these orders move into the services phase where we are supposed to take care of the support services for these projects. So, we are in a way trying to close all the projects quickly, get our acceptances, get our money, and move into the services phase.

Dilip Sahu:

I understand the desire is to go into 100% annuity services of the business. What I had some confusion is, in Q3 the order book was some Rs. 650 to Rs. 750 crore but build phase was only Rs. 85 crore. I think every quarter we keep on billing Rs. 35 to Rs. 55 crore, but the backlog is still Rs. 85 crore. So, are we booking new orders? Am I missing something?

Management:

There are two factors which you have to bear in mind. First, out of the orders which are billed every quarter some have already moved into services. And what we are billing for those projects is services. So, the reduction will not come into the build phase for that.

Second, while we don't go for new orders, at times we do get a change request which was originally agreed with our customer at the time of order because at a later date it is realized that some more work has to be done to configure the solution as per customer's requirement. So, both these factors actually have to be kept in mind.

Dilip Sahu:

Sure. I have some questions.

Management:

Go ahead. If you want a detailed conversation, you could also connect with our IR head

Dilip Sahu:

No, no. It's quarter related. Basically, Rs. 85 crore or whatever we will get, will it continue over the next one or two quarters?

Management:

See, barring a couple of projects where it is taking longer and the customer is taking time to sign off the earlier acceptances, I think most of the orders should get over in



the next two to three quarters as far as the build phase is concerned.

Dilip Sahu:

Great. Coming back to the distribution business, typically consumer business has a gross margin of 3% to 4%, enterprise may be 5% to 6%. It doesn't look like we are there yet. But are we going to kind of reach a gross margin of 3.5% or 4% in the distribution business?

Management:

No, we are already at about the number which you are quoting for both consumer and enterprise distribution. But to get a real picture of it, one has to wait. For example, consumer distribution has kind of in a way started afresh. If you go back last year same quarter, the revenues had gone down to Rs. 70 crore and they are rebuilding. So, once they reach the scale which we want to target then the actual profitability will be visible. But our existing gross margins are very much close to what you are mentioning as the standard gross margins for these businesses.

Dilip Sahu:

Okay. So, it's a matter of stabilizing the business in terms of the supply chain and the channel to get the dues out of internal EBITDA, right? Is that correct?

Management:

No. I wouldn't say that because supply chain and stability of business is not an issue; we have been in these businesses for decades. The point is reaching a particular scale in terms of revenue so costs don't vary that much. It's only revenue and the topline numbers that can seek better net margins.

Dilip Sahu:

Coming to revenue, Apple business got discontinued from 2019 March; that's fairly a large chunk of the business, like Rs. 350 odd crores in the consumer business. This is quarterly number, right?

Management:

I have with me our Business Head for Consumer Distribution, Mr. Sutikshan. I would request him to kindly present his perspective on that.

Sutikshan Naithani:

Just to answer what you are looking for is that we are a multi-brand & multi-channel distribution company. Of



course, one would like to have as many brands to deal with but if you look even at the last quarter, we will be in a position or we would be building up our business on quarterly basis. We would be in a position to cover up whatever we lost on this side of the business. But if you look at it, there was no significant gain from that line of the business. So, practically it does not make a bigger impact in terms of what we lose by way of business.

Dilip Sahu:

Okay. Last question is on the debt. Last quarter, I think our net debt was 900 crore. If I remember correctly, our current net debt is around 700 crore. We collected around 360 crore last year. So, is the debt going as per your plan?

Management:

That's the endeavour. Yes, you are right that during the quarter also, we have paid about 160 crore. So, the endeavour is to bring down the debt to a realistic level in the next year or so. You know, the only word of caution is that a large chunk of our collections are from government in the SI projects. So, it may vary by a quarter or so here and there in terms of the timing.

Dilip Sahu:

Okay. Can we kind of look at a net debt of 300 crore in this financial year?

Management:

No, I wouldn't want to consider it for this financial year. In the next financial year, definitely our estimate is that we should be able to do it. But as I mentioned, we will have to see how it goes with the collections that we have targeted.

Dilip Sahu:

Sure. Thank you very much.

Moderator:

Once again, participants, if you wish to ask a question, you may please press "0" and then "1". We have a question from Sanjay from Tech Mahindra. Your line is unmuted.

Sanjay:

Hello. Good afternoon, Sir. I have been an investor in HCL Infosystems. Actually, it's very disappointing for the last so many quarters. I have been just waiting for a turnaround. I have been listening to all the measures you have been taking. I need some kind of a positive feedback from you clarifying when all of this will end. It is likely that some



profit would be shown in the balance sheet. Which are the items which would be going off the loss items from the balance sheet?

Management:

We have already shared our plan with respect to how we are working on turning the company to a profitable company. I think you will have to go by that. At this stage, if you ask me to announce a date, I am afraid we are not permitted by Board. While we have internal estimates, we are not permitted to give any forward-looking statement. However, your concern is well taken. And we are working on doing what we can at our end in order to yield profits. And as you have been reading and as I mentioned earlier in this call, we have done a lot of rationalization in terms of the businesses that we are in, the customers that we are dealing with, etc. So, the objective was one of achieving a growing and a profitable company.

Sanjay:

Is this rationalization still in process or is it over? Or, can we expect it in the next quarter?

Management:

It's largely done now except for one or two pieces which Ranga shared with you, for example, about the Middle East, where we are looking at divestment. But largely what we had planned in terms of our rationalization has been done. Now it will take us a quarter or two to stand up and start running with the key businesses that we are focusing on. So, I guess you will have to bear with us for a few more quarters.

Sanjay:

You said your profit margins are in single digit in the distribution business, in both enterprise and consumer. Right? Also, you said that your expense figures are going to kind of stay. They are almost fixed.

Management:

Yeah, except for supply chain cost, which of course vary with the volume, most of the other costs related to distribution business are not proportionately variable. There is very marginal growth in the cost as compared to the revenue.



- Sanjay:** Okay. When I see your balance sheet, basically I can see the employee cost and finance cost remains the same. Other expenses vary a lot. So, could you please highlight?
- Management:** Other expenses has multiple elements on it. And besides the normal items, it has certain items which are one-off for a particular quarter. So, I will request my IR person to be in touch with you to explain quarter by quarter how it has trended.
- Sanjay:** Okay. As a whole, can I take it that the company is seeing the worst and it is in the direction of positive towards getting some profitability at least?
- Management:** That's what we believe.
- Sanjay:** Okay. Thank you, sir.
- Moderator:** At this time, there are no further questions from the participants. So, I would like to now hand over the floor back to Mr. Rangarajan. Thank you, and over to you, sir.
- Rangarajan Raghavan:** Thank you all for joining the call. See you next quarter. What you see are the IR contacts on the screen. Feel free to contact IR if you have any other questions. Thank you all. Bye.
- Moderator:** Thank you so much, sir. Thank you, participants. That does conclude our conference call for today. You may all disconnect now. Thank you and have a pleasant evening.