

# **HCL**

**HCL TECHNOLOGIES LTD.**

**ANNUAL REPORT 2005 - 2006**



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## BOARD OF DIRECTORS

**MR. SHIV NADAR**

Chairman & CEO

**MR. T. S. R. SUBRAMANIAN**

Director

**MS. ROBIN ABRAMS**

Director

**MR. AJAI CHOWDHRY**

Director

**MR. SUBROTO BHATTACHARYA**

Director

**MR. AMAL GANGULI**

Director

**MR. P. C. SEN**

Director

### Auditors

Price Waterhouse  
Chartered Accountants  
New Delhi

### Bankers

**Citibank, N.A.**

Global Corporate & Investment Banking  
DLF Centre, 5th Floor  
Parliament Street  
New Delhi-110001

**Deutsche Bank AG**

Corp. Office – DLF Square  
4th Floor, Jacaranda Marg  
DLF City, Phase – II  
Gurgaon-122002

**Standard Chartered Bank**

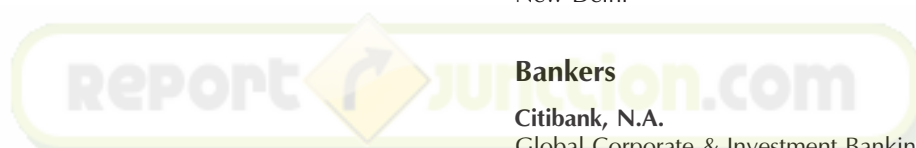
Corporate & Institutional Banking  
Credit Operations, India  
H-2, Connaught Circus  
New Delhi-110001

**ICICI Bank Limited**

ICICI Tower  
NBCC Place, Bhisham Pitamah Marg  
Pragati Vihar  
New Delhi-110003

**HDFC Bank Limited**

B-6/3, Safdarjung Enclave  
DDA Commercial Complex  
Opp. Deer Park  
New Delhi-110029



## MANAGEMENT'S DISCUSSION AND ANALYSIS (MD & A) OF FINANCIAL CONDITION OF HCL TECHNOLOGIES LIMITED

Investors are cautioned that this discussion contains forward looking statements that involve risks and uncertainties. When used in this discussion, words like 'anticipate', 'believe', 'estimate', 'intend', 'will', and 'expect' and other similar expressions as they relate the Company or its business are intended to identify such forward-looking statements. The Company undertakes no obligations to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Actual results, performances or achievements could differ materially from those expressed or implied in such statements. Factors that could cause or contribute to such differences include those described under the heading 'Risk Factors' in the Prospectus filed with the Securities and Exchange Board of India (SEBI) as well as factors discussed elsewhere in this report. Readers are cautioned as not to place undue reliance on the forward-looking statements as they speak only as of their dates. The following discussion and analysis should be read in conjunction with the Company's financial statements included herein and the notes thereto.

Information provided in this MD&A pertains to HCL Technologies Limited and its subsidiaries on a consolidated basis, unless otherwise stated.

### INDUSTRY STRUCTURE AND DEVELOPMENT

#### The Indian IT Industry

Indian IT-ITES industry continued to build on the strong growth momentum of the recent past. Over the years, the stature of Indian IT and BPO services companies has grown on the back of a steady reputation for high quality delivery at costs that are significantly lower than rates at which comparable services can be sourced from overseas vendors.

According to the National Association of Software and Services Companies (NASSCOM), the software industry in India which was worth US\$ 5.7 billion in FY 1999-2000, has grown at a compounded growth rate of over 31% in last 6 years to US\$ 29.6 billion in FY 2005-06. NASSCOM has projected the overall software and services industry to grow at 25~28% and reach revenues of US\$ 36-38 billion in FY 2006-07.

The total direct employment in the Indian IT-ITES sector is estimated to have grown by over a million during last 6 years, from 284,000 in FY 1999-2000 to 1,293,000 in FY 2005-06

As per the NASSCOM survey, the Indian IT-ITES industry has registered 33% growth in exports, with revenues of US\$ 23.6 billion in FY 2005-06, as compared with export revenues of US\$ 17.7 billion in FY 2004-05. Overall the Indian IT-ITES industry (including domestic market) grew by 31% in FY 2005-06 with revenues of US\$ 29.6 billion, up from US\$ 22.5 billion in FY 2004-05.

Of the total IT-ITES exports in FY 2005-06, IT software and services grew by 33%, registering revenues of US\$ 13.3 billion; while the ITES-BPO segment generated revenues of US\$ 6.2 billion, registering a growth of 37%. Engineering services and product exports grew from US\$ 3.14 billion in FY 2004-05 to US\$ 4 billion in FY 2005-06. Domestic market revenues were at US\$ 6 billion in FY 2005-06 as compared with US\$ 4.8 billion in FY 2004-05.

