

# HCL Technologies

17 October 2012

Reuters: HCLT.BO; Bloomberg: HCLT IN

## Performance On Margins Front Strong; Retain Hold

HCL Technologies' (HCLT) 1QFY13 US dollar revenue was in line with estimates. While the 3.1% QoQ growth was led by infrastructure management services (IMS, up 10.4% QoQ), software services growth was subdued at 0.5% QoQ mainly due to a 2% QoQ decline in blended billing rates. A heartening feature was the 20bps QoQ expansion in margins (our estimate was a 139bps QoQ fall) achieved despite wage hikes and pricing pressure, and was a result of a higher employee utilisation rate. This led net profit to rise 3.6% QoQ at Rs8.8bn, 9.2% above our estimate and 12.8% above consensus estimate. We have slightly cut our FY14E revenue by 5.4% even as we raised EBITDA and margin estimates by 2.1% and 146bps, respectively, while increasing our FY14E EPS by 7.6%. Consequently, we have retained our Hold rating on the stock with a revised target price of Rs647 (12.5x FY14E EPS, Rs600 TP earlier).

**IMS drives revenue, software services subdued:** HCLT reported a 3.1% QoQ growth in US dollar revenue at US\$1,114mn (our estimate US\$1,117mn), while rupee revenue grew 2.9% QoQ at Rs60.9bn (1.2%/0.7% below our/consensus estimates). IMS was again the growth driver, posting an impressive 10.4% QoQ growth at US\$295.8mn. Software services growth was subdued at 0.5% QoQ, mainly due to a 2% QoQ fall in blended billing rates. Volume growth stood at 2.5% QoQ. Business process outsourcing (BPO) posted a healthy 5.3% QoQ growth, topping US\$50mn.

**Margins surge, despite wage hike, led by higher employee utilisation rate:** HCLT reported a 20bps QoQ rise in margins at 22.2%, ahead of our/consensus estimates by 159bps/233bps, respectively. This was despite the wage hike and lower pricing, and was aided by a higher employee utilisation rate (77.4% excluding trainees, 75.1% in 4QFY12). The higher margin led to a 3.6% QoQ rise in net profit at Rs8.8bn, 9.2%/12.8% higher than our/consensus estimates, respectively.

**Upgrade FY14E EPS 7.6%, retain Hold:** Going forward, HCLT's good show on revenue and margins is heartening, although valuation at 11.2x FY14E EPS prevents us from taking a more favourable view on the stock. We have cut FY14E revenue 5.4% on lower software volume, even as we increased EBITDA/margin estimates by 2.1%/146bps, respectively, and raised FY14E EPS by 7.6%. **Therefore, we have retained our Hold rating on HCLT with a revised TP of Rs647 (12.5x FY14E EPS, Rs600 TP earlier).**

## HOLD

Sector: Information Technology

CMP: Rs580

Target Price: Rs647

Upside: 11.5%

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### Key Data

Current Shares O/S (mn)	694.0
Mkt Cap (Rsbn/US\$bn)	402.9/7.6
52 Wk H / L (Rs)	606/373
Daily Vol. (3M NSE Avg.)	1,322,849

### Price Performance (%)

	1 M	6 M	1 Yr
HCL Tech.	2.3	20.7	32.6
Nifty Index	0.9	7.0	10.6

Source: Bloomberg

Y/E June (Rsmn)	1QFY12	4QFY12	1QFY13	QoQ (%)	YoY (%)	FY11	FY12	Chg (%)
Revenue	46,513	59,191	60,910	2.9	31.0	160,342	210,312	31.2
Direct costs	31,871	38,367	39,457	2.8	23.8	109,140	140,558	28.8
Gross profit	14,642	20,824	21,453	3.0	46.5	51,202	69,754	36.2
SG&A expenses	6,693	7,815	7,943	1.6	18.7	23,714	29,503	24.4
EBITDA	7,949	13,009	13,510	3.9	70.0	27,488	40,251	46.4
Depreciation and amortisation	1,309	1,525	1,692	11.0	29.3	4,976	5,642	13.4
EBIT	6,640	11,484	11,818	2.9	78.0	22,512	34,609	53.7
Other Income, net	238	153	356	132.7	49.6	257	706	174.7
Forex gains/(losses)	(179)	(576)	(609)	5.7	240.2	(819)	(1,875)	128.9
Income before income tax	6,699	11,061	11,565	4.6	72.6	21,950	33,440	52.3
Tax	1,728	2,525	2,718	7.6	57.3	4,854	8,180	68.5
Equity investee and minority interest	(3)	5	1	-	-	(1)	0	-
Net profit	4,968	8,541	8,848	3.6	78.1	17,095	25,260	47.8
Diluted EPS (Rs)	7.1	12.2	12.6	3.5	77.1	24.5	36.1	47.3
Gross profit margin (%)	31.5	35.2	35.2	-	-	31.9	33.2	-
EBITDA margin (%)	17.1	22.0	22.2	-	-	17.1	19.1	-
EBIT margin (%)	14.3	19.4	19.4	-	-	14.0	16.5	-
Net profit margin (%)	10.7	14.4	14.5	-	-	10.7	12.0	-

