



**Annual Investors Call of HCL Infosystems Ltd.
August 21st, 2013**

SPEAKER: Management

Management:

Thank you for joining us in this session.

FY12-13 was undoubtedly one of the most challenging years for us as we faced multiple headwinds. Despite the headwinds, many good initiatives and actions were undertaken, which may not be completely reflected in the reported results. Let us walk through these new initiatives and the headwinds followed by the overall performance. The analysis may contain some forward-looking information including statements about HCL Infosystems' outlook on plans, strategies, or anticipated events. The forward-looking information and statements are subject to risks and uncertainty that could cause actual results to defer materially from those that may be inferred from the statements being shared today.

The macroeconomic headwinds and the environment that the entire IT industry in India is going through are well known. The issues that domestic IT players like us are facing today are primarily due to the economic growth slowdown that has affected both the B2B and the consumer business. Secondly, the sharp swing in currency exchange rate affects our hardware business due to high-import dependence. We import Rs. 1500 crores worth of components and products. A small part of the Rs. 1500 crores is passed on to the consumer or to the end customers whenever there is increase in the input cost because of unfavourable exchange rate. A major part of this amount is locked in long-term rate contracts whereby any foreign exchange fluctuations cannot be passed on to the customers. This adversely affects our performance. Thirdly, the government business is increasingly becoming more challenging. A significant part of our business is with government, which has been impacted by delays in sign-offs and timely payment issues. So these three headwinds - the exchange rate volatility, overall economic slowdown and public sector projects with delays in payments or in acceptance of milestones, have all impacted our business. These headwinds were experienced throughout the year and some of these became more acute towards the end of FY13.

Against this backdrop, we can look at what exactly transpired in our business in FY13. As part of the last year highlights, significantly large IT solutions orders were secured by the business. As communicated in past quarters, we had stressed upon becoming extremely selective about customers that we would do business with for large System Integration (SI) deals. Today our go/no-go ratio where we decide to pursue versus decide not to pursue a deal is literally 1:3. This translates into just about 25% of the deals actually meeting all the threshold norms that is IRR, ROI and cumulative cash flow. From the selectively pursued deals, some significant wins during the year were UIDAI-Aadhaar Managed Services

Programmes, Defence Communication Network and a few e-Public Distribution System Projects. Despite a very selective pursuit of business, we have maintained a healthy order book of almost Rs. 4000 crores in SI business. New orders added during the year were about Rs. 2700 crores. Hence, despite cleaning up the whole order book on account of non-moving projects, the order book was maintained at similar levels at which we had entered the year. Order backlog consists of orders to be executed over the next few years and is a good indication of a future revenue visibility as far as System Integration business is concerned.

The average cycle for conversion of these orders to revenue is about 2.5 to 3 years except programmes like UIDAI, for which it is larger. The second highlight for the year was portfolio diversification in the Distribution Business. This was the reason for the creation of an arm's length subsidiary called Digilife Distribution and Marketing Services (DDMS), which would enable us to distribute competing brands. This in turn would grow our portfolio beyond the traditional array, which was heavily concentrated on a single brand of mobile phones. Hence, the non-telecom distribution part of the business almost doubled. There are miles to go on this path because the Telecom Distribution is still a dominant part of our portfolio though last year we have made good headways and our non-telecom distribution has become sizable.

There were a series of quarters of decline in the telecom distribution business in this FY as our principal partner was undergoing a churn in its portfolio and was facing reverses globally. However in the last quarter, we witnessed some stability in the portfolio and there was a good pickup in the telecom distribution as well. In the end of 2012 and the first quarter of 2013, our Principal changed its entire portfolio from old platforms and operating systems to new platforms. Hence, the business side declined rapidly to less than Rs. 300 crores a month in the month of December. The Telecom Distribution business has now crossed over Rs. 400 crores a month with an increase in sales month-after-month, over the last six months. As a result, telecom distribution, increased 14% QoQ in the AMJ'13. Therefore, there was a good movement in the last quarter in both telecom distribution as well as non-telecom distribution. There was a significant drop of almost Rs. 1600 crores in the telecom distribution business over FY 12. Most of this was in first three quarters as the principal was undergoing a portfolio churn and erosion in their market share.

The mobility business, the new business initiative of the company, has been able to counter the declining trend in the PC industry globally and in India. Many consumers are adopting tablets as opposed to PCs or laptops as their first computing device. HCL Infosystems was the first

PC manufacturer in India to introduce tablets and thereby entered a space to compete with telecom giants like Apple, Samsung and Indian OEMs like Micromax and Karbonn. The Mobility business has now observed a good traction and in last one year was able to register a five-fold growth as compared to the previous year with market share varying from 8% to 13% in different months of the year. HCL Infosystems is one of the serious contenders and the largest PC player in the tablet space in India presently.

