

October 17, 2012

 Shashi Bhusan
 shashibhusan@plindia.com
 +91-22-66322300

 Pratik Shah
 pratikshah@plindia.com
 +91-22-66322256

Rating	Accumulate
Price	Rs581
Target Price	Rs660
Implied Upside	13.6%
Sensex	18,611
Nifty	5,660

(Prices as on October 17, 2012)
Trading data

Market Cap. (Rs bn)	389.1
Shares o/s (m)	670.3
3M Avg. Daily value (Rs m)	762.1

Major shareholders

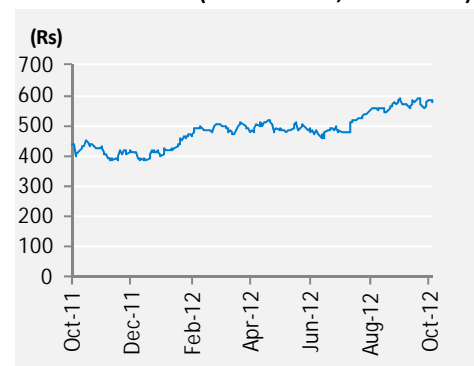
Promoters	62.18%
Foreign	20.31%
Domestic Inst.	9.33%
Public & Other	8.18%

Stock Performance

(%)	1M	6M	12M
Absolute	2.3	20.7	32.6
Relative	1.9	13.5	23.2

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	47.6	43.9	8.4
2014	53.8	48.5	11.0

Price Performance (RIC: HCLT.BO, BB: HCLT IN)


Source: Bloomberg

HCL Technologies (HCLT) reported weaker-than-expected revenue performance, but better-than-expected margin performance despite margin headwinds. The management remains confident about the margins. We see little downside risk to our estimates, but see limited upside in the stock price. We revise our margin estimates and target price upward; however, downgrade rating to "Accumulate".

- Strong margin performance:** HCLT reported constant currency growth of 2.9% QoQ (PL: 4.2%). EBIT margin was flattish (Cons.: ~200bp erosion) at 19.4%, with headwinds like forex (-10bps) and wage hike (-80bps), offsetted by tailwinds from efficiencies & utilization (+72bps) and G&A leverage (+18bps). Overall volume growth of 4.5% is in line with expectation. Moreover, decline in onsite (-1.2% QoQ) volume for software services was attributed to transition to offshore.
- Focus shifts on deal win, margin headwinds to get stronger:** HCLT is eyeing for restructuring deals in the pipeline OND-12. According to TPI, US\$61bn TCv of deals would come for restructuring. The company is likely to step-up S&M investments. We expect wage hike (-100bps impact), higher S&M, currency appreciation and lower number of working days to erode margins in Q2FY13. The company has reaped the benefit of margin tailwinds due to project transitions to offshore in Q1FY13. However, the management remains confident of using levers like pyramid rationalization, facility consolidation and utilization improvement to help retain the margin.
- Is it time for re-rating?** Stronger-than-peer growth pushes forward an argument for multiple re-rating. FCF and return ratios continue to be volatile compared to peers; however, on LTM basis, we can see the improvement. We will wait for sustainability before putting forward re-rating arguments. *(Exhibit 3,4)*
- Valuation & Recommendation – Downgrade to 'Accumulate', with revised TP of Rs660:** We expect HCLT to deliver stronger-than-peer performance in FY13. However, we downgrade to 'Accumulate' rating, with a TP of **Rs660**, 13x Mar-14e earnings estimates (roll our model forward to FY14). *(Exhibit 2)*

Key financials (Y/e June)	2011	2012	2013E	2014E
Revenues (Rs m)	160,342	210,312	245,424	278,626
Growth (%)	27.6	31.2	16.7	13.5
EBITDA (Rs m)	27,488	40,251	49,041	54,517
PAT (Rs m)	17,099	25,260	33,025	37,315
EPS (Rs)	24.8	36.4	47.6	53.8
Growth (%)	28.0	46.7	30.7	13.0
Net DPS (Rs)	7.4	12.5	13.3	15.0

