HCL INFOSYSTEMS

HCL Infosystems Quarterly Investor Conference Call

Q2 Earnings Conference Call

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Speakers : **Mr. Premkumar Seshadri, Executive Vice Chairman and Managing Director, HCL Infosystems Ltd.**

Mr. S G Murali, Group Chief Financial Officer, HCL Infosystems Ltd.

Mr. Bimal Das, Joint President, Enterprise Distribution Business, HCL Infosystems Ltd.

Moderator: Good day, Ladies and Gentleman. Welcome to HCL Infosystems second quarter audio conference call. We will start with the presentation and then follow up with question and answer session. We would like to begin with mandatory disclaimer. This call may contain forward-looking information including statements concerning our outlook for the future as well as some of the other statements of belief, future plans and strategies. These forward looking statements and informations are subject to risk and uncertainties that they entail. We have on the call with us Mr. Premkumar Seshadri, Executive Vice Chairman and Managing Director, HCL Infosystems Ltd., Mr. S G Murali, Group Chief Financial Officer, HCL Infosystems Ltd. and Mr. Bimal Das, Joint President, Enterprise Distribution Business, HCL Infosystems Ltd. Now I will hand over the call to Mr. Premkumar. Over to you, sir.

Premkumar Seshadri: Welcome to the second quarter interaction. As indicated on slide number 2, we are looking at the results from the context of our key units, which are part of HCL Infosystems Ltd. - Distribution, Services, Learning and Infotech.

The small carve out here essentially highlights the significant synergy that was seen in the last quarter which we would be witnessing going forward. I would be essentially talking about the box highlighted in red which indicates our presence in the enterprise space and the rest in the consumer space.

Moving to slide number 3, as far as the business highlights are concerned, there was a contraction in the Q2 revenue by 22%; the revenue declined from Rs 1471 crores to Rs 1147 crores. The Enterprise business revenue grew almost 35% year on year, out of which there was a very strong Q-on-Q growth and also a year-on-year growth of 74% in the Products Distribution business.

The Services business registered 1% growth Q-on-Q and 16% growth year on year. The Care business, which is the OEM servicing business, registered Q-o-Q growth of 2.5% and a Year-on-Year growth of 5%. The key focus area was trying to bring in a larger amount of synergy across the offerings and in the context of some of the key OEM relationships.

The Consumer Business or Consumer Distribution business has contracted significantly almost by 37% Q-on-Q and has seen a significant amount of both volume and margin pressure on account of the product and price rationalization by the principal.

The consumer business saw quite a bit of churn in terms of market share, and the impact of the same were felt in the quarter that went by.

The impact of the revenue is also seen in the context of the P&L of Q2, including loss of almost Rs 64 crores as against Rs 48.5 crores for Q1.

The SI project execution has been the focal point, as far as that business is concerned, with one large project achieving commercial closure and another power project nearing commercial closure.

This has been the highlight of the Q2 that went by from the context of the revenue as well as the system integration business in the non-services and distribution business.

Apart from this, there has been some good recognition in Infotech and the Care business.

Moving on to slide number 4, this fundamentally focuses on the enterprise business which is the product distribution business. There has been greater number of deals due to the integration of products and services, as they get into larger involvement in terms of technology refresh space, as well as in the context of extending the lifecycle of existing infrastructure.

Some benefits of this, both in the context of pipeline increase as well as in the context of profitability were seen, as there was a definite traction in these businesses.

Enterprise Services has both domestic and global presence. The Care business is another business where we have worked with the OEMs.

There has been continued focus on the larger number of OEMs coming into the framework. A very large portion of these OEMs who were looked at to be involved, are already involved as far as the distribution categories are concerned, and there are definitely a few more that will keep getting added with the time.

The impact of the emerging services space and infra application integration is good. Therefore, it is important to look at the client accounts from a product and distribution side. There has also been traction in the key areas of investment made in the context of cloud mobility, an extension to the Internet of Things traction. The Global business continues to grow. I would now handover to Mr. S G Murali who would walk you through Q2 FY16 P&L snapshot. Over to you Murali.

SG Murali: Thank you, Prem. Good afternoon to all of you. Wish you all a very Happy New Year. I am going to present the overall P&L snapshot for the last quarter.

In the earlier presentations we have been presenting the snapshots of Distribution, Services, Learning, SI and other businesses. This was the format which was earlier used. Since, many of the OEMs are common as Prem had explained about looking at the synergies between the various enterprise businesses, be it enterprise product distributions, domestic or global enterprise services or Consumer Services business. In the Enterprise Distribution and Services Business, the customers are common, and the size of these business enterprises is becoming as big as the Consumer Distribution business. Thus it's very important to give the summary of financials for the distribution business and services, as provided in slide 5. The same information is on slide number 6 where we will show the size of the consumer business and enterprise business in terms of how big is the Consumer business and the Enterprise business.

Moving on to slide number 5 which shows the consumer distribution and the enterprise distribution distinctly.