Source: Company, Nirmal Bang Institutional Equities Research

(US GAAP numbers)

## Exhibit 1: Key financials

Y/E June (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	125,882	160,342	210,312	253,111	277,255
YoY (%)	18.9	27.4	31.2	20.4	9.5
EBITDA	25,785	27,488	40,251	51,915	54,827
EBITDA (%)	20.5	17.1	19.1	20.5	19.8
Adj. PAT	13,058	17,095	25,260	32,866	36,247
YoY (%)	2.3	30.9	47.8	30.1	10.3
FDEPS (Rs)	18.6	24.4	36.1	46.9	51.7
RoE (%)	20.5	22.1	26.4	27.3	24.4
RoCE (%)	18.7	17.0	22.5	24.5	21.2
P/E (x)	31.1	23.8	16.1	12.4	11.2
EV/EBITDA (x)	15.7	14.5	9.8	7.3	6.5

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Actual performance versus our estimates, Bloomberg consensus estimates

(1QFY13)	Achieved	NBIE estimates	BBG cons. estimates	% variation from NBIE estimates	% variation from BBG consensus estimates
Consolidated revenue (US\$m)	1,114	1,117	-	(0.3)	-
Consolidated revenue (Rsmn)	60,910	61,647	61,348	(1.2)	(0.7)
EBITDA (Rsmn)	13,510	12,694	12,177	6.4	10.9
EBITDA margin (%)	22.2	20.6	19.8	159bps	233bps
EBIT (Rsmn)	11,818	11,093	10,782	6.5	9.6
EBIT margin (%)	19.4	18.0	17.6	141bps	183bps
Net profit (Rsmn)	8,848	8,103	7,846	9.2	12.8

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

## Key result data points

### Segmental details – IMS drives growth yet again

- For 1QFY13, it was the IMS segment that was yet again the key growth driver for HCLT, growing in double digits at 10.4% QoQ to touch US\$295.8mn (our estimate US\$279mn).
- It should be noted that the IMS business has grown faster than the company average for seven out of the past eight quarters, clearly reflecting the fact that this has been the segment that has driven HCLT's above-peer revenue growth.
- Software services revenue was subdued in 1QFY13, growing 0.5% QoQ (US\$768mn, our estimate US\$790mn) – Volume growth was 2.5% QoQ, but blended pricing declined 2% QoQ, which, in our view, is the only negative in this quarter's results.
- BPO revenue grew by a healthy 5.3% QoQ to top US\$50mn, a sign that the restructuring in the business towards more non-voice revenue is beginning to show results.

### Exhibit 3: Segment-wise break-up – IMS is key driver

(US\$m)	1QFY12	4QFY12	1QFY13	QoQ (%)	YoY (%)
Software services	709	764	768	0.5	8.2
IMS	246	268	296	10.4	20.1
BPO services	47	48	50	5.3	7.7
<b>Total</b>	<b>1,002</b>	<b>1,080</b>	<b>1,114</b>	<b>3.2</b>	<b>11.1</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 4: Software services – Operating metrics