Profitability & Valuation	2011	2012	2013E	2014E
EBITDA margin (%)	17.1	19.1	20.0	19.6
RoE (%)	22.1	26.4	27.9	26.4
RoCE (%)	15.8	20.0	22.3	22.5
EV / sales (x)	2.6	2.0	1.6	1.4
EV / EBITDA (x)	15.1	10.3	8.3	7.2
PE (x)	23.4	15.9	12.2	10.8
P / BV (x)	4.7	3.8	3.1	2.6
Net dividend yield (%)	1.3	2.1	2.3	2.6

Source: Company Data; PL Research

Exhibit 1: Conference call highlights

Positives	Analysis
Total hedge book has been increased to US\$1,465m (Q4FY12: US\$1,385m)	The company has increased hedge book by US\$80m in Q1FY13. The company has US\$1,155m (Q2FY12: \$1,136m) of cash flow hedges with US\$548m maturing in less than a year @Rs51.79. Forwards: \$985m, Options: \$480m. The hedge policy of the company remains same – Hedging 40% of net receivables.
IMS grew 10.4% QoQ (<i>Exhibit 7</i>)	IMS continues to be the forte of HCLT. Our recent discussion with peers indicated that HCLT continues to win market share in IMS vertical. According to the management, more than 80% of new deals are from F500/G2000 companies. Data Centre Services saw an increase of 20% YoY. 60% of IMS deals have DC as components to it. Most of IMS contracts won by the company are in a steady state. We expect IMS to give stability to HCLT margin as company moves toward pyramid rationalization aggressively in IMS vertical.
BPO sprung a positive surprise, Revenue grew 5.3% QoQ and EBITDA margin improved 246bps (<i>Exhibit 8</i>)	BPO delivered strong growth in the quarter as the recent deal wins started to ramp-up. According to the management, BPO is expected to deliver company level margin in 3 year’s time. Moreover, BPO now has more outcome-based pricing compared to activity based. Currently, voice based revenue is ~36% of its total revenue.
Revenue growth in USD terms at 3.2% QoQ (@cc: 2.9%) (<i>Exhibit 5</i>)	Revenue growth for the quarter was softer than anticipated. We expected 4% USD terms revenue growth. However, overall volume growth of 4.5% was in line with the expectation. The lower revenue growth was largely attributed to offshore transition, which comes at lower billing rate.
Negatives	Analysis
Top 5 clients grew by 1.9% QoQ, 6-10 clients grew by 3.2%, Top 10-20 clients declined by -0.1% QoQ (<i>Exhibit 9</i>)	HCLT’s management is keen on improving the quality of top 10 clients. The company currently has all the top 10 clients from F500, whereas five out of 10 clients are G2000. We expect the growth in top 20 clients to be more consistent, going forward. RoI of F500/G1000 clients are better. We expect focus on top clients mining to improve both stickiness to growth and margin. However, current quarter witnessed softness in growth after strong performance in Q4FY12.
DSO still sticky at 83 days(billed receivables moved to 57 days from 59 days, unbilled moved up to 24 from 243days compared to previous quarter)	The sticky DSO is largely attributed to sharp jump in FPP projects (Q1FY13: 51.2%, Q4FY12: 50.8%, Q3FY12: 49%, Q2FY12: 46%). Most of the projects are milestone based, hence, increase in unbilled revenue. We expect DSO to decline as milestones of the projects are achieved. HCLT witnessed DSO decline of 2 days in first 15 days of Q2FY13.
Strong client addition of 38, with 12 multi-year multi-million dollar deals, excluding HCLT contract renewals (<i>Exhibit 6</i>)	HCLT added 38 new clients (Q4FY12: 40, Q3FY12: 52, Q2FY12:57, Q1FY12: 66, Q4FY11: 70), with no net new client additions. The company managed to win 12 (Q4FY12: 8; Q3FY12:14; Q2FY12:18, Q1FY12: 12, Q4FY11: 20) multi-year multi-million dollar (the company’s definition of deals are >US\$20m compared to peers of >US\$50m). The management has shifted focus to execution in H1FY13, but expected to make further investment in S&M in OND-12. Moreover, the focus has shifted now to win more G2000/F500 clients, ~67% of client win over last 8 quarters are G2000/F500. The weaker client addition in the quarter is attributed to focus on execution. The company would be chasing restructuring deal in H2CY13. The deal-win rate of the company is ~51%.

