



HCL Infosystems Quarterly Investor Conference Call

Q3 FY17 Earnings Conference Call

2nd February 2017

**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. Sutikshan Naithani, Joint President, Consumer Distribution Business, HCL
Infosystems Limited**

Moderator:

Good day, ladies and gentlemen. I am Harpreet Kapoor, the moderator of this call. Welcome to HCL Infosystems' Quarter 3 Results Audio Conference Call. We will start with the presentation and then follow up with the 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 the mandatory disclaimer. This call may contain forward-looking information including statements concerning our outlook for the future as well as beliefs, future plans and strategies, which are subject to risk and uncertainties. We have on the call with us Mr. Premkumar Seshadri, Executive Vice Chairman and Managing Director, HCL Infosystems, Mr. S. G. Murali, Group Chief Financial Officer, HCL Infosystems Limited, and Mr. Sutikshan Naithani, Joint President, Consumer Distribution Business, HCL Infosystems Limited. I would request Mr. Premkumar to take over the call.

Premkumar Seshadri:

Thank you, Harpreet. Good afternoon. Thanks for being here for the Q3 discussions. I will begin with our structure, tracking our individual businesses, the Consumer Distribution business, then, the entire Enterprise Business consisting of both the Distribution and the Services side, and finally, the Infotech business which is focused around the System Integration area (refer slide 3).

Despite a challenging environment in the last quarter which has seen significant compression of revenue, we have sustained the momentum in our Enterprise and Project Execution space. From a business highlight point of view, we had a compression of almost 24% Q-on-Q—from Rs 1,002 crore in Q2 FY17 to Rs 765 crore. The enterprise business on a year-on-year (Y-on-Y) continued to show a growth of 5%. On the product side, the revenue growth was 5% Q-on-Q and 20% Y-on-Y. There was a 4% Q-on-Q revenue decline in Services and a dip of 8% Y-on-Y aligned to contract rationalization, our focus area, where we have been trying to migrate from some of the low margin contracts to higher margin ones. Hence, the revenues

which we see as a compression is an outcome of such rationalization.

At the consumer business with almost a 50% Q-on-Q compression, there was significant challenge. This was on account of two key counts—first, owing to the liquidity problem in the market place, as witnessed across the country in the last quarter, both at the channel level and individual level; and second, as a result of the transition in our strategy from an exclusive erstwhile principal partner to multiple brands.

With regard to system integration (SI), we continued with our sustained execution. We have reached the last phase of many projects. In the last quarter we have been able to get a major collection of almost Rs 200 crore from a project we did for a defence client. From a metrics point of view, the loss before interest & tax for Q3 was Rs 18.5 crore against Rs. 3.3 crore in Q2, and the loss before tax was at Rs 65.8 crore against Rs 49.1 crore in the last quarter.

To provide us with a deeper insight on the profit and loss statement and the specifics of various businesses, I request Mr. Murali to take over.

S. G. Murali:

The consolidated revenue for the quarter was Rs 765 crore as against Rs 1002 crore in the previous quarter (refer slide 5). The revenue has declined by Rs 237 crore. A large part of this revenue decline has been in the consumer distribution business. The SI business, where projects are coming to a closure, is also accountable for the decline. The profit before provision for doubtful debts write-off and expected credit loss was around Rs 1.3 crore in the last quarter. This has become negative in the current quarter. There has been a negative movement of about Rs 17 crore. Provision for doubtful debts is at Rs 7 crore, which is marginally lower than the previous quarter when it was at Rs 8.3 crore. The loss before interest and tax, which was Rs 3.3 crore in the last quarter, has increased to Rs 18.5 crore in the current quarter. There is a movement of about Rs 15 crore, almost entirely attributable to the SI business. The financial cost has marginally gone up by about Rs 1.5 crore primarily due to the average debt

during the quarter which was higher than the previous quarter. The loss before tax is at Rs 65.8 crore for the quarter compared to about Rs 49.1 crore in the earlier quarter.