The Learning industry has undergone big upheavals with many peer companies facing significant challenges in terms of their receivables situation and their declining volumes. Though a late entrant in the technology-enabled learning space, we have learned significantly from experiences of some of the other peer companies. The business took a disciplined approach towards customer engagement rather than increasing the number of customer acquisitions. As a result, we have one of the best performances in terms of NPAs in this business. The operating leads of our smart classrooms (called DigiSchool) are selective about their customers and focuses on assessment of their credit worthiness. Timely collection is again extremely crucial, and this is one area wherein the business has achieved good success. Our NPA performance probably is the best in the industry and as a result, HCL Learning showed significant positive growth as opposed to some of our competitors' who had a massive drop in their sales and were less profitable.

HCL Care was another start-up initiative that leverages our national service presence to start offering break-fix services to brands besides our flagship brands. The business signed up with multiple OEMs in the last one year. Revenue is yet to fructify in this business as we have begun by signing-up OEMs and then consequently build capabilities and network that will deliver break-fix services to consumers all over the country. The good news is that multiple sign-ups have happened which would reflect in the revenue of HCL Care.

From an overall perspective, operating profit for the year was positive despite some significant provisions for doubtful debts, exchange rate hits and a steep drop in the revenue of our largest part of our distribution portfolio, i.e. the telecom phone distribution. Despite these reversals, the business declared an operating profit before doubtful debt and exchange rate impact of Rs. 57 crores. Regardless of reported loss for the full year, because of the internal efficiencies in revenue conversion and working capital management had an operating free cash flow, which was at positive Rs. 170 crores for FY13.

Some of the new initiatives started showing positive signs in the year including Non-telecom Distribution, Mobility, HCL Learning and break-fix services to multiple brands through the HCL Care network. The key low light was the performance of the PC business and hardware solutions business, which was impacted by significant industry headwinds.

PC industry as a whole has seen a global degrowth and the Indian market is also facing similar challenges. Moreover, along with the degrowth, severe margin pressures have also been witnessed as all competitors are aiming for market share in a shrinking market.

The Telecom distribution business shrank in the first three quarters of the financial year. Almost Rs. 1600 crores of our revenue fell year-on-year. In fact, the entire revenue decline for the company year-on-year can be attributed to this single instance. All other businesses put together registered marginal gain or marginal growth in the revenue.

Old system integration projects which are about five or six-years old are still undergoing execution even as many of these customers like BSNL, MTNL and ITI are in financial distress. In addition, as the milestones in these projects are not being met, this is resulting in cost increase, pile up of receivables and increase in finance cost. Therefore, system integration and solutions business have been impacted because of these public sector projects.

The last couple of months of financial year witnessed a massive exchange rate swing and hence had to take significant hits in the fourth quarter because of these exchange rate movements. The last quarter impact taken to the P&L was to the tune of Rs. 20 crores in terms of reported exchange rate loss. In addition, increase in cost of goods sold has resulted in loss in the margins. The change was of almost Rs. 26 crores as we had to restate cost, to complete number of projects where there was an import-content involved. Also there were certain losses on payables that are over 12 months old; these will be amortized in FY13-14 over the year. Therefore, it is a significant hit that we have taken for a second year in a row because of sharp swings in exchange rate. We cannot hedge and diversify from these uncertainties due to current restrictions on forward cover and hedging from RBI.

Interest cost burdens remained high because of the bills receivables in our system integration projects. Moreover, with hardening of interest rates, our interest costs have increased. On a year-on-year basis, our interest costs have increased by over Rs. 50 crores from FY12 to FY13. Therefore, exchange rate, BR provisions, high interest costs, and

headwinds of PC industry are some of the low-lights that impacted our performance.

The telecom distribution decreased from Rs. 6388 crores to Rs. 4844 crores. Taking cues from the developments in the Indian market we have decided to reduce our exposure to the business outside of the country. In the telecom distribution business as a whole, there was a decrease of Rs. 1668 crores in the entire year, which was partially compensated by our IT and Digital entertainment distribution business, which grew from Rs. 444 crores to Rs. 853 crores. This achievement is due to significant new principal sign-ups that we achieved throughout the year. Some of the new principals that we added in the last quarter include Simmtronics, Molex, Huawei, D-Link, Acer and so on.

In the last quarter the performance of telecom distribution business showed healthy growth, which gives us confidence that, the reverses that were seen earlier was probably due to the principal undergoing its full portfolio revamp. Telecom products distribution business saw a 14% jump sequentially in AMJ '13.

The enterprise hardware and solutions business and the system integration business grew from Rs. 584 crores to Rs. 790 crores. This growth came largely on account of new orders such as UIDAI and Defence Communication Network. This business at the EBIT level before provisions and before interest also registered a good growth year on year. This indicates that the new deals that we are winning are generating significant operating profit. Unfortunately, the profitability of this business has been impacted due to significant provisions on old projects, cost overruns and interest costs because of money locked in these projects. The new engagements are witnessing revenue conversions and are incrementally profitable.