Source: PL Research

Exhibit 1: Strong performance across the line (Rs m)

Y/e June	Q1FY13	Q4FY12	QoQ	Q1FY12	YoY	Cons(e)	PL(e)	Var VS PL (e)
Sales (\$ m)	1,114	1079.6	3.2%	1002.2	11.1%	NA	1,125.48	-1.0%
Sales	60,910	59,191	2.9%	46,513	31.0%	61,319	62,014.1	-1.8%
Operating Profit	13,511	13,009	3.9%	7,949	70.0%	12,169	12,588.9	7.3%
<i>OPM</i>	<i>22.2%</i>	<i>22.0%</i>	<i>20 bps</i>	<i>17.1%</i>	<i>509 bps</i>	<i>19.8%</i>	<i>20.3%</i>	<i>188 bps</i>
PBT	11,566	11,062	4.6%	6,699	72.6%	10,524	10,448.9	10.7%
Tax	2,718	2525	7.6%	1728	57.3%	2,657	2,403.2	13.1%
<i>Tax Rate</i>	<i>23.5%</i>	<i>22.8%</i>	<i>67 bps</i>	<i>25.8%</i>	<i>-229 bps</i>	<i>25.2%</i>	<i>23.0%</i>	<i>50 bps</i>
PAT	8,848	8,541	3.6%	4,971	78.0%	7,867	8,045.6	10.0%
EPS	12.84	12.15	5.7%	7.11	80.6%	11.11	11.45	12.2%
Average (USD rate)	54.69	54.8	-0.3%	46.4	17.8%	NA	55.10	-0.8%

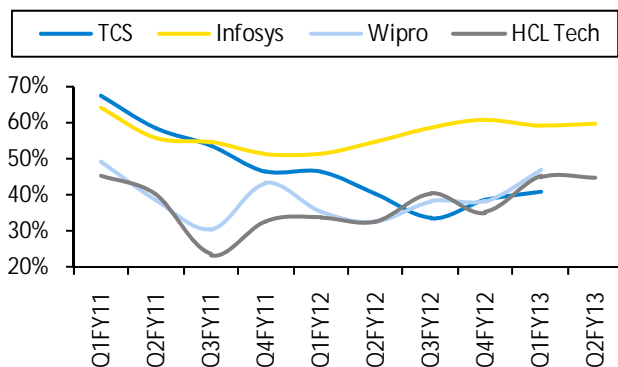
Source: Company Data, Bloomberg, PL Research

Exhibit 2: Revising estimates upward for FY13 and FY14 for higher margin, we roll our model for FY14

	New		Old		Revision	
	FY13	FY14	FY13	FY14	FY13	FY14
Sales (Rs m)	245,424	278,626	245,428	281,338	0.0%	-1.0%
EBITDA	49,041	54,517	47,258	53,479	3.8%	1.9%
<i>EBITDA Margin</i>	<i>20.0%</i>	<i>19.6%</i>	<i>17.1%</i>	<i>18.5%</i>	<i>284 bps</i>	<i>110 bps</i>
EPS	47.73	53.94	45.78	52.64	4.3%	2.5%
Multiple	13		13		0.0%	
Target Price	660		580		13.8%	