With more and more companies abroad increasingly adopting offshore based support for development and maintenance, the outlook for India based IT and BPO services providers is expected to be positive in the next few years. The NASSCOM McKinsey report predicts that IT/BPO industry will reach US\$ 60 billion by year 2010.

### COMPANY OVERVIEW

#### About HCL Technologies Limited

HCL Technologies Ltd ('HCL' or the 'Company') ranks amongst India's leading global IT Services companies, providing software-led IT solutions, BPO and IT infrastructure management services. The company leverages an extensive offshore infrastructure with its global network of 26 offices in 15 countries to deliver solutions across select verticals including Banking, Insurance, Retail & Consumer, Aerospace, Automotive, Semiconductors, Telecom and Life Sciences.

HCL Technologies Ltd along with its subsidiaries offers solutions in 1) IT Services, 2) BPO Services and 3) IT Infrastructure Management Services:

**IT Services:** HCL's offerings can be broadly classified under two heads i.e. enterprise software services and product engineering services. The enterprise software services comprise customized solutions, maintenance of legacy systems and implementation of packaged applications. HCL has partnerships with leading software product companies and has created several Centers of Excellence to develop capabilities across a broad range of practice domains. In the product engineering space, HCL offers full lifecycle services, from requirements definition to design of prototype, architecture, development, testing, technical help desk, field support, maintenance as well as upgrades. With select software product companies, the service portfolio extends beyond engineering to implementation services.

**BPO Services:** HCL BPO delivers multi-channel contact management and back office services for select complex processes in banking, insurance, manufacturing, retail and telecom. The accent is on advanced customer handling and communication skills, a sensitized approach for managing client-side process stakeholders, integration with process experts and certifications such as COPC and BS: 7799. HCL's BPO Services are highly regarded for significant, sustained value delivery, bolstered by an incident-free track record and renewal of all major contracts.

**Infrastructure Management Services:** HCL's Infrastructure Services enable customers to operate and manage their IT assets with a high degree of resource efficiencies, in an environment that is engineered to achieve security, reliability and availability. The services are compliant with state-of-the-art quality standards such as ISO 9002, BS: 7799 etc. Unique in-house tools and diagnostics provide enhanced visibility into the customer's IT infrastructure to optimize performance, increase availability and reduce costs.

These service lines are delivered to customers in key verticals such as Aerospace, Automotive, Banking and other Financial Services, Insurance, Life Sciences, Media, Publishing and Entertainment, Retail, Semiconductors and Telecom.

### RISKS & CONCERNS, RISK MITIGATION

The Software industry thrives on a dynamic and highly competitive business environment, characterized by rapid technological change and innovations that constantly challenge conventional business models. Your company too faces several business risks, of which some prominent ones are discussed hereunder.

#### Internal Risks

- Business concentration risks
- M&A execution risk
- Investment portfolio-related risks

## External Risks

- Competition-related risk
- Employee-related risks
- Exchange rate risks
- Geo-political risks

## Internal Risks

### *Business concentration risks*

Your Company has taken steps to ensure that it does not become too dependent on a few clients, specific service lines or any particular geography. Your company's business is predominantly export oriented with over 97% of revenues earned overseas. The US and European region contributed 55.8% and 25.2% revenues respectively in the year under review, while the rest of world including India constituted the balance of 19%. Your Company's business growth is partly dependent on the IT budgets of its clients, most of whom are foreign corporations, which in turn depend on the global economic environment.

Your Company generates revenues from a total of around 450 clients to ensure a well diversified spread. Given the pre-eminence of the North American continent as the largest IT spender in the world, a large share of the Company's revenues comes from the US. However, conscious efforts are being made to reduce this dependence. Non-US revenues as a percentage of the total revenues of the Company have been steadily increasing over the years. During the year under review, your Company concluded a significantly large IT services contract with the UK based retailer. Your Company is also increasing its focus on the Asia Pacific region besides Japanese market. Recently, your company has signed a Joint Venture with NEC Corp of Japan to exploit the potential for more business in Japan.

A very high dependence on certain segments of the IT services market may also pose certain risks in the event of a slowdown impacting such segments. The Company had recognized this aspect and had undertaken multiple initiatives during the past few years to rebalance its business portfolio. As a result of these initiatives, the Company has managed to reduce its dependence on its traditional stronghold of product engineering and now has substantial revenues coming in from end user applications, enterprise consulting, business process outsourcing and infrastructure management services. Your Company currently has a well balanced mix of offerings in Software services apart from Infrastructure management services and BPO services. In IT services 35% of total revenues are derived from Application Consulting services, 24% from Technology lead services, 17% from enterprise consulting services. BPO services and infrastructures management services constitute 13% and 11% of the total revenues.

