HCL Infosystems Ltd.
Q4 FY19 Results Audio Conference Call

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

Moderator: Good day ladies and gentlemen, I'm Harpreet Kapoor, the moderator of this call. Welcome to HCL Infosytems Q4 and FY19 results audio conference call. We will start with the presentation and then follow up with a Q&A session. For the duration of the presentation, all participants' lines will be in listen-only mode. This presentation is available in the Investor Relations section of the company website. We would like to begin with a mandatory disclaimer. This call may contain forward-looking information including statements concerning our outlook for the future as well as some of our other statements of belief, 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 Infosytems; Mr. Kapil Kapur, Chief Financial Officer HCL Infosystems & Mr. Bimal Das, President, Enterprise Distribution Business. So, I would like to now hand over the proceedings to Mr. Rangarajan. Thank you and over to you sir.

Rangarajan Raghavan: Thank you, Harpreet. Let's straightaway go to slide 2 where we have shown the current organisation structure with legal entity and the business units. This actually shows all the continuing business and you can now see it yourself what is shown in this slide. Let's move to slide 3, where we are giving business highlights. In the financial year '19, the revenue was Rs. 4,340 crore, as compared to the previous financial year, which was Rs. 3,565 crore. As a breakup in this, the distribution business in FY19 has been about Rs. 3,722 crore as compared to the previous financial year which was Rs. 3,017 crore. And as a break up of enterprise distribution and consumer distribution, enterprise distribution has done a revenue of Rs. 1,704 crore in FY19 as compared to previous financial year, Rs. 1,525 crores. Consumer distribution has done a revenue of Rs. 2,018 crores in FY19 as compared to the previous financial year, Rs. 1,492 crores. Global services business revenue for FY19 was Rs. 486 crore as compared to the earlier year which was Rs. 376 crore. In SI projects, the pending order book size stood at Rs. 460 crore as on March 31. During this financial year we collected about Rs. 310 crores from SI project. Profit/loss before interest, tax and exceptional items was Rs. 25.6 crore of loss in FY19 as compared to the previous year which was about Rs. 35.5 crore of loss.

Moving to the next slide, to give a quarter four update, Q4 revenue was about Rs. 1,011 crore as compared to Q4 FY18 which was Rs. 1,058 crore. Out of that distribution business revenue was Rs. 845 crore for Q4FY19 and this was actually Rs. 908 crore for the Q4FY18, previous financial year. Enterprise distribution revenue was Rs. 432 crore in Q4FY19 as compared to Q4FY18 which was Rs. 444 crore. Consumer distribution revenue was at Rs. 413 crore in Q4FY19 which was Rs. 464 crore in Q4FY18. Global services revenue was Rs. 142 crore in Q4FY19 versus Rs. 101 crore for Q4FY18. Profit /loss before interest, tax and exceptional items for Q4FY19 was Rs. 14.5 crore loss as compared to Q4FY18 which was Rs.18.4 crore loss.

Moving to the next slide on the update relating to systems integration, there are few challenges faced in getting the customer acceptance and payments, especially in the power sector. We did actually mention this in the earlier call as well, and delay in realizing SI receivables has impacted company's capacity to invest in other businesses for the growth potential. In terms of the real estate, we do have few properties which are not actually utilized fully because of sale of some of the businesses, which we have done over last one year. So, since these properties are not being utilized, the board has approved to monetize two of the properties located in Noida and one property in Pune proceeds to be used for repayment of the loans.

Now I'll hand it over to Kapil next slide for detailed financial updates.

Kapil Kapur: Good afternoon to all of you. I'm on slide number 6 and I would take you through the Q4 P&L performance. Ranga just shared with you that the revenue for the quarter was Rs. 1,011 crores, and in the quarter, we have taken provisions of about Rs. 34 crores in the SI business. As Ranga shared with you, we have seen certain SI project receivables are taking long and especially we have seen this in the power sector projects. So, we have taken a provision of Rs. 34 crores in our quarter four profit and loss account towards SI receivables. The net finance cost of the company in line with the decreasing debt position came down to about Rs. 25 crores for the quarter. The profit and loss before tax was a loss of Rs. 39.5 crores. Basically, this was impacted due to the higher provisions which I just shared with you taken during the quarter. In the quarter we were able to get Rs. 2.5 crores by monetization of our Learning content on outright sale. So that was a plus in the learning business.