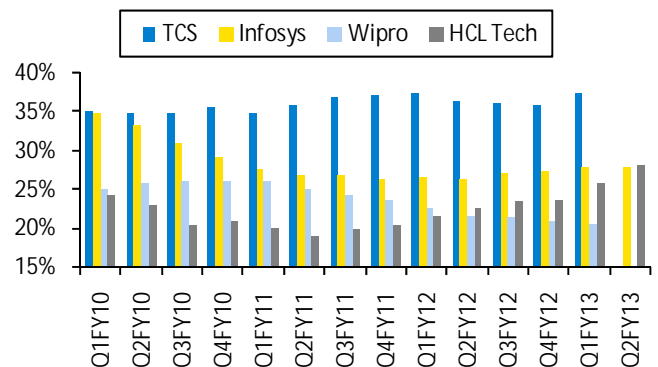
Source: PL Research

Exhibit 3: FCF/EBITDA (LTM): Steady improvement since Q3FY11



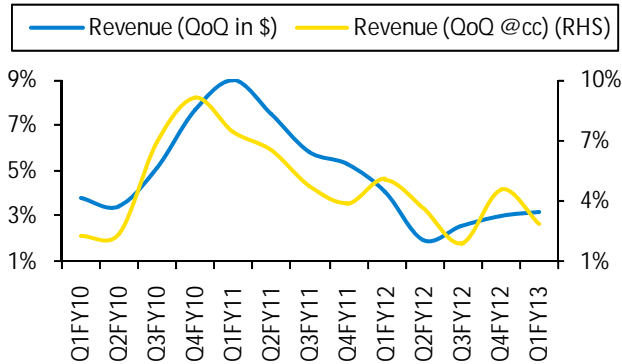
Source: Company Data, PL Research

Exhibit 4: RoE (LTM): Sustainability holds key for re-rating



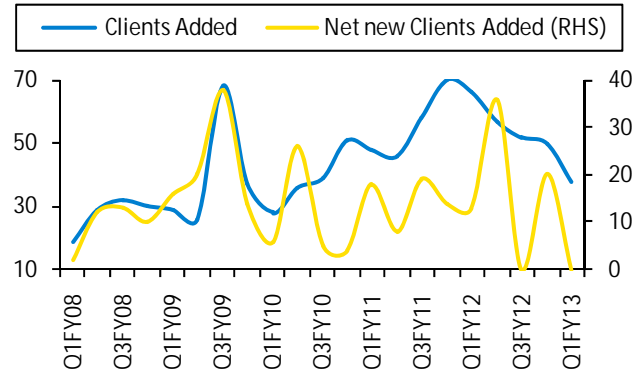
Source: Company Data, PL Research

Exhibit 5: Revenue growth in constant currency dipped



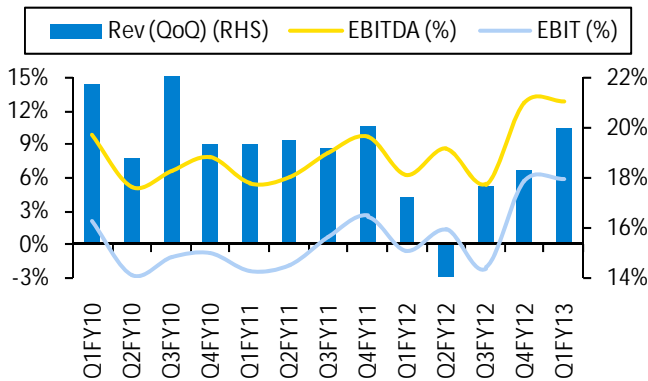
Source: Company Data, PL Research

Exhibit 6: Net client addition weak as focus shift on execution



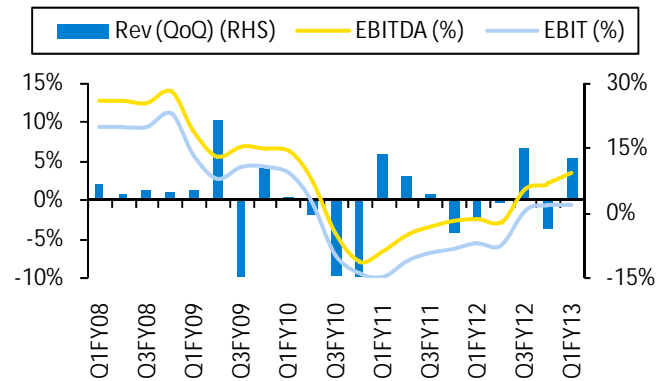
Source: Company Data, PL Research

Exhibit 7: IMS: Drive margin up by helping in pyramid rationalization



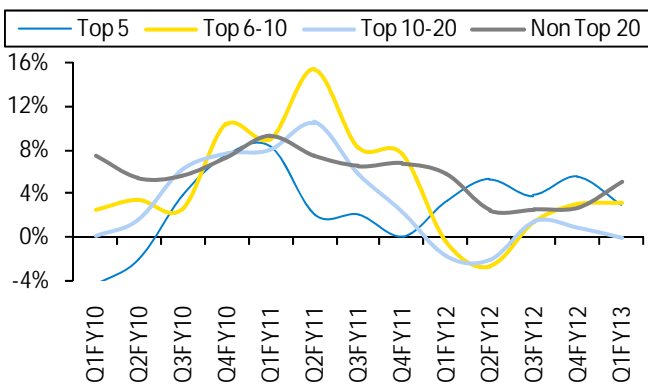
Source: Company Data, PL Research

Exhibit 8: BPO: Margin expansion and growth - a positive surprise



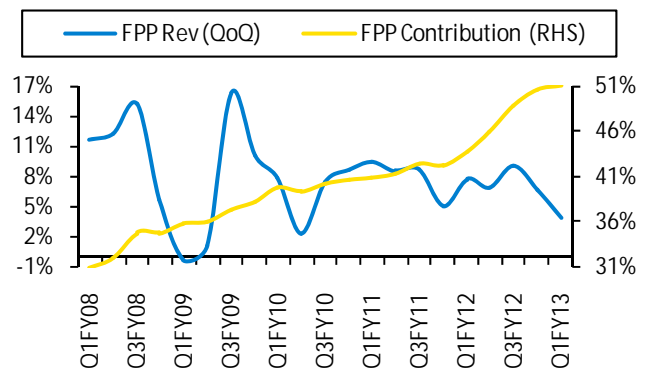
Source: Company Data, PL Research

Exhibit 9: Growth driven by non-top 20 clients



Source: Company Data, PL Research

Exhibit 10: FPP contribution continues to grow



Source: Company Data, PL Research

Income Statement (Rs m)

Y/e June	2011	2012	2013E	2014E
Net Revenue	160,342	210,312	245,424	278,626
Raw Material Expenses	109,140	140,558	161,952	185,090
Gross Profit	51,202	69,754	83,472	93,536
Employee Cost	—	—	—	—
Other Expenses	23,714	29,503	34,431	39,020
EBITDA	27,488	40,251	49,041	54,517
Depr. & Amortization	4,974	5,641	6,139	6,570
Net Interest	—	—	—	—