### *M & A execution risks*

Your Company has been growing on the back of a strategy which leverages both the organic as well as the inorganic route and had undertaken a series of acquisitions in the previous four fiscal periods. The Company naturally faces a risk with respect to its merger and acquisition related transactions. The risk exposures in this area are as follows:

- a) increase in cost on account of staffing/advisory fees to consultants
- b) lapses in due diligence
- c) difficulties in integration of acquired entities within the operational fabric

The Company follows a very structured approach in pursuance of its M & A strategy. Many of the risks are mitigated by restricting the choice of target companies by applying certain rigorous selection criteria as also by proper resourcing of the integration effort.

### *Investment portfolio related risks*

Your Company has consistently carried a high level of surplus cash and accordingly has an active treasury department. As a policy, no part of the surplus cash is allowed to be invested in high risk assets such as equities and low liquidity assets like real estate. There are clearly laid down policies that govern treasury operations, and the activities are periodically audited by internal audit. The primary area of risk for the Company's market exposures are related to the interest rate risk on its investment securities. To mitigate interest rate risk, all surplus funds are invested in appropriate avenues upon a review by the investment committee. However, the guiding principles of all investment decision are safety of investments, followed by liquidity and returns.

## External Risks

### *Competition-related risk*

The Indian IT services market remains a very competitive space. The Company is facing competition not only from other large Indian IT vendors but also global vendors who are increasing their India presence given the popularity of the Indian offshore model.

To maintain its competitive edge in this landscape, the Company has been making significant investment in software engineering processes and offshore methodologies. All of the Company's software development centers are ISO 9001 certified. Most of the Company's centers have also obtained Capability Maturity Model (CMM) Level 4 or Level 5 accreditation. The Company has also built a world class sales and marketing infrastructure to service its global clientele. To achieve maximum penetration within the various target markets with a high degree of sensitivity to the culture and needs of the local market, the Company has established locally incorporated companies in several countries, which are also managed by locally recruited professionals.

Your Company also maintains constant touch with various specialist analyst firms worldwide through participation in IT conferences and industry specific events attended by CIO's of major corporations. Your company believes that its rigorous, research oriented approach to identify, qualify and develop relationships has been a key differentiator in the market place.

### *Employee-related risks*

**Attrition:** The Software industry is highly dependent on skilled human resources. With the increasing presence of global IT services corporations in India and major multinational banks and corporations scaling up their India based offshore operations through captive units, your Company faces the risk of losing its talented employees, which in turn can impact the execution of its current and future projects.

Your Company had launched an innovative "employee first" campaign last year along with several other initiatives aimed at making your company an employer of choice. In addition, your Company continues its focus on in-house training and development plans to ensure that its global talent pool is kept abreast of the latest developments in information technology and constantly upgraded with other soft skills and leadership training.

**Availability of Skilled manpower:** Your Company is also affected by the supply side constrains in a very competitive environment where the demand for quality skilled resources outstrips supply.

Company has invested considerable time and other resources towards developing Brand HCL in the past few quarters. With a competitive salary constantly benchmarked to the market, world class infrastructure, excellent work culture, investment in training and development and

opportunity for growth, your Company is committed to building a reputation as an employer of choice. Further, your Company works in close association with over 50 colleges including the 7 prestigious Indian Institutes of Technologies (IITs). It also works in association with the top 10 business schools including the Indian Institutes of Managements (IIMs). The location of the Company's development centers are also in cities which have good availability of skilled manpower.

#### **Exchange rate risk**

The functional currencies for the Company's operations are the respective currencies of the countries in which it operates. Substantially all of its revenues are generated in U.S. dollars and to a lesser extent, certain European and Asian currencies, while most of its expenses are incurred in Indian rupees and to a lesser extent, U.S. dollars. As described above, a substantial amount of its investments is held in Indian rupees. It also holds investments in certain countries, consisting primarily of investments by its subsidiaries, which are denominated in the local currency. It is therefore subject to the effects of exchange rate fluctuations between these currencies.

Your Company actively books foreign exchange forward covers to hedge completely against foreign currency fluctuations related to its billed receivables and anticipated realizations from projected revenues. The Company does not speculate in foreign currency.

There is some foreign exchange risk which arises from accounts payable to overseas vendors. This risk is partially mitigated as the Company has receipts in foreign currency from overseas customers and holds some of its cash in foreign currency bank accounts.