Next slide, slide number 7 is similar to the previous slide, just that here you get a view of how the two distribution businesses stack up. So, consumer distribution was relatively subdued in this quarter as compared to immediately preceding quarter because there's a bit of seasonality with our consumer business, because we cater largely to the ecommerce and the online marketplace where new launches and rollouts happen in different quarters and therefore, we see some volatility in the revenue between various quarters. Enterprise distribution was able to maintain its profitably as you would see in the slide.

Next slide that is slide number 8 is a full year snapshot of how the performance of the company looks. So, if you see, revenues were at Rs. 4,340 crores. Our profit before provisions was at Rs. 6.6 crores as compared to a loss of Rs. 28.6 crores in the previous year that is FY18. Now, this about Rs. 35 crores of positive swing that came because of two key factors, one of them being better performance of our global services business in Singapore where we made a better profit as compared to previous year. And the second reason is that we were able to sell our learning content on outright basis to certain customers which resulted in a positive flow to our profit. So, these are the two key factors which resulted in this swing. Again, on a year-on-year basis, the net finance cost decreased to about Rs. 114 crores from about Rs. 137 crores in the previous year. The profit and loss before tax, that is loss before tax was at Rs. 139.5 crore and basically this was impacted due to the higher provisions that we took during this quarter and this year which I shared with you.

So, this is as far as the FY19 position goes. Now, I will hand it back to Ranga to take you through performance of each of the businesses during the quarter and year.

Rangarajan Raghavan: Yeah, thanks Kapil. We saw the financial details of consumer distribution in the earlier slide. Just to highlight what really happened in this particular business, the multi-brand, multi-channel model has worked well for us. And the business made inroads for the Telecom Service Provider Channel in the e-Brandstore segment. The new models by principals were also successfully launched by the consumer division. HMD Global for Nokia devices continued to contribute to the business. And these are all a few updates on consumer distribution.

And moving to the next slide on the enterprise distribution, we looked at the financials of enterprise distribution in the earlier slides. Some of the highlights of this business are; channel business was the key contributor to the revenue. Enterprise distribution also directly provides the technology solutions to the customers by leveraging the strategic alliances with the global technology companies. There is focus in this year to build capability to provide solutions for enterprise IT structure as well as for the digital enterprise. These are the few updates of the enterprise distribution.

Looking at the next slide, where we have shown the distribution financials, and this was earlier also discussed in the previous slide, and just to tell you that distribution, both the enterprise distribution and the consumer distribution, together they have done about Rs. 845 crores of revenue in Q4 with a profit of about Rs. 3.1 crore as compared to the earlier year which was Rs. 908 crores for the Q4FY18 with a loss of about Rs. 0.2 crore.

Moving to the next slide on the global services update, global services revenue we saw in the previous slides, and the best part of global services was the automation initiative which has actually helped us in terms of the improving margins. In terms of the capability building, we have actually gone through quite a lot of efforts on improving the employee skill set on the datacenter and networking as a technology areas. And moving to the next slide, it gives the update on the top line and the bottom line. The consolidated revenue for Q4 was Rs. 142 crore and the profit was about Rs. 13.6 crores as compared to the previous year it was about Rs. 101 crore in Q4FY18 and profit before interest and tax was about Rs.4.8 crore.

Moving to the next slide as an update, system integration, as I said, in the highlights, Rs. 460 crore is the pending order book which is divided as Build phase of about Rs. 60 crore, Managed services of about Rs. 40 crore & support services and annuity; which is AMC of about 360 crore. As stated in the highlights, the focus has been actually on the execution and collection with customers including government and defense. And in some of the projects we do have some challenge in terms of getting the final sign-off and getting out the money, specifically in the power sector, and we are working on that. On the known non-collectible, we did take certain provisions like Rs. 33.8 crores as Kapil mentioned.