The revenue for the quarter, is Rs 1147 crores, compared to the previous quarter revenue of Rs 1471 crores. Largely the drop in revenue has been due to the Consumer Distribution business where there is a drop of almost Rs 300+ crores during the last quarter. This has been due to the product and pricing rationalization by the principal.

Overall, the profit before provision for bad and doubtful debt, before write-offs and impairments, is at minus Rs 20.6 crores as compared to minus Rs 9 crores in the last quarter. This is higher loss than the last quarter. The provision for doubtful debts, write-offs and impairments, was at Rs 10 crores compared to Rs 14 crores in the previous quarter.

Other income was Rs 6.6 crores in the last quarter. In the current quarter it is at Rs 2.1 crores. And the profit before interest and tax is at minus Rs 28.8 crores which was at minus Rs 16.7 crores in the previous quarter.

The finance cost has gone up by Rs 4 crores, mainly due to the working capital in the SI business. Due to this the acceptance cost has gone up by 3 crores, and incremental debt has gone up by about Rs 50 crores contributing to the increase of about Rs 4 crores in the net finance cost.

Overall, the loss for the quarter is at Rs 64 crores, compared to Rs 48.5 crores in the previous quarter. This has gone up by about Rs 15 crores which is attributable to four aspects. One, interest cost going up by 4 crores during the quarter. Second, Q1 saw a one-off gain of about Rs 4 crores from the other income. Third, in the distribution business or consumer distribution business, due to the drop in revenues, there is a drop of about Rs 5 crores. Fourth, loss in the Services Business has increased by about Rs 4 crores.

Moving on to slide number 7, the Enterprise business has three sections. One is the Enterprise Product Distribution business, which was the erstwhile Enterprise Distribution business. The Enterprise Product Distribution business has seen significant momentum. There has been a scale up from roughly about Rs 120 crores in the same quarter last year to almost double of that, to Rs 214 crores in this quarter. Last quarter it was Rs 200 crores. This quarter, it is at Rs 214 crores which shows stability and momentum for growth. Revenue growth is at 6% quarter-on-quarter.

The portfolio expansion with the OEMs and product additions has been continuing to expand. Major customer acquisitions have continued in the quarter, registering new channel partners as well to service these customers.

The last point is significant synergies both in terms of business as well as operational synergies with an integrated go-to-market with enterprise services business.

Especially the technology refresh deals are largely coming with technology lifecycle expansion bundled in many of the builds which are coming up in the last couple of quarters. And the combined go-to-market is actually helping address this space in a synergistic manner. So Enterprise business is on a good momentum at this point of time.

Moving on to Slide number 8 which is the Enterprise Services. This covers both the domestic and the global. This again compared to last year, same quarter, is at Rs 184 crores. Today, it is at Rs 213 crores, more or less similar levels as the last quarter.

Year-on-Year, there has been a growth of 16%. There has been investment in terms of building capabilities over the last couple of quarters, which resulted in some good customers' win in the last quarter. New partnerships with some large global OEMs have been signed. Continuous investment is there in the service delivery capability especially to address the emerging businesses in this space.

The booking pipeline is very good. At this point of time the CAGR is greater than 20%.

In the Enterprise Business - Care, which is the Consumer Services business, there is a year-on-year growth of 5%. Last year, same quarter, it was Rs 39 crores as compared to Rs 41 crores in this quarter. Signing up with key OEMs for exclusive service center tie-ups has taken place. These service centers were under roll-out in the last two quarters. As planned, close to about 50% of the new service centers have already been rolled out.

In the initial phase, an Opex will come in, due to the new service centres. However, in about three to four months' when the footfall increases and the service call volumes goes up, it will start contributing to margin as well. The balance of the rollout is likely to get completed between now and end of Q3. Care again is poised for a good growth going forward.

Overall, the results for Enterprise business as a cut, last year, same quarter was at Rs 346 crores in terms of revenue. Today it is at Rs 468 crores. This was Rs 453 crores for the last quarter. The profit before interest and tax, compared to the last quarter of a loss of Rs 15.3 crores, the loss for this quarter is at Rs 12.5 crores. Enterprise business seems to be progressing well.

Moving on to slide number 11 is Consumer business - Consumer Distribution. There has been further strengthening of the partnership with Microsoft with a tie-up for the Surface distribution, effective from 1st January 2016. This is a new product category. The company is the pan India distributor for all segments of micro web devices in the telecom space. The urban distribution has been added to the existing portfolio effective from 1st January 2016. However, this is with a pressure on margins. This contract is effective from 1st January 2016.

Overall, Q2 revenue declined by 35%. It has been explained in the last couple of quarters that the principal has been going through product and price rationalization, which is impacting both the sales as well as the margin. That is what is seen in this slide in terms of a revenue drop. There has also been a tie up with Acer Notebooks for the online channel.