#### **Geo-political risks**

The ability of Indian IT/BPO services companies to secure offshore projects from client organizations abroad is often subjected to threat perceptions as regards the Indian subcontinent. In the recent past, we have seen some forms of hostilities between India and Pakistan. There has also been a lot of civil unrest in other neighboring countries with proximity to India. These can have negative implications for the operations of the Company. To mitigate these risks and to ensure continued delivery of services to clients irrespective of any geo-political disturbances, the Company has made adequate investments in disaster recovery and business continuity systems.

#### **INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY**

The Company and its Management have ensured that adequate systems for internal control commensurate with company's size are in place. These ensure that its assets and interests are carefully protected. Well-documented processes have been implemented throughout the organization to ensure that policies are promoted and adhered to. There are clear demarcation of roles and responsibilities at various levels of operations.

The Company has a dedicated Internal Audit team which ensures that

- adequate processes, systems, internal controls are implemented and these are commensurate with the size and operations of the Company.
- transactions are executed in accordance with policies and authorization.
- resources have been deployed as per the business plan, policies and authorization.

The Company has a rigorous business planning system to set targets and parameters for operations which are reviewed with actual performance to ensure timely initiation of corrective action if required.

The Company's Audit Committee, which is a sub committee of the Board, reviews adherence to internal control systems, internal audit reports and

implementation of suggestions. This Committee reviews all quarterly and yearly results of the Company and conveys to the Board its recommendation for consideration of such results and their approval.

#### **HUMAN RESOURCES**

The Company commenced a unique "employees first" initiative during the year under review, with an explicitly stated corporate objective that our people will take priority over all other stakeholders including customers. Under this overall theme, your Company launched a slew of programs aimed at increasing employee satisfaction, such as a Companywide trouble ticketing system, user friendly automated appraisal systems, 360 degree feedback appraisals, and web enabled training systems. The responses from employees reassure us that we are on the correct path. Your Company believes that its efforts under the "employees first" agenda will serve well to make a difference in our human resources management.

During the Fiscal year 2005-06 company along with its subsidiaries made net addition of 8,536 employees as compared to 7,732 employees during the previous year. The net addition to IT services in FY 2005-06 was 3,713 as compared to 5,259 in the previous year, registering an increase of 22%. In BPO the Company added 3,471 employees during the year as compared with 2,064 employees during the previous year, registering a growth of 60%. The company added 1,352 employees in its infrastructure services in FY 2005-06 as compared to 555 in previous year registering a growth of 85%. The Total employee strength of the company as on year ended 30th June 2006 was 32,626 as compared to 24,090 employees as on 30th June 2005, an increase of 35.43%

The gender mix of the Company though predominately in favor of men has improved to 77.0 : 23.0 (Men : Women) as on 30th June 2006 compared to 78.8 : 21.2 as on 30th June 2005.

#### **OPPORTUNITIES AND THREATS**

##### **Opportunities**

The year 2005 witnessed the coming of age of the Indian IT multinationals, with many indigenous players beginning to build noticeable presence in other locations—through cross border acquisitions, major onshore contract wins and extending organic growth into other near shore locations in various other countries. Simultaneously, global majors are continuing to significantly ramp-up their offshore delivery capabilities—predominantly in India, which vindicates the efficacy of the global delivery model and highlighting India's increasingly important role in the global IT landscape.

According to the **NASSCOM-McKinsey Report 2005**, the total addressable market for global offshoring is approximately \$300 billion, of which \$110 billion will be off shored by 2010. India has the potential to capture more than 50 per cent of this opportunity and generate export revenues of approximately \$60 billion by growing at 25 per cent year-on-year till 2010. Also inherent advantages like abundant talent supply, strong cost- and-leadership oriented companies, regulatory support, scaleable high-quality infrastructure, and a growing domestic market, which have been instrumental in driving the growth of this sector till date will continue to do so in the coming years.

Offshore adoption will continue to rise with offshore penetration across service lines increasing steadily over the forecast period (IDC forecasts share of offshore IT services spending to grow from 2.7 per cent in 2005 to 3.6 per cent of the total IT services spending by 2009). According to TPI estimates, nearly US\$ 100 billion in total contract value is due to come up for renewal over 2006-07.

##### **Threats**

Inspired by the Indian IT-ITES success story, several other nations have started representing alternate destinations for offshore based outsourcing. However, India still remains a preferred offshore destination; the main



challenge is from countries like China, Malaysia, Philippines, East European Countries and Canada.

Potential threat for the Company comes from the leading Indian IT vendors, Global IT Services companies having bases in India. Company is addressing same by coming up with differentiators and being competitive. Also it is expanding operation to counter the near shore threat.