In terms of the SI financials in the next slide, if you see consolidated revenue for Q4 was about Rs. 30 crore, and this has actually resulted in a loss of about Rs. 38.9 crore in Q4FY19. If you compare with Q4FY18, which was revenue of about Rs. 56 crore and a loss of about Rs. 17.3 crores. And moving to the next slide, I did actually highlight this during the initial slide. We do have a few unutilized properties and we are actually looking at monetizing this in phases. Currently, board has approved for selling three properties to actually repay our loan, and the details are in the slide. That's it from our end as update for the quarter and update for the year. If there are any questions, we could take it now.

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 press 01 on your telephone keypad and wait for your name to be announced. The first question of the day we have from Gautam, individual investor. Your line is unmuted.

Gautam: Yeah. Hi, thank you. The question that I had was on net debt. Could you please help us with the net debt amount that we have post the monetization efforts?

Kapil Kapur: The net debt position as of March end was about Rs. 600 crores excluding extended credit by Vendors, which we have on our balance sheet. The gross loan was about Rs. 840 crores, and then there was cash and investments of Rs. 240 crores, so the net debt is about Rs. 600 crores. Now, monetization activity has just been initiated with the approval from the board, and we are in the process executing the agreements, etc. and concluding the transactions for the first three properties that the approval has come in for. So, in total, we have about properties realizable worth about Rs. 300 crores. And in first stage, we are looking at properties of about 100 crores getting liquidated. Then we would see how it goes and may have to look at the situation at the end of probably this calendar to see how things are shaping up.

Gautam: Okay. Can you explain about the property monetization?

Kapil Kapur: These are basically properties that are lying completely vacant or are being used in a very limited way because we have had changes in the business. Earlier when we were in services business, we were present across the country, and that is the time we had acquired these properties. Now, keeping these properties is not making sense because on one side we are servicing the debt with a cost of about 11%, on the other side we are holding vacant properties without actually any use, and spending money on maintaining them. So that's how the board took this view.

Gautam: Okay. The second question that I had was on the global services. I think the global service clearly stands out as one of the better business in terms of verticals that we have. I wanted to know the opinion like in terms of the upcoming year, are we planning to expand it; in terms of margins and others as well, we see that global services is a much better business. So how do you see it in the upcoming year?

Kapil Kapur: So global business, you are right, has been steady with its growth and its performance. We had done last year an expansion thereby investing about S$5 million into the command center, etc. which we had built up for the business. So immediately there are no plans to do any further investment. We will see how it goes and then probably take a call on this.

Gautam: Does the cloud business also come within the purview of global services?

Rangarajan Raghavan: See currently we are servicing Singapore government business, and yes you know there is a cloud opportunity which is coming up for the government because government has been actually very, very cautious in terms of moving their data into the cloud. And whatever little is happening in terms of the government side, that service also comes under this, yes.

Gautam: Okay. And in terms of distribution business, the margin expansion, I mean, it's not as expected as projected during the beginning of the year. So how is it going to be in the upcoming year?

Kapil Kapur: Yeah. So, see distribution business is into two parts as you are aware, one is the consumer distribution, and the other part is enterprise distribution. And in consumer distribution business, we typically make margin of about 2.5%, at best 3% at gross level. The expenses are not too many. And so basically that business operates at that level of margin and we don't see any significant margin expansion in that business. Now, coming to the enterprise side of distribution, it's where your question really applies. So basically, in enterprise distribution business, we have two tracks or two different internal lines of businesses. One is where we do the business through channel, and the other one is where we do business the business directly as HCL. So, this direct business which we do as HCL is where the better margins are. And the more the mix moves in favor of that business, the more one would make margins in terms of blended margins. So, we have with us Bimal who is heading that business, so I will request him to throw some more light on how the margin structures operate and what is he looking at going forward.

Gautam: Yes.