The products business, whether it's the enterprise PC products or the traded IT products such as servers and storage and networking products performed fairly flat in this year. There was a sharp downturn of Rs. 1546 to Rs. 1581 in the capital spend by B2B customers, the enterprise and the government customers. However, enterprise hardware business revenues grew marginally 2.5% for the year.

The Office Automation business witnessed a sharp decline as enterprises and government organizations tighten their new capital spends. The least critical of that capital spend for an enterprise is on copiers, printers and audio-visual systems. This impact in the business continues even this year.

In the company's services portfolio, the enterprise IT services moved from Rs. 332 crores to Rs. 349 crores. Therefore, there was a marginal increase in enterprise services. Though on a revenue basis there was little growth in terms of the mix, the mix has moved substantially from government sector services to private sector services. At the beginning of the year about 70% of the service banks **was** from the government sector while at the end of the year the majority of service bank was from the private sector. In the year, the business won 41 bids from different private and government sector customers including marquee customers like IndusInd Bank, JCB, Apollo Tyres, Toyota Kirloskar etc.. Our Annual Contract Value (ACV) from managed services business grew from about Rs. 70 crores to Rs. 130 crores in the year, which going forward gives us a good revenue visibility in managed services. .

The company also won significant managed services orders from the overseas business. The company started the managed services business in Singapore and in the Middle East. In Singapore the business has already booked 28 contracts in the year. The TCV (total contract value) of these deals in Singapore is of the order of \$40 million. This TCV is over a four to five year contractual period and means a secure revenue visibility of \$10 million per year. In the first few months of this financial year we have been able to register robust bookings in managed services in Singapore.

This year a number of service wins in the Middle East were gained as the managed services business expanded. The company achieved robust wins from Qatar Foundation, Dubai Airport and Doha Bank. So there has been a good beginning in the enterprise service business as the overseas part of the business is being ramped up.

The business was impacted by a decline in the warranty repair revenue that was generated from the consumer products i.e the PC business & telecom products distribution business. Every product sold comes with a warranty and service entitlement, which is counted as a service revenue for HCL Care. As the product business, including the phone distribution and the computing products businesses witnessed a volume pressure last year, it also had its reflection in terms of HCL Care revenue. Hence, HCL Care revenue decreased from Rs. 93 crore in the year to Rs. 71 crore.

Office Automation services revenue, in line with office automation products sales, also saw a corresponding decline. Hence, the strategy in the service business has been to position services as brand agnostic multi-brand services. The strategy is not only to move from just offering break-fix services to owned products and brands to servicing multiple

products and brands but also to make it outcome-based. This approach is being reflected in our service line, which has been growing.

HCL Care encountered a reversal due to decline in the Nokia repair volume and our own warranty service income as PC volumes came down. However, a number of new partnerships were signed to make the service network available to other customers. Some of the significant new partnerships include Samsung, Lenovo, Philips and Emerson. The service to these products is being offered under the HCL Touch brand through a network of 15 HCL owned centres and over 150 authorised service partners. The HCL Touch network is expanding very rapidly to emerge as the largest network of consumer electronic service provider in the country. The recent sign ups have given confidence to the business that it has a unique value proposition in this space.

Within the mobility and consumer computing business, the computing devices segment for consumers and SMB witnessed a sharp decrease in the business – from Rs. 557 crores to Rs. 384 crores. This decrease in revenue was more than compensated by a high growth in the tablet business, which grew from Rs. 52 crores to Rs. 260 crores. Therefore, the company's devices business as whole registered a growth from Rs. 609 to Rs. 644. But the entire growth came from the tablet business while performance was driven down by the PC part of the portfolio.

The tablet business in the Middle East expanded to eight countries. The latest addition in terms of regional focus is now Turkey where ME tablets have been introduced through a large official sponsorship deal with Galatasaray. Galatasaray is one of the most popular and largest Turkish sports club and plays in the European League. This association was made towards the end of the last financial year.

HCL Learning observed a Y-o-Y flat performance for classroom additions as well as for revenue. However, this is a business where accumulated installed-base of classrooms translates into revenue conversion over a five-year life cycle. Hence every year as classrooms are accumulated, the business increasingly becomes more profitable. This business was started about two-and-a-half years ago and now has reached a point where it is almost breakeven. In the last quarter, the business was profitable and for the year at the EBIT level the business has turned to profit. One of the contributors to this profitability has been the focus on margin expansion. Gross Margin in this year expanded by 400 base points. In addition, the business maintained its NPA levels at below 3% by being extremely selective of the kind of schools that were engaged with. This is in comparison to the high double digit NPAs of the competitors. Therefore, HCL Learning has turned out to be a good margin, steady growth business. .