Despite a significant drop of almost 50% in the total revenue of consumer business, which was Rs 442 crore in the last quarter and is at Rs 221 crore in the current quarter, we have been able to more or less sustain profitability in the last quarter. The profit before interest and tax is Rs 2.3 crore compared to Rs 3.3 crore in the previous quarter. Enterprise business overall has had a significant improvement compared to the last quarter. From about Rs 18.5 crore in the last quarter, the loss has come down to about Rs 11.5 crore. In the Learning business, the loss at Rs 1.7 crore has remained close to the loss of Rs 0.5 crore as incurred in the last quarter. In SI & Solutions the loss has actually gone up from about Rs 11 crore profit in the last quarter to about Rs 11 crore loss in the current quarter; there has been a movement of about Rs 22 crore.

In Services, our revenue has actually declined from about Rs 254 crore in the first quarter to Rs 244 crore in the second quarter to about Rs 234 crore in the current quarter (refer slide 6). While the revenues have declined largely due to the rationalization of contracts, the loss has also come down significantly from about minus Rs 16 crore in the previous quarter to about Rs 8.9 crore in the current quarter.

In the Enterprise Distribution business, the revenue is close to where we were in the last quarter and the loss before interest and tax is very close to where we were in the last quarter.

With regard to the product side of the Enterprise Business (refer slide 7), there has been a 5% Q-on-Q revenue growth and 20% Y-on-Y revenue growth. The distribution has enhanced at the distribution partner level including the original equipment manufacturers (OEMs). The revenue has actually grown from Rs 244 crore in the last quarter to Rs 256 crore in the current quarter.

Enterprise Services is where the bulk of the action has been in the last couple of quarters. While we saw a revenue decline of about 4% Q-on-Q and about 8% Y-on-Y, several initiatives have been undertaken during the quarter.

We had discussed about contract rationalization in the last quarter itself. We are trying to prune out the loss-making contracts. This quarter hopefully we should be able to exit such contracts, and we will have a good portfolio of contracts to take forward. With regard to the penetration into corporates, while bidding for contracts, we had put certain restrictions in terms of the deal size and the minimum margin. By adopting the go-to-market (GTM) strategy, during the last two–three quarters, we have acquired new contracts during the last quarter worth about Rs 100 crore of total contract value (TCV).

Simultaneously, while we were rationalizing the contracts, we were also looking at various initiatives to improve the costs across several parameters, the overheads, especially sales, general and administrative (SG&A) costs. We have been able to make quite a significant improvement in this as well.

In Enterprise Services, the revenue has declined from about Rs 244 to Rs 234 crore in the current quarter. Overall, the consolidated revenue in Enterprise Business is at Rs 490 crore. In the last quarter it was at Rs 488 crore. The loss has been coming down consistently from about Rs 18.5 crore to Rs 11.5 crore in the current quarter.

In consumer distribution, there has been almost a 50% Q-on-Q revenue decline. Owing to lower sales because of demonetization in November, and owing to the transition to a new OEM that our business is undergoing, we faced a blackout period in December, when we had no sales, hence, the overall sales declined from about Rs 442 crore to Rs 221 crore. Though the revenue has declined substantially, we have been able to sustain the profitability. Mr Sheshadri will provide us with an overview of the consumer distribution business.

Premkumar Seshadri:

As we had stated earlier, we are shifting from a single brand, single channel kind of an organization to a multi-brand, multi-product organization. As part of this transition, one of our principal partners has assigned their phone business to a new company which will manufacture these products under the erstwhile Nokia name and the product will probably be available in the market in the next quarter. However, this arrangement will be non-exclusive in nature in line with our multi-brand strategy.

We are also in advanced stage of discussions with multiple other players and as we progress we will be announcing about their progress. During this transition period and till the time the products hit the market, our revenues will remain subdued.

S. G. Murali:

The revenue, which was at Rs 442 crore in the last quarter is at Rs 221 crore (refer slide 10); the profit at Rs 2.3 crore remains very close to Rs 3.3 crore, where we were in the last quarter.

In SI business (refer slide 11), we executed projects worth about Rs 75 crore during the quarter. The pending order book shows the value at Rs 930 crore. Our build phase was about Rs 180 crore. Most projects are nearing completion, hopefully between this quarter and the next. While the Managed Services is about Rs 150 crore, for the pending book and the AMC, the annuity type revenue, it's about Rs 600 crore.