Other Income	(561)	(1,170)	551	1,152
Profit before Tax	21,953	33,440	43,453	49,099
Total Tax	4,854	8,180	10,429	11,784
Profit after Tax	17,099	25,260	33,025	37,315
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	17,099	25,260	33,025	37,315
Avg. Shares O/S (m)	688.7	693.3	693.3	693.3
EPS (Rs.)	24.8	36.4	47.6	53.8

Cash Flow Abstract (Rs m)

Y/e June	2011	2012	2013E	2014E
C/F from Operations	16,986	27,912	31,526	35,666
C/F from Investing	(7,751)	(12,588)	(10,062)	(10,309)
C/F from Financing	(8,723)	(13,849)	(16,202)	(18,378)
Inc. / Dec. in Cash	512	1,475	5,262	6,979
Opening Cash	4,686	5,198	6,673	11,935
Closing Cash	5,198	6,673	11,935	18,914
FCFF	16,080	20,315	27,108	31,487
FCFE	10,688	18,297	22,108	25,487

Key Financial Metrics

Y/e June	2011	2012	2013E	2014E
Growth				
Revenue (%)	27.6	31.2	16.7	13.5
EBITDA (%)	6.8	46.4	21.8	11.2
PAT (%)	31.5	47.7	30.7	13.0
EPS (%)	28.0	46.7	30.7	13.0
Profitability				
EBITDA Margin (%)	17.1	19.1	20.0	19.6
PAT Margin (%)	10.7	12.0	13.5	13.4
RoCE (%)	15.8	20.0	22.3	22.5
RoE (%)	22.1	26.4	27.9	26.4
Balance Sheet				
Net Debt : Equity	0.2	0.1	—	(0.1)
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	23.4	15.9	12.2	10.8
P / B (x)	4.7	3.8	3.1	2.6
EV / EBITDA (x)	15.1	10.3	8.3	7.2
EV / Sales (x)	2.6	2.0	1.6	1.4
Earnings Quality				
Eff. Tax Rate	22.1	24.5	24.0	24.0
Other Inc / PBT	(2.6)	(3.5)	1.3	2.3
Eff. Depr. Rate (%)	22.4	22.8	21.0	19.7
FCFE / PAT	62.5	72.4	66.9	68.3