## DISCUSSION ON FINANCIAL PERFORMANCE RELATING TO OPERATIONAL PERFORMANCE

The Financial Statements have been prepared in compliance with the requirements of Companies Act 1956, and Indian Generally Accepted Accounting Principles (GAAP), and Mandatory accounting standards issued by the Institute of Chartered Accountants of India ("ICAI").

The discussion on financial performance in the Management Discussion and Analysis is on standalone financial of HCL technologies Limited.

## RESULTS OF OPERATIONS (STANDALONE)

(Rs. in crores)

	Fiscal years ended June 30				
	2002	2003	2004	2005	2006
<b>Service revenue</b>	723.4	871.7	1,128.0	1,447.0	3,032.9
Cost of Revenue	264.4	404.9	606.6	789.5	1,635.5
Administration and other expenses	137.1	201.3	266.2	328.4	675.9
<b>Total Expenditure</b>	<b>401.5</b>	<b>606.2</b>	<b>872.8</b>	<b>1,117.9</b>	<b>2,310.9</b>
<b>Operating profit before interest, depreciation and amortization</b>	<b>321.9</b>	<b>265.5</b>	<b>255.2</b>	<b>329.1</b>	<b>722.0</b>
Interest	1.7	1.1	5.5	5.6	12.7
Depreciation	35.5	49.3	56.9	67.6	138.8
<b>Operating profit after interest, depreciation and amortization</b>	<b>284.7</b>	<b>215.1</b>	<b>192.8</b>	<b>255.9</b>	<b>570.5</b>
Other Income	133.2	107.8	146.7	83.0	83.3
<b>Profit before tax</b>	<b>417.9</b>	<b>322.9</b>	<b>339.5</b>	<b>338.9</b>	<b>653.8</b>
Provision for tax	15.9	13.8	13.8	9.6	15.4
<b>Profit after tax</b>	<b>402.0</b>	<b>312.5</b>	<b>325.7</b>	<b>329.3</b>	<b>638.4</b>

## FISCAL 2006 COMPARED TO FISCAL 2005

During the year under review, the Scheme of Amalgamation ("Scheme") of DSL Software Ltd., Shipara Technologies Ltd., HCL Technologies BPO Services Ltd., HCL Technologies (Mumbai) Ltd., Aquila Technologies Ltd. and HCL Enterprise Solutions (India) Ltd., all subsidiaries of the Company ("Transferor Companies") with the Company was approved by the Hon'ble High Courts of Delhi and Karnataka vide their orders dated October 28, 2005 and December 16, 2005 respectively. With the completion of filing of the said Orders with the Registrar of Companies, NCT of Delhi & Haryana and the Registrar of Companies, Bangalore on March 8, 2006, the scheme became effective retrospectively from April 1, 2005, the appointed date.

Accordingly, results of the Company for the year ended June 30, 2006 include the results of the Transferor Companies for the fifteen months period from April 1, 2005 to June 30, 2006 and are not comparable with results of fiscal year 2005.

**Service Revenues.** The Company's revenues of Rs.3,032.9 crores in fiscal 2006 were 109% higher than that for fiscal 2005. Excluding the revenues

of Transferor companies, revenue at Rs.1,992.7 Crores in fiscal 2006 were higher by 38% than that for fiscal 2005

In fiscal 2006, the revenues from America were Rs. 1,944.2 crores. Share of America in the total revenue dropped to 64% in fiscal 2006 from 77% in fiscal 2005. In an effort to derisk its business model, the Company is focusing on the markets in Europe, Australasia, Singapore and Malaysia. These markets contributed about 36% to the Company's revenues in the current fiscal and it is expected that their contribution is likely to increase in the coming years.

**Cost of Revenues.** The cost of revenues increased by 107% from Rs.789.5 crores in fiscal 2005 to Rs. 1,635.0 crores. This was mainly on account of an increase in employee costs. Employee costs of the Company increased to Rs. 1171.9 crores in fiscal 2006 from Rs. 491.0 crores in fiscal 2005, an increase of 138%. Employee costs as a percentage of service revenues have increased to 38.6% in fiscal 2006 from 34% in fiscal 2005. The increase in employee costs has been driven by an increase in number of employees during the year from total of 12,552 in the previous year to 25,534 in the year ended June 30, 2006. The Company also subcontracts certain projects to its subsidiaries and third parties. These costs increased to Rs. 463.1 crores in fiscal 2006 from Rs. 298.5 crores in fiscal 2005.

Excluding the cost of revenues of Transferor Companies, cost of revenue increased by 45.9% from Rs. 789.5 crores in fiscal 2005 to Rs. 1,151.7 crores and employee cost increased to Rs. 719.6 crores in fiscal 2006 from Rs. 491.0 crores, an increase of 46.5%.