With the completion of a project, we have been able to collect about Rs 200 crore from one of the large customers in a defence project.

Premkumar Seshadri:

As you would be aware, with regard to the SI business, we are nearing the end of the build phase. We have about Rs 180 crore in the build phase (refer slide 11). About four or five quarters earlier, there were a significant number of projects. Now, as we are coming more towards the build phase and end of projects, we are looking at final sign offs and so on. In the last quarter, we saw the impact of some of the cost overruns and deductions. This is quite typical of the SI business prior to final sign offs and so on. During this time, often customers raise issues which we have to

address though we do continue to contest some of them and bring it to logical conclusions.

S. G. Murali:

The revenue for this quarter in SI is Rs 59 crore which was Rs 76 crore in the last quarter (refer slide 12). The loss for the quarter, loss before provision for doubtful debts/write off and expected credit loss is at Rs 7.3 crore. We had a profit of about Rs 10.7 crore in the last quarter, so there is a movement of about Rs 19 crore. This is primarily the reason for the incremental loss between the last quarter and this quarter. So a large part of the loss can be attributed entirely to the SI business. The provision for doubtful debts during the current quarter is at Rs 3.7 crore while it was around Rs 0.4 crore earlier. Overall, the loss for the quarter, that is, the loss before interest and tax is Rs 11 crore; it was a profit of Rs 11.2 crore in the last quarter. The Rs 22 crore movement between the last quarter and the current quarter shows a Rs 3 crore accelerated depreciation which we have used in one of the business lines because of the change in technology. About Rs 2 crore is used towards liquidated damages which the customer has levied for one of the overseas SI projects. This project has got completed now and has moved into a 3-year warranty phase. Separately, on the SI business, we had about Rs 7 crore for cost overruns and about Rs 5 crore on account of deductions made by the customers at the time of the final sign-off of the projects.

The gross debt during the quarter was about Rs 1,472 crore. We had a cash balance of about Rs 436 crore. The net debt was at about Rs 1,036 crore at the end of the quarter. During the last 4 quarters, that is, Q3 of 2016, Q1 of 2017, Q2 of 2017 and Q3 of 2017, the debt has been around the same level about Rs 1034, Rs 1029, Rs 1048 and Rs 1036 crores. We have been keeping a tight control on the overall net debt. While revenue has declined in the Consumer Distribution business, Enterprise Distribution business has showed good traction. I conclude my presentation here and leave the floor open for any questions that you may have.

Premkumar Seshadri:

Over to the moderator.

- Moderator:** Thank you so much, sir. With this, we will open the floor for our Q&A interactive session. Participants, if you wish to ask a question, you may please press “0” and “1” on your telephone keypad and wait for your name to be announced. The first question we have is from Dikshit Doshi from Milestone Financial. Your line is unmuted.
- Dikshit Doshi:** In the SI business you mentioned that only Rs 180 crore is in build phase, so can we say the rest, that is, Rs 750 crore would be executed perhaps over a span of say six years?
- S. G. Murali:** On an average about six–seven years is the tenure; some of the contracts take even 10–11 years, the residual part of the contract usually takes about five–six years to materialize.
- Dikshit Doshi:** Okay. And after the Rs 180 crore build phase, can you tell us how much would be the pending receivables?
- S. G. Murali:** The total receivable as of Dec 31, 2016 is about Rs 680 crore.
- Dikshit Doshi:** Just one more question. Sir, you mentioned that in Enterprise Services we are shifting from the low margin to higher margin contracts and you also mentioned that we are almost at the end of this transition. However, we are still making losses and this is not a small size business; we have almost crossed the Rs 1000-crore mark in Services business. So when do you see that there would be profitability in the business?
- Premkumar Seshadri:** There have been a large number of contracts which were taken at different points in time and, in today’s context, they are not viable. Owing to contractual obligations, we have not been able to ignore them. At the same time, there was also a need to refocus the organization from pursuing predominantly government sector based contracts to private sector-based contracts. So over the last one year the new digital solutions and investments required in competency building as well as towards go-to-market have impacted the ability to translate itself into a profitable entity. With respect to this last quarter itself we have acquired new contracts with TCV of almost Rs 100

crore which has got booked into the defined segment at the defined margin levels. So I think we are starting to see the green shoots and over the next few quarters things would definitely be better.