Particulars	1QFY12	4QFY12	1QFY13	QoQ (%)	YoY (%)
<b>Revenue (US\$m)</b>					
Onsite	409	437	443	1.4	8.2
Offshore	300	327	325	(0.7)	8.2
<b>Total</b>	<b>709</b>	<b>764</b>	<b>768</b>	<b>0.5</b>	<b>8.2</b>
<b>Volumes (person months)</b>					
Onsite	30,074	32,339	31,966	(1.2)	6.3
Offshore	80,171	88,762	92,104	3.8	14.9
<b>Total</b>	<b>110,245</b>	<b>121,101</b>	<b>124,070</b>	<b>2.5</b>	<b>12.5</b>
<b>Billing rates (US\$/person month)</b>					
Onsite	13,611	13,513	13,861	2.6	1.8
Offshore	3,743	3,684	3,527	(4.3)	(5.8)
<b>Blended</b>	<b>6,435</b>	<b>6,309</b>	<b>6,189</b>	<b>(1.9)</b>	<b>(3.8)</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Software services - service line break-up (US\$ terms)

- Enterprise application services – Down 1.9% QoQ; **a clear sign that discretionary spending remains under stress; in view of the challenging economic environment, a rebound appears unlikely any time soon**
- Engineering and research and development (R&D) services – Up 0.4% QoQ
- Custom application services – Up 2.2% QoQ.

### Industry verticals (US\$ terms)

- Manufacturing – Up 0.3% QoQ
- Financial services – Up 4.5% QoQ; **this vertical continues to rebound, with the revenue decline in 3QFY12 being followed by a 2.2% QoQ growth in 4QFY12 and now over 4% growth, as HCLT has won deals worth US\$1bn in this vertical**
- Retail and consumer packaged goods (CPG) – Up by a strong 10.4% QoQ
- Healthcare – Up by an impressive 14.6% QoQ; **this follows a 22.3% QoQ growth witnessed last quarter, which is a positive sign and gives more all-round flavour to the growth posted by HCLT**
- Media, publishing & entertainment – Up 7.8% QoQ
- Energy-Utilities-Public Sector – Down 1.1% QoQ
- Telecom – Down 3.3% QoQ.

### Geographies (US\$ terms)

- North America – Up 3.9% QoQ; **healthy growth in the largest market**
- Europe – Up 2.8% QoQ
- Rest of the World – Up 1.2% QoQ.

### Employee data

- Gross hires at 6,372 in 1QFY13, net hires at 1,016
- Total employee base at 85,335 at the end of 1QFY13
- Attrition in software services declines to 13.4% (13.7% in 4QFY12)
- Employee utilisation rate, including trainees, at 74.2% (72.4% in 4QFY12)
- Employee utilisation rate, excluding trainees, at 77.4% (75.1% in 4QFY12).

## Valuation

Going forward, HCLT's good show on revenue and margins front is heartening, although its valuation at 11.2x FY14E EPS prevents us from taking a more favourable view on the stock. We have slightly cut our FY14E revenue by 5.4% on likely lower volume growth in software services even as we raised EBITDA and margin estimates by 2.1% and 146bps, respectively, while increasing our FY14E EPS by 7.6%. **Consequently, we have retained our Hold rating on the stock with a revised target price of Rs647 (12.5x FY14E EPS, Rs600 TP earlier).**

### Exhibit 5: Earlier estimates, revised estimates

Particulars	Earlier estimates	Revised estimates	Chg (%)
<b>FY13E</b>			
Revenue (Rsmn)	255,460	253,111	(0.9)
EBITDA (Rsmn)	47,951	51,915	8.3
EBITDA margin (%)	18.8	20.5	174bps
EPS (Rs)	41.8	46.9	12.2
<b>FY14E</b>			
Revenue (Rsmn)	293,223	277,255	(5.4)
EBITDA (Rsmn)	53,714	54,827	2.1
EBITDA margin (%)	18.3	19.8	146bps
EPS (Rs)	48.1	51.7	7.6

Source: Nirmal Bang Institutional Equities Research

## Rating history

Date	Rating	Market price (Rs)	Target price (Rs)
2 June 2011	Buy	514	620
1 July 2011	Buy	493	620
28 July 2011	Buy	504	603
12 August 2011	Sell	408	381
23 September 2011	Hold	382	394
30 September 2011	Sell	410	394
23 November 2011	Hold	386	437
2 January 2012	Buy	388	504
17 January 2012	Buy	425	504
30 March 2012	Hold	478	504
18 April 2012	Hold	496	515
29 June 2012	Hold	461	515
25 July 2012	Buy	514	600
4 October 2012	Hold	590	600

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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