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e June	2011	2012	2013E	2014E
Shareholder's Funds	84,329	107,298	129,121	154,058
Total Debt	21,240	19,222	14,222	8,222
Other Liabilities	6,903	13,362	13,362	13,362
Total Liabilities	112,472	139,882	156,705	175,642
Net Fixed Assets	22,165	24,775	29,193	33,372
Goodwill	41,878	49,404	48,910	48,470
Investments	2,780	2,943	2,943	2,943
Net Current Assets	35,257	44,708	57,607	72,806
<i>Cash & Equivalents</i>	<i>5,198</i>	<i>6,673</i>	<i>11,935</i>	<i>18,914</i>
<i>Other Current Assets</i>	<i>63,822</i>	<i>87,429</i>	<i>98,120</i>	<i>111,143</i>
<i>Current Liabilities</i>	<i>33,763</i>	<i>49,394</i>	<i>52,447</i>	<i>57,252</i>
Other Assets	10,392	18,052	18,052	18,052
Total Assets	112,472	139,882	156,705	175,642

Quarterly Financials (Rs m)

Y/e June	Q2FY12	Q3FY12	Q4FY12	Q1FY13
Net Revenue	52,452	52,156	59,191	60,910
EBITDA	9,702	9,591	13,009	13,510
<i>% of revenue</i>	<i>18.5</i>	<i>18.4</i>	<i>22.0</i>	<i>22.2</i>
Depr. & Amortization	1,278	1,308	1,410	1,574
Net Interest	—	—	—	—
Other Income	(670)	(136)	(423)	(253)
Profit before Tax	7,637	8,042	11,062	11,565
Total Tax	1,911	2,016	2,525	2,718
Profit after Tax	5,726	6,026	8,541	8,847
Adj. PAT	5,726	6,026	8,541	8,847

Key Operating Metrics

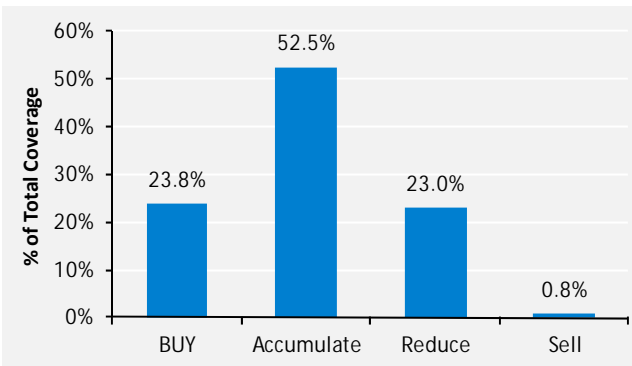
Y/e June	2011	2012	2013E	2014E
Volume (persons months)	398,854	465,877	124,070	145,782
Pricing (US\$ / Hr)	35.9	36.1	35.2	35.7
Currency (INR/USD)	45.3	50.4	52.0	49.5
SW. Devp. Cost (% of sales)	68.1	66.8	66.0	66.4
SG&A (% of sales)	14.8	14.0	14.0	14.0
Revenue (US\$ m)	3,545	4,152	4,720	5,629
EBITDA Margin Expansion/(Erosion) (bps)	(333)	200	84	(42)
Tax Rate (%)	22.1	24.5	24.0	24.0

Source: Company Data, PL Research.



Prabhudas Lilladher Pvt. Ltd.
 3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India
 Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

This document has been prepared by the Research Division of Prabhudas Lilladher Pvt. Ltd. Mumbai, India (PL) and is meant for use by the recipient only as information and is not for circulation. This document is not to be reported or copied or made available to others without prior permission of PL. It should not be considered or taken as an offer to sell or a solicitation to buy or sell any security.

The information contained in this report has been obtained from sources that are considered to be reliable. However, PL has not independently verified the accuracy or completeness of the same. Neither PL nor any of its affiliates, its directors or its employees accept any responsibility of whatsoever nature for the information, statements and opinion given, made available or expressed herein or for any omission therein.

Recipients of this report should be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The suitability or otherwise of any investments will depend upon the recipient's particular circumstances and, in case of doubt, advice should be sought from an independent expert/advisor.

Either PL or its affiliates or its directors or its employees or its representatives or its clients or their relatives may have position(s), make market, act as principal or engage in transactions of securities of companies referred to in this report and they may have used the research material prior to publication.

We may from time to time solicit or perform investment banking or other services for any company mentioned in this document.