Bimal Das: Thanks Kapil. Like Kapil said, we have two GTMs, one is a partner led, another is HCL led. Partner led is typical the product distribution business where you make 2% to 3% margin. But in case of HCL led business, , we have a hybrid model, where we actually go to the end customer, we work around 300 to 350 end customers on different solution tracks. And for that, last year was, especially last two quarters was a little tough because of the different market conditions. So, we have built a pipeline, we have built the skill sets like we mentioned earlier inside the systems that are both for cloud as well as for infrastructure datacenter business, we are doing that. This work is in progress, we will see better margins as we move ahead with this.

Kapil Kapur: Just one add-on to what he mentioned, and as probably you would have heard Ranga also say, that in order to grow these businesses and you know kind of get them to the scale which they can, we need working capital deployment. Now, currently, because there are delays in SI business and the money flow there is not as per plan in certain specific projects, so to some extent, we are constrained in investing into the distribution business. And that also impacts our ability to do the direct business to be able to get better margins.

Gautam: Okay. And I have two final questions.

Kapil Kapur: Yes.

Gautam: One I think we are clearly finding it very hard with the SI business. I think last year same time it was communicated that the management would try everything to take us out of the SI business, at least come to close of build phase and come into the support and other models. When I compare last quarter results with this one, I can still see that the build phase has come down only by Rs. 10 crore and it's not moving much. So now what is our take and how do we plan to move out of; are we planning to shut the SI business or what are we trying to do with SI business?

Kapil Kapur: So practically we have shut down SI business three years back when we stopped taking any fresh orders. You know that is the time when the company's board directed all of us not to take anymore orders till such time we complete the orders in hand. And basically, since then we have been working hard to conclude the build phase. I won't say that we are completely unsuccessful. In certain projects, especially certain defense projects we have been able to conclude them and conclude them with the customer as well; whereas in two or three large projects which are there with the power sector, is` where we are facing challenges in terms of getting customers acceptance, it is taking time. So, you are right that by now we would have wanted to and we had planned to be through with our build phase, but unfortunately, some of these orders and the way they have moved with the customer, we have not been able to conclude them. But barring these orders, the other orders have tracked what we had planned, they have moved into the AMC phase or are in the process of moving into the services phase. I think now it's a matter of these few leftover orders where we have to focus harder and see what best we can do there to close them out. But basically, the point is that here there is a big dependency on the customer in terms of them signing the acceptances of various milestones, and if that gets delayed by the customer, then definitely it impacts both the cost as well as the timelines of the project closure and movement into the services space.

Gautam: So, with the provisions that has been done in the current fiscal, can we say that in the upcoming year we would not have other provisions or at least we would not be negative?

Kapil Kapur: No, it will be difficult for me to give any forward-looking statement, because we still have sign-offs spending. So, it will entirely depend on how the quickly customer closes the sign-offs and gives us the acceptance. So, I cannot commit that there will be no provisions. It will entirely depend on how these orders trend with the customer in next few quarters.

Gautam: Is it fair enough to say that by the end of the year the SI projects would be completed, fiscal?

Kapil Kapur: See, we would want to, and in fact, if you ask me, we would have wanted to close it by the fiscal which we have closed just now. Our plan was to close it by FY19. But unfortunately, due to reasons beyond our control, it has gone into the next fiscal. So, if you ask me, I'm willing to close it in a quarter's time. But there has to be a reciprocation from the customer and customer should be equally enthusiastic to sign it off and accept it. And you know how sometimes government works, so it takes longer and much longer than what you anticipate. So, you are right, internally, we are targeting much before the end of the fiscal year to close this, but how they actually go about we will have to see as we go along, we will keep you posted.

Gautam: Thank you. And the last question that I have is on the rights issue. Does the company expect any sort of right issues to bring down the debt?

Kapil Kapur: As of now there is no plan to do any rights issue. We did it in 2017 November if you would recall. So that round was purely to repay the debts, and that time we had taken estimation on certain SI inflows, we had taken estimation on the money that we were getting from rights issue, basis which we had worked out the amount that we raised through rights issue. If SI inflows would have been as per our plan or estimate, then, possibly by now, debt would have been at a much more reasonable level, and much more realistic level. Today it is inflated because of the money locked into SI projects. So immediately we don't have any plans for any rights issue.