**Administration and other expenses.** These costs among others consist of rent, communication costs (including on project), travel costs (including on project), electricity, repair and maintenance, software license fees, legal and professional charges, etc. As a percentage of service revenue, such costs decreased to 22% in fiscal 2006 from 23% in fiscal 2005. The cost has increased by Rs. 347.28 crores; increase of 106% as compared to fiscal 2005. Excluding the costs pertaining to Transferor Companies, these costs increased by 39.5% which is in line with increase in revenues.

**Operating profit before interest, depreciation and amortization.** Operating profit before interest, depreciation and amortization increased by hefty 119% during the fiscal from Rs.329.097 crores to Rs. 722.04 crores. As a percentage of revenues this increased from 22.7% in 2005 to 23.8% in 2006.

**Depreciation.** Depreciation increased to Rs. 138.8 crores in fiscal 2006 from Rs. 67.6 crores in fiscal 2005. The gross block has increased to Rs. 1014.1 crores in fiscal 2006 as compared to Rs. 632.1 crores in 2005 which has caused this increase in depreciation. The increase in gross block is due to net addition during the current year of Rs. 213.29 cores and assets acquired under the scheme of amalgamation of subsidiaries of Rs. 168.73 crores.

**Other income.** The Company's other income was Rs. 83.3 crores in fiscal 2006 as compared to Rs. 83.0 crores in fiscal 2005. This mainly comprises of dividend on investments in debt mutual funds and gains resulting from sale of such investments. To take advantage of lower tax rate applicable on long-term capital gains, the Company invests in growth funds and has unrealized capital gains of Rs. 34.3 crores (net of tax liability of Rs. 17.4 crores) as of end of fiscal year 2006.

**Taxation.** The net tax expense for fiscal 2006 was Rs. 15.4 crores as compared to Rs. 9.6 crores in fiscal 2005.

**Profit after tax.** The Company's profit after tax increased to Rs. 638.4 crores in fiscal 2006 from Rs. 329.3 crores in fiscal 2005, an increase of 94%. As a percentage of revenue this is 21% in fiscal 2006 against 22.8% in fiscal 2005.

**TAX DEDUCTIONS**

A substantial portion of the profits of the Company's operations is exempt from income tax, these profits being attributable to export operations of undertakings situated in Software Technology Parks (STP). Under the tax holiday, the taxpayer can utilize an exemption from income tax for a period of any ten consecutive years beginning from the financial year when the unit started operations. The tax holiday on all facilities under STPs expire in stages by 2009. The profits arising out of the domestic business are subject to corporate income tax at the rate of 33.66%. The exemption period on certain undertakings have expired in 2005 and 2006

**LIQUIDITY AND CAPITAL RESOURCES*****Cash Flows from Operating Activities***

Cash generated from operations provide the major sources of funds for the growth of the business. Net cash provided by operating activities was Rs. 774.0 crores and Rs. 265.7 crores in fiscal 2006 and 2005 respectively. The increase in cash from operating activities in fiscal 2006 is due to growth in business activities as well as due to amalgamation of subsidiaries companies.

***Cash Flows from Investing Activities***

In fiscal 2006, an amount of Rs. 202.0 crores was received from redemption of debt mutual funds while Rs. 10.5 crores of bonds were redeemed. During the year, a net amount of Rs. 302.9 crores was invested in fixed assets, and Rs. 39.9 crores was used for investments and loans to subsidiaries. A sum of Rs. 10.8 crores was contributed by the company towards its 49% stake in the share capital of NEC HCL Technologies Limited, a newly established joint venture company as per Joint Venture agreement with NEC Corporation, Japan and NEC System Technologies

Limited. Cash from investing activities also arose from income on investment and repayment of loans which had been advanced to the subsidiaries. Net cash outflow, thus, from investing activities was Rs. 133.3 crores in fiscal 2006 as compared to an inflow of Rs. 239.5 crores in 2005.

The thrust of the Company's treasury policy is to reduce risk and maintain the maximum possible safety, while earning reasonable returns from the investment of surplus funds.

***Cash Flows from Financing Activities***

Cash flow from financing activities in the year under review was an outflow of Rs. 641.8 crores mainly due to an outflow of Rs. 586.6 crores pertaining to the dividend declared in the previous fiscal year as well as the interim dividends paid during the year under review and repayment of long term debt of Rs.130.8 crores.

The Company had initiated various stock option plans for grant of options to its employees. As of June 30, 2006, 17,037,287 stock options were in force under these Plans. Each option granted under the Plan, entitles the holder thereof with an option to apply for and be issued two equity shares of the Company. During the fiscal 2006, the Company has received Rs. 88.4 crores on exercise of such options by the employees.