Moving on to the slide number 12 we would give a snapshot of Consumer Business Financial. The revenue is at Rs 567 crores as compared to the last quarter of Rs 873 crores. Profit before provision for doubtful debts and impairment has come down from Rs 19.2 crores to Rs 13.9 crores. And the profit before interest and tax which was at Rs 18.9 crores has come down to Rs 13.9 crores while the last part of the drop is attributable to the drop in volume. There has been continuous rationalizing of costs every time there has been a drop in the volumes in the last couple of quarters. There has been rationalization of manpower, rationalization of overheads in line with the volume drop to try and see how best the impact from the bottomline can be minimized.

Moving on to the slide number 13 for System Integration and Solutions, the project execution has been the focus. Most of the projects which are in the build phase are coming towards 70% - 85% completion. During the last quarter, projects of about Rs 152 crores have been completed. The UIDAI project continued to progress well. As of 31st December 2015 enrollment of about

95.26 crores people has been reached. One of the major Defence projects has been enabled for commercial closure, and another project is likely to get into commercial closure towards the end of this quarter. Good progress has been achieved in some of the power projects which are also moving towards commercial closure.

Financial inclusion is a business where investment has been taking place in the last couple of quarters. Two large contracts were won during the quarter and hopefully some accruals of revenue can be seen in this in the next three to four months, once the project implementation is completed.

The pending SI order book of about Rs 1410 crores at the end of Q1 is at Rs 1256 crores now. Roughly about Rs 550 crores is in build phase and about Rs 700 crores is AMC phase. In terms of System Integration and Solutions' financial, this also includes the Financial Inclusion business within it, and the PC mobility business also. The consolidated revenue has dropped from Rs 153 crores to Rs 140 crores largely because the build phase of the projects are coming down as they have moved into the maintenance phase. The profit before interest and tax was minus Rs 6.1 crores for the last quarter, and is at minus Rs 4.8 crores in the current quarter.

Moving on to slide number 15, there has been work on tying up the term loan facility more in terms of aligning cash flows that is the debt servicing requirements with the future cash flows of the business. There has been a tie up of a new term loan facility of Rs 700 crores. This is a 4-year term loan with a 1-year repayment moratorium. There has also been a tie up with a Rs 300-crore working capital facility for India operations. With this the debt servicing repayment part is largely aligned to the estimated cash flows of the various businesses going forward.

Premkumar Seshadri: Thank you Murali. I would now request the coordinator to open the floor for Q&A session.

Shelly Gandhi: This is Shelly Gandhi from Torrent Capital.
Can you repeat the debt number, incremental debt and the term for loan structure?

Premkumar Seshadri: It is not an incremental debt.

SG Murali: At the end of the quarter, it is at Rs 1301 crores compared to Rs 1251 crores in the last quarter. The term loan facility is a four-year term loan with a 1-year repayment moratorium and the term loan is for Rs 700 crores. Separately, there is a tie up for working capital facility of Rs 300 crores. The balance will be an unsecured loan like CPs which is there at this point in time.

Shelly Gandhi: Thanks.

Moderator: There is a question from Mr. Ketan Gopani from EA Investment.

Ketan Gopani: Can you throw some light on the major order win from Defense and Power project?

SG Murali: It is clarified that there was no mention about an order win. I want to clarify that - one of the Defense projects has reached commercial closure, which means it is being executed and there is a build phase which has been completed. Similarly, another power project is very close to getting to a commercial closure.

Ketan Gopani: Can you define the size and nature of prospect.

SG Murali: These are all typical system integration projects, and many of these are on multiple years of build and then subsequently multiple years of maintenance. A large part of the build is the key area where the projects need to be completed from a cash flow point of view. Commercial closures of the projects have been reached which means that the money was not due until yesterday, becomes due from today.

Moderator: There is a question from Mr. Rajeev from Integral Partners.

Rajeev: In the Consumer Distribution business, in this particular quarter, the revenues have dropped because of rationalization by the principal. So is there any visibility as to how long is the rationalization going to continue and when can a turn be expected from this towards the higher revenues.

Premkumar Seshadri: The product rationalization and the maturity of the new platforms of the principal is the journey undertaken. One of the key strategies the company had taken into consideration over a few quarters back when the strength was seen, was to start looking at emphasis around the enterprise side. Compared to a few years back from almost 70 to 75% of revenue being dependent on the Consumer Distribution business, it has significantly reduced the dependency on this now. So the overall revenues of Rs 1147 in the quarter that went by, the Consumer Distribution side represents a very small portion compared to what it was a few years ago.

The dependency being talked about from 80-85% is coming down to almost close to half of that. So there is a belief that the Consumer Distribution business would be challenged. And the focus is to ensure that the Enterprise Distribution business makes up for the appropriate drop as one goes along.

Premkumar Seshadri: Thank you very much for being here. I guess, you may have questions subsequent to this conference, and if you have any, Sumeet from our team would be very happy to take it forward. Thank you very much.