Gautam: Thank you so much. That's all the questions that I had, thanks.

Moderator: Thanks for your question. This is the final reminder. Participants, if you still have any questions, you may please press 0 and then 1. We have a question from Chetan Shah, individual investor. Your line is unmuted.

Chetan Shah: What is the current order book on the global services business side? Then you have an expanded arrangement with the various Singapore government authorities for global services. What is the real potential of this business over the next couple of years? And what would be the steady state margins for global services business?

Kapil Kapur: Chetan, this business operates at about 25% margin, and between 25 to 29% margin, and basically here we have you know kind of we are one of the three contenders who have signed up master services agreement with the government of Singapore. And in turn, the master services agreement gives us the eligibility to be service providers to various agencies in the Singapore government. So, we currently service about 60 agencies in Singapore. Of course, after having signed the MSA, every time we go and pick up an agency, we have to participate in a bid with the agency where, as I mentioned, three people have signed the MSA, we three amongst ourselves have to place our respective bids and whosoever gets the order is eligible to execute it. So here the orders typically come from agencies for two to three years, and there are a lot of additional work which comes to you as change request or as add-on work because you have signed up with an agency. So, the order book is not something which is very relevant from the way this particular business operates. While we may have a reasonable chunk of it tied up, but what is important here is that how many agencies out of 100 odd agencies do you cater to and what services with those agencies are with you, and how sticky you are with that agency in terms of the business that you do, and what additional business do you expect out of that agency during the course of your relationship.

Chetan Shah: These margins that you mentioned were, I assume, the gross margins. So, what would ideally be the PBT or the EBIT margins?

Kapil Kapur: So, EBIT margin if I recall, is in the range of about 17% to 18%.

Rangarajan Raghavan: On the overall revenue, it's about 18%, but this excludes the pass through revenue.

Kapil Kapur: So, there are two components of revenue in this business. One is where we bill the agency for services given by Singapore government and we get the money from the agency and pass it onto Singapore government. The other part of the revenue is where we provide services and we bill them. So, on the overall gross revenue, the Gross margin is about 11 to 12%, but as I said there is an element of pass-through. If you were to take that out, then you make about 15-16% EBITDA on the net revenue, that we earn.

Chetan Shah: Okay. Another question on the systems integration side, can you just tell me what is the debt on account of the systems integration business and the receivables in that business?

Kapil Kapur: So, at the treasury we don't operate for a particular business, we have a centralized treasury where all our banking limits are centralized. So as a result, we are borrowing at a corporate level, not for a business specific level. So, there is no debt which is directly associated with systems integration business, but the; see, the capital employed in systems integration business is about Rs. 225 crores, and the receivables are about Rs. 575 crores. So, there are certain payables which are there for vendors. So, net of payables it is about Rs. 225 crores, and the gross BR-only which is recoverable from customers is about Rs. 575 crores.

Chetan Shah: You know my worry is the amount of interest that we continue to pay. Last year we paid almost Rs. 115-120 crores of interest. You said you run a net debt of about Rs. 600 crores. So why is this that with a Rs. 600 crores debt, we are paying such a huge amount of interest?

Kapil Kapur: No, that Rs. 600 crore we are talking about as on date, and we are talking about net. Gross I told you is about Rs. 800 crores. And if you were to see it over a period of time, the debt has come down. But if you were to look at March '18, my gross loans were about Rs. 1200 crores. So, Rs. 1200 is now down to Rs. 800. So, this is a cost on, let's say, Rs. 1000 crore. It is not a cost on Rs. 600 crore.

Chetan Shah: Yeah, I get it. Okay. Thanks. That's it from me.

Moderator: Thanks for your question. Next, we have Hardik, individual investor. Your line is unmuted.

Hardik: Hello.

Kapil Kapur: Yeah.