Dikshit Doshi: Do you expect we can turn around by FY18?

Premkumar Seshadri: I wouldn't comment specifically in terms of timelines as that would be a forward looking comment.

S. G. Murali: The trajectory will continue to improve going forward.

Premkumar Seshadri: And you are seeing the trajectory over the last two quarters and I don't see many surprises to that trajectory at this point.

Dikshit Doshi: Okay. Earlier you had mentioned that in the Financial Inclusion business, there is a transaction fee on a per transaction basis. So, post demonetization how have you handled these issues to maintain a balance?

Premkumar Seshadri: Our focus around the Financial Inclusion business was significantly lower than what it could have been in the previous years because we were trying to make sure that our play in that space was largely technology-led. We had built equipment (handheld device) which we leveraged and that was the purpose of the business. To answer to your specific question, there has been a lot of remittances into the account; the customers that we are dealing with are definitely seeing that upscale, but I think our scale is not very large because you are essentially talking about 0.1% kind of increase. We had stopped focusing around that business almost about three quarters away. Our entire focus today is around the enterprise business, execution of SI contracts, rebranding and looking at multi-brand consumer distribution area.

Dikshit Doshi: You had mentioned that we are targeting some business in Oman in the e-governance side; if you could elucidate?

Premkumar Seshadri: These are ongoing discussions that we are doing with some of our partners there, in fact, we had signed an MoU also with few of the customers there essentially around

some of the digital services that we are able to offer to them.

Dikshit Doshi:

Okay. Thank you.

S. G. Murali:

Thanks, Dikshit.

Moderator:

We have a question from Gurvinder Wasan from Principal Mutual Fund. Your line is unmuted.

Gurvinder Wasan:

Good evening. You mentioned that you have receivables of around Rs 680 crore lined up in SI. Do you expect to receive them, in terms of cash, in about a quarter or so?

S. G. Murali:

Out of Rs 680 crore, roughly about Rs 200 crore is something which has been billed and we are in the process of following up on the collections. For such large projects actually the sign-off process itself takes significant time. Queries emerge towards the end of the project. So about Rs 200 crore of this is already due which has been billed and hopefully in the next two quarters (between this quarter and next quarter) we should be able to bill the balance which is in the contract, and whose work is in progress. Collection then usually takes about a quarter or two depending on the project. But I would say the milestone completion phase has started for most of the projects.

Gurvinder Wasan:

In terms of cash flows at the beginning of the year we were having a discussion and you had mentioned that you were expecting around Rs 300 crore by March 2017. You have already collected Rs 200 crore in the quarter gone by and have billed another Rs 200 crore. So would you end up having Rs 400 crore instead of Rs 300 or is Rs 300 crore the least amount achievable?

S. G. Murali:

No. I will say that 400 crore is achievable. If everything goes well, we can do better. But at least Rs 400 crore is clearly achievable.

Gurvinder Wasan:

So between March last year and this March what is the net debt? In March last year, it was around Rs 1,260 crore.

S. G. Murali:

Net debt now is about Rs 1,028.

Gurvinder Wasan: What I have in my record is that a year back, in March 2016, gross debt was Rs 1,480, there were cash and cash equivalent of Rs 250 crore, so net was around Rs 1,230.

S. G. Murali: In March 2016, Rs 1,303 was the gross debt and about Rs 269 crore was the cash equivalent and about Rs 1,034 was the net debt. We have been able to keep a tight hold on the net debt. Last 4 quarters we have been able to hold it at about Rs 1,030 to Rs 1,040 crore, despite incurring a cash loss at every quarter. Now that the projects are getting completed, the cash which starts flowing in will help us to start bringing down the debt. We also need to pay the vendors who have been waiting for a long time.

Gurvinder Wasan: So, would you say between Rs 45 to 60 crore per quarter gets offset as a net run rate of cash losses? Besides, is there any likelihood of selling any other asset, LRD, etc.?

S. G. Murali: The current receivable is about Rs 80 crore. This was about Rs 170 crore in the beginning of the year. We are hopeful that in this quarter we should be able to monetize it and bring down the debt to the extent of about Rs 80–82 crore.