As a result of the above, the total amount of cash and cash equivalents available with the company as of June 30, 2006, was Rs. 106.2 crores, including Rs. 19.5 crores acquired on amalgamation of subsidiaries companies. Management believes that these balances along with cash from continuing operations and existing credit facilities will be sufficient to meet all needs of the Company in the next fiscal year.

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## DIRECTORS' REPORT

Dear Shareholders,

Your Directors have pleasure in presenting this Fourteenth Annual Report together with the Audited Accounts for the year ended June 30, 2006.

### FINANCIAL RESULTS

The highlights of consolidated financial results of your Company and its subsidiaries prepared under Indian GAAP are as follows:

(Rs. in crores)

	Year ended June 30, 2006*	Year ended June 30, 2005
<b>Income</b>		
Sales	4,571.58	3,351.20
Other income	109.29	120.03
	<b>4,680.87</b>	<b>3,471.23</b>
<b>Expenditure</b>		
Cost of goods sold	126.53	102.98
Cost of services	2,368.19	1,754.67
Administration and other expenses	1,165.60	736.31
Finance costs	8.13	10.18
Depreciation and amortisation	203.05	151.58
	<b>3,871.50</b>	<b>2,755.72</b>
<b>Profit before tax, minority interests, share of loss of equity investees and amalgamation adjustment</b>	<b>809.37</b>	<b>715.51</b>
Provision for tax	(55.89)	(49.80)
<b>Profit before minority interests, share of loss of equity investees and amalgamation adjustment</b>	<b>753.48</b>	<b>665.71</b>
Adjustment under the scheme of amalgamation of companies	(61.06)	-
<b>Profit before minority interests and share of loss of equity investees</b>	<b>692.42</b>	<b>665.71</b>
Share of loss of equity investees	-	(0.49)
Share of minority shareholders	(1.75)	(46.50)
<b>Net Profit</b>	<b>690.67</b>	<b>618.72</b>

\* During the year under review, a Scheme of Amalgamation under sections 391 to 394 of the Companies Act, 1956 for amalgamation of DSL Software Ltd., Shipara Technologies Ltd., HCL Technologies BPO Services Ltd., HCL Technologies (Mumbai) Ltd., Aquila Technologies Ltd. and HCL Enterprise Solutions (India) Ltd., all wholly owned subsidiaries of the Company ("Transferor Companies") with the Company was approved by the Hon'ble High Courts of Delhi and Karnataka. The effective date of amalgamation is April 1, 2005.

Accordingly, consolidated results for the year ended June 30, 2006 include results of the Transferor Companies for the fifteen months period from April 1, 2005 to June 30, 2006 and are not comparable with those of the corresponding previous year. The results of the Transferor Companies for the three months period from April 1, 2005 to June 30, 2005 have been adjusted in consolidated Profit & Loss A/c & shown under "adjustment under the scheme of amalgamation" as the results of the Transferor Companies for three months, as aforesaid, have been considered in previous year ended June 30, 2005. Also refer to para on "Amalgamation of Indian Subsidiaries" given in this Report.

The highlights of financial results of your Company as a stand-alone entity prepared under Indian GAAP are as follows:

(Rs. in crores)

	Year ended June 30, 2006*	Year ended June 30, 2005
<b>Income</b>		
Revenues	3,032.92	1,447.01
Other income	83.34	83.02
	<b>3,116.26</b>	<b>1,530.03</b>
<b>Expenditure</b>		
Cost of revenues	1,634.99	789.51
Administration and other expenses	675.90	328.41
Finance charges	12.74	5.62
Depreciation	138.80	67.56
	<b>2,462.43</b>	<b>1,191.10</b>
<b>Profit before tax</b>	<b>653.83</b>	<b>338.93</b>
Provision for tax	(15.44)	(9.66)
<b>Profit after tax</b>	<b>638.38</b>	<b>329.27</b>
Balance brought forward from previous year	836.20	1,109.78
Profit acquired under the scheme of amalgamation	363.73	-
<b>Amount available for appropriation</b>	<b>1,838.31</b>	<b>1,439.05</b>

	Year ended June 30, 2006*	Year ended June 30, 2005
<b>Appropriations</b>		
Proposed final dividend [including Rs. 0.66 crores (previous year Rs. 0.59 crores) paid for previous year]	130.04	128.47
Corporate dividend tax on proposed final dividend [including Rs. 0.09 crores (previous year Rs. 0.08 crores) paid for previous year]	18.24	18.01
Interim dividend	386.06	373.28
Corporate dividend tax on interim dividend	54.14	50.16
Transfer to general reserve	63.84	32.93
<b>Balance carried forward</b>	<b>1,185.99</b>	<b>836.20</b>
<b>Total</b>	<b>1,838.31</b>	<b>1,439.05</b>