Hardik: Yeah. As I understand, we are about to monetize our assets and all. So, by the end of the next fiscal year, we are targeting to monetize over Rs. 300 crores of assets, right?

Kapil Kapur: No, no, not the entire Rs. 300 crores. I mentioned to you that our total property is about Rs. 300 crores, out of which, our assessment is that about Rs. 200 crores is what we don't need, because our business has changed, and the property is either highly underutilized or is you know vacant. So, in first tranche we are looking at Rs. 100 crores and that also will be in phased manner, so right now we have picked up property worth about Rs. 35 odd crores and taken an approval from the board.

Hardik: Okay. Are these figures the book value or the realizable values?

Kapil Kapur: This I am talking about realizable value. Book value will be only about Rs. 60 or Rs. 70 crores of the total properties.

Hardik: Okay. Correct. After this, is it reasonable to expect the company on a corporate level to be cash positive, because as your debts would also come down?

Kapil Kapur: Yeah...

Hardik: Your interest cost would also come down.

Kapil Kapur: Yeah. So, to the extent we are able to monetize the properties and repay the debt, yes, the finance cost would come down. But it will not be zero. So…

Hardik: No, no, can we expect the company to be cash positive by the next fiscal year?

Kapil Kapur: That's a forward-looking statement which I cannot give, I'm not authorized by my board. To answer your specific question, just liquidation of property can reduce the burden, it cannot completely wipe out the finance cost.

Rangarajan Raghavan: The major thing is actually the SI receivable. We did talk about the SI receivable, a few of the challenges, and we have also made certain provisions during the quarter. And the major part is actually stuck with the SI projects you know.

Hardik: Hello

Rangarajan Raghavan: Yes.

Hardik: Yeah. So, those receivables are not impacting your cash EPS. I was just talking about your cash company being positively on the cash flow.

Kapil Kapur: Why not? If that money comes in, of course, I will use it to repay debt and bring down my finance cost and improve profitability.

Hardik: Correct. All right. Okay. That's it from me.

Moderator: Thanks for your question. Next, we have Gautam, individual investor. Your line is unmuted.

Gautam: Yeah. Thank you. I had one question on the next fiscal. If there were to be one vertical where the management is doubling down and investing heavily, what is that vertical where you see major advantage going forward?

Kapil Kapur: See, now we are in three businesses, and they have their own trajectories in terms of growth as well as profitability. So incidentally, you know none of these businesses want major investment. They just, especially Singapore business is kind of on its own, and does not need any cash for growth also. In distribution business, we may require working capital to scale up, but that's about it, and that's also in certain number of days. It is not going to be very heavy. It is not going to be some Rs. 400-500 crores of investment. It is reasonable working capital, say 10 days or 12 days, the way we invest today in order to scale up the enterprise distribution. Consumer distribution, as it is, currently operates on either no working capital or little working capital. So, the only need for working capital is in enterprise distribution if we need to scale it up faster and that also will be limited, it will not be you know kind of exorbitant.

Gautam: Okay. So, does that mean that going forward we look forward for all three verticals, we continue to play in all three verticals?

Kapil Kapur: No, no, sorry I couldn't get you.

Gautam: So, I was looking for is there any particular out of the three verticals where we are doubling down heavily, not in terms of capital invested or something but in terms of the returns that we expect in the coming year.

Kapil Kapur: No, I think they will pretty much continue to operate at the level at which they do today, in terms of the profitability profile, with a little upside possible in enterprise distribution as Bimal explained if we were to invest that incremental working capital. So, I don't see any of these businesses skyrocketing, but they will continue on their trajectory the way they are.

Gautam: Okay, thank you.

Moderator: So, 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 for the final remarks. Thank you, and over to you, sir.

Rangarajan Raghavan: Yeah, thank you. Thank you all. If there are any further questions, you know there are details given, you can contact the investor relations person, Sumeet Ahluwalia. Thank you. Bye.

Moderator: Thank you so much speakers. Thank you, investors, for joining in. That does conclude our conference call for today. You may all disconnect now. Thank you and have a pleasant evening.