Gurvinder Wasan: This is getting pushed quarter-on-quarter, so what is the hurdle?

S. G. Murali: As I had explained earlier, we have multiple lenders who are now being converted into a consortium. As there are multiple lenders, the joint documentation is taking some time to materialize. Hopefully, this quarter we should complete the financial closure. Once we obtain the NOC, we should be able to liquidate this receivable.

Gurvinder Wasan: Fair enough. Okay. From the rating agency perspective you have a dual rating. We had heard from you a month back that the Rs 200 crore receivables might yield a short-term rating.

S. G. Murali: I would say that if you observe, we have been working on a strategy consistently. You are aware of the restructuring; we had exited from certain businesses, as we had no option. So winding up those businesses was one agenda

but we had to look at exigencies and create new businesses as well. The new businesses were in the incubation stage. Enterprise Distribution now has attained the scale of about Rs 100 crore a month and this was built in the last 18 months. Enterprise Services is turning around, Global Services is doing reasonably well. If we are successful, the scale of that business can change too. System Integration is our first priority, and we are trying to complete these projects to enable collection so that we can bring down the debt. We have been tracking our strategy consistently and that is something which gives comfort to both the lenders and the agencies. As they are large-scale projects, it takes a little longer than what we think to achieve closure of SI projects. As Prem said, we are focussing on Distribution and Enterprise business. In the consumer distribution business we have now migrated to a multi-brand model. This is a new business which would take time to emerge. We have very good capabilities in this business. Separately on the Enterprise business, both in terms of distribution as well as services, we have made good progress.

Gurvinder Wasan: However, despite consumer business and consumer distribution, the revenue is coming down and still not giving you gains.

S. G. Murali: We have also been optimizing costs continuously throughout the year.

Gurvinder Wasan: Sure. But do you think that if the SI loss had not flown into this quarter, the run rate of the loss wouldn't have gone up? If I am right to understand, in a quarter or two this would fall in place. I hope it doesn't really overshoot further.

S. G. Murali: You are absolutely right, Gurpreet. Once the last phase of the SI project is over, we will have much better predictability because the other businesses are repeatable transactions where we know how each business would scale and the time it would take to do so.

Gurvinder Wasan: On your net debt of Rs 1,036 you have a receivable of Rs 680, so the rest is 200–300 crore?

- S. G. Murali:** The receivable of the SI business is Rs 680 crore. We have the receivables in other businesses as well which is the LRR amounting roughly about Rs 80–85 crore. So, whatever receivables come it will go back to pay the debts and creditors incurred for that business.
- Premkumar Seshadri:** Also, once the last phase of the SI is completed, some more receivables will come in.
- Gurvinder Wasan:** Okay. If things work out both on a P&L and balance sheet, things would change in five–six quarters.
- S. G. Murali:** The overall environment also has been a little bit difficult for the enterprise. But we have been able to execute consistently amidst all challenges. So, within one or two quarters, we would be in a better position to predict.
- Gurvinder Wasan:** Fair enough. All the best. Thanks.
- Moderator:** Thanks for your question. Next we have Sheetal Saha, individual investor. Your line is unmuted.
- Sheetal Shah:** Yes, sir. Good evening. This is regarding the SI business. You have mentioned that currently the receivables are around Rs 680 crore. In the next few quarters you have taken some cost overruns and some costs associated with contracts. So, should one expect that in the few quarters there will be significant losses associated with the receivables?
- S. G. Murali:** Normally this should not happen. But what happens is when such large projects get completed, there is a possibility that the customer may raise certain disputes. Some projects have done well without any deductions or liquidated damages, whereas in some projects, we have seen that the customer raises certain disputes. We are able to resolve some of these disputes alongside the closure of the project itself. But in some cases, where the stakes involved are high, we collect our money and contest the deduction. I would say that largely we do not see anything different compared to what we have seen in the current quarter.