\* During the year under review, a Scheme of Amalgamation under sections 391 to 394 of the Companies Act, 1956 for amalgamation of DSL Software Ltd., Shipara Technologies Ltd., HCL Technologies BPO Services Ltd., HCL Technologies (Mumbai) Ltd., Aquila Technologies Ltd. and HCL Enterprise Solutions (India) Ltd., all wholly owned subsidiaries of the Company ("Transferor Companies") with the Company was approved by the Hon'ble High Courts of Delhi and Karnataka. The effective date of amalgamation is April 1, 2005.

Accordingly, the standalone results of the Company for the year ended June 30, 2006 include results of the Transferor Companies for the fifteen months period from April 1, 2005 to June 30, 2006 and are not comparable with those of the corresponding previous year. Also refer to para on "Amalgamation of Indian Subsidiaries" given in this Report.

## TRANSFER TO RESERVES

Your Company proposes to transfer Rs. 63.84 crores to the general reserve. An amount of Rs. 1,185.99 crores is proposed to be carried forward in the Profit & Loss Account.

## OPERATIONS

In the fiscal year under review, the Company had a healthy growth in its revenues and profits. Even though conditions in the marketplace remain favourable for the large Indian IT services companies in terms of volumes, pricing has not improved given the high degree of competition in the market.

## DIVIDEND

During the year under review, your directors had declared and paid three interim dividends as per the details given hereunder:

S. No.	Interim dividend paid during the year ended June 30, 2006	Rate of dividend	Amount of dividend paid Rs./crores	Distribution tax paid by the Company Rs./crores
1.	1 <sup>st</sup> Interim Dividend	Rs. 4/- per share	128.10	17.97
2.	2 <sup>nd</sup> Interim Dividend	Rs. 4/- per share	128.75	18.06
3.	3 <sup>rd</sup> Interim Dividend	Rs. 4/- per share	129.21	18.12

Your directors are pleased to recommend a final dividend of Rs. 4/- per share for the financial year ended June 30, 2006, subject to approval of the shareholders at the ensuing Annual General Meeting. The total amount of dividend (including interim dividends paid) for the year ended June 30, 2006 is Rs. 515.44 crores as against Rs. 501.82 crores for the previous year. The dividend, if approved, will be paid to those members whose names appear in the Register of Members on the date of the ensuing Annual General Meeting. Under the Indian Income Tax Act, 1961, the receipt of dividend is tax-free in the hands of the shareholders. Dividend distribution tax paid/payable by the Company would amount to Rs. 72.38 crores.

## CENTERS/FACILITIES

The Company services its customers through a network of centres/facilities situated in the city of Bangalore, Chennai, Gurgaon, Noida, Hyderabad, Kolkata and Mumbai.

## AMALGAMATION OF SUBSIDIARIES

### Amalgamation of Indian subsidiaries

During the year under review, the Scheme of Amalgamation ("Scheme") under sections 391 to 394 of the Companies Act, 1956 for amalgamation of DSL Software Ltd., Shipara Technologies Ltd., HCL Technologies BPO Services Ltd., HCL Technologies (Mumbai) Ltd., Aquila Technologies Ltd. and HCL Enterprise Solutions (India) Ltd., all wholly owned subsidiaries of the Company ("Transferor Companies") with the Company was approved by the Hon'ble High Courts of Delhi and Karnataka vide their orders dated October 28, 2005 and December 16, 2005, respectively. With the completion of filing of the said Orders with the Registrar of Companies, NCT of Delhi & Haryana and the Registrar of Companies, Bangalore on March 8, 2006, the Scheme became effective retrospectively from April 1, 2005, the appointed date.

Further, consequent to the amalgamation of the aforesaid Transferor Companies with the Company -

1. Stand-alone results of the Company for the year ended June 30, 2006 include the results of the Transferor Companies for the fifteen months period from April 1, 2005 to June 30, 2006 and are not comparable with those of the corresponding previous period.

Similarly, consolidated results of the Company for the year ended June 30, 2006 include results of the Transferor Companies for the fifteen months period from April 1, 2005 to June 30, 2006. The results of the Transferor Companies for the three months period from April 1, 2005 to June 30, 2005 have been adjusted in consolidated Profit & Loss Account and shown under "adjustment under the scheme of amalgamation" as the results of the Transferor Companies for the aforesaid three months have been considered in previous year ended on June 30, 2005.