A window of opportunity in this business can be seen because of the weakening of the competitors. Many of them are reeling under severe crisis in terms of their balance sheets even as HCL Learning has been registering growth. Moreover, as a brand the business is supported by a good service network & has an engaging content. With these strengths, the business intends to gain more market share.

On a consolidated basis, if one looks at the different segments, the IT and digital entertainment distribution added Rs. 409 crores as compared to the previous year. The mobility business added Rs. 208 crore, which is a walk from previous year to next year. The system integration business grew by Rs. 205 crores as compared to previous year, and the enterprise services business grew to Rs. 36 crores. However, there is a sharp decline in telecom distribution that dropped by almost Rs. 1660 crores, which took away all the gain in the new growth areas whether it be enterprise services, mobility or IT distribution.

Therefore in the year as a whole the company registered a decline from Rs. 10840 crores to Rs. 9295 which is a drop of 14% in revenue. The entire drop emerged because of the single line of business - the telecom distribution. In other businesses if there is a drop in one segment then there is a corresponding growth in another too. For examples – while the PC business dropped but the tablet business grew; while the Care business declined on the other hand the enterprise services grew. The telecom distribution business, which is the dominant part of the distribution portfolio still could not be compensated by other portfolio additions in IT and DE. Hence, a 14% drop year-on-year in revenue was registered.

On a year on year analysis in terms of profit, from a pre-PAT profit of Rs. 84 crores in FY12, the Learning Business added Rs. 8 crore as compared to the previous year. The revenue was flat at Rs. 92 crore and profit grew by Rs. 8 crores as compared to the previous year in this business.

Mobility business was incepted in FY12 and in the first year it was not profitable. This year the business has turned profitable. Between the two years, there has been a positive movement of Rs. 14 crores. In terms of incremental margin contribution, the Enterprise services growth of Rs. 36 crores translates to about Rs. 7 crores.. These three initiatives actually contributed to profit growth. Profits in the last year gained from a onetime transaction of the sale of Infinet Business to Tikona, unlike this year where there was no such transaction. There was a Rs. 26 crore gain, which was a part of the Rs. 84 crore which was not there in this year.

On account of hardening of interest rates, interest cost increased by Rs. 52 crores,. In addition, the working capital showed an increase for bulk of the year, . It was only in the last quarter where there was liquidation of the working capital. Distribution business observed a drop of Rs. 58 crores owing to a Rs. 1600 crore drop in telecom distribution.

PC and enterprise solution businesses suffered losses on account of cost overruns in many government projects, exchange rate hits and write offs that had to be taken on account of overdue receivables. All these factors affected this line of the business. Hence, there was a reporting loss of Rs. 126 crore from prior period profit of Rs. 84 crores.

–In a snapshot, there was a 14% drop in revenue (Y-o-Y) due to decline of telecom distribution which was partly compensated by growth in system integration, mobility, IT and digital entertainment distribution.

In January 2013, the company initiated the restructuring of different businesses. There was an announcement of the plan to create different subsidiaries for the businesses with different operating parameters, industry peers & opportunities and challenges. The present status is that the Honourable Delhi High Court on 20th of July 2013 has called for a meeting with creditors, investors and lenders. All the three bodies have voted in favour of going ahead with this scheme. Going forward there are certain statutory steps that have to be taken. The company is undergoing these steps, and expects to complete the process by the end of this calendar year. As of now, the process is moving as per plan and no unforeseen issues have emerged.

In line with the restructuring process, some parts of the organisation are being re organised with a focus on cost optimisation. All of these actions were completed in FY12-13 and the company will see an annualised cost benefit of Rs. 37 crores into FY13-14. These actions were completed towards the end of Q3 or Q4, and hence its full year impact would now be seen in FY14. Additional cost optimisation actions are underway which will be completed in H1 of this financial year with the annualised impact of about Rs. 25 crores. The company is also streamlining some of its cost structures. .

Thank You.

Moderator:

Thank you so much, sir. With this, we are going to start the Q&A interactive session. I would request all the attendees and the participants, if you wish to ask any questions, you may press “0” and “1” on your telephone keypad please. I repeat, participants, if you wish to ask any questions you may press “0” and “1” on your telephone keypad. I would

like to repeat once again, participants if you wish to ask any questions you may press “0” and “1” on your telephone keypad.

Management:

In case you have any queries on the performance of the company for the quarter or the full year, please feel free to get in touch with our company secretary as well as the investor relations team and we would certainly get back to you. Thank you again for joining the call today.

Moderator:

Thank you so much, sir. With this we conclude the Conference Call for today. Wish you all a great day ahead. You may all disconnect your line. Thank you so much.