- Sheetal Shah:** Can you throw some light on the Customer Distribution business apart from the principal? Who are the other OEMs that we have signed up and going forward with?
- Premkumar Seshadri:** One of our principals has assigned their contract to Nokia and we await the products starting next quarter. With regard to other OEMs, this information is not yet made available on the public domain; we are in the final stages of sign-up and on-boarding and so on; perhaps, in the next meeting we would be able to throw some light on this issue.
- S. G. Murali:** We have certain non-disclosure agreements. At this point in time, given that they have not reached the finality, it is not appropriate for us to share the information. It is still work-in-progress.
- Sheetal Shah:** Okay. Thanks.
- Moderator:** We have a question from Viraj Naithani from Jupiter Financials. Your line is unmuted.
- Viraj Naithani:** I would like to know what the future of SI business is once the build phase is over. Are we going to shut it down or how is it going to work?
- S. G. Murali:** In terms of our new business acquisition, we are looking at the SI business capability and we have a good amount of wins both within the country and outside. So we are not pursuing government contracts, but we are actually taking this capability into the enterprise space.
- Viraj Naithani:** Okay. So it is for private companies, right?
- S. G. Murali:** It's basically for private companies.
- Viraj Naithani:** Okay, sir. And, roughly, what would be the net debt in FY18?
- S. G. Murali:** I had mentioned earlier that when the SI projects get completed, the realization out of these projects largely goes towards the repayment of the debt. The balance debt

is basically a working capital required for the other business.

Viraj Nethani: All right. Are managed services and support ancillary area revenue-related businesses? Would you be able to have some visibility in those businesses?

S. G. Murali: We will continue with the goods business and the annuity businesses and bring in technology to improve margin in these businesses.

Premkumar Seshadri: One of the things that we have to look at in these businesses is that these businesses stretch over a long period. So costs incurred and manpower involved need to be taken into account. However, we are trying to put a lot of effort towards tooling this well so that execution becomes better than it appears on paper at the beginning of the contract.

Viraj Naithani: Okay. So would there be better visibility, once the build phase is over?

Premkumar Seshadri: Yes, visibility will be better. We would be able to see how much of the margins get squeezed and how much profitability would be enhanced. However, we have already started working on many of these areas, looking at standardization, tooling and so on. We are trying to put together shared services so that these areas help us to make these businesses more profitable.

Viraj Naithani: Okay. What are we doing on financial inclusion side or it's just a business left over right now?

Premkumar Seshadri: We are not focussing on it now; we may revisit this later.

Viraj Naithani: All right, sir. Okay. Thank you. Good luck, sir.

Premkumar Seshadri: Thank you.

Moderator: Next, we have Dikshit Doshi from Milestone Financials. Your line is unmuted.

Dikshit Doshi: Sir, few more questions. On the services part of SI, would the billing be done on a monthly basis?

- S. G. Murali:** Most of these contracts are on a quarterly billing.
- There are one or two contracts which have half-yearly billing; the bulk of the contracts is on quarterly billing. Once the project is completed, for instance, the AMC contracts, which are running at this point in time, the collection happens in a predictable timeframe, between about 45–60 days as soon as the billing starts.
- Dikshit Doshi:** Okay. Are we exploring anything similar to the Aadhar case, in any other country?
- S. G. Murali:** We have had some discussions around it and distinctly there are a few opportunities, but none has reached the fructification stage.
- Dikshit Doshi:** You mentioned that in the consumer business discussions are ongoing for other multi-brands but you would not want to name them now. Would there be global handset players or Indian players?
- Premkumar Seshadri:** We will look at a broad set of partners and brands. I think it would include global brands and others also.
- Dikshit Doshi:** Okay. And would they be all handset brands?
- Premkumar Seshadri:** Yes.
- S. G. Murali:** We have been only into mobile consumer distribution.
- Premkumar Seshadri:** Our capability, which is second to none, is essentially around the mobile business across various types of channels be it online, organized trade or other new innovative channels which are emerging today.
- Dikshit Doshi:** Okay. Thank you, sir.
- Moderator:** Thanks for your question. At this time, there are no further questions from the participants. Sir, I would like to now hand over the floor back to Mr. Premkumar for the final remarks.

Premkumar Seshadri: Thank you, Harpreet. Thank you everyone for being here at the quarter three results discussion. It was a pleasure having you. For further questions, you could write to sumeet.ahluwalia@hcl.com. We would be happy to answer the same. Thank you very much.

S. G. Murali: Thank you.

Moderator: Thank you, sir. Thank you, participants, for joining the call.