Indiabulls

HCL TECHNOLOGIES LIMITED RESEARCH

EQUITY RESEARCH — **August 27, 2008**

RESULTS REVIEW

Share Data

Market Cap	Rs. 153.1 bn
Price	Rs. 229.80
BSE Sensex	14,296.79
Reuters	HCLT.BO
Bloomberg	HCLT IN
Avg. Volume (52 Week)	0.21 mn
52-Week High/Low	Rs. 336 / 180
Shares Outstanding	666.3 mn

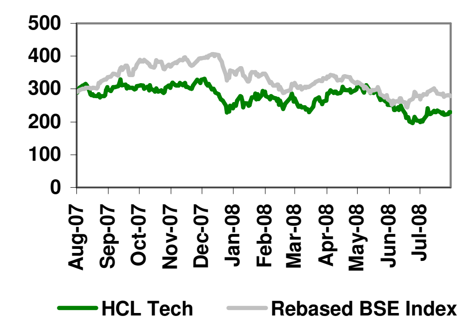
Valuation Ratios (Consolidated)

Year to 30 June	2009E	2010E
EPS (Rs.)	25.1	27.1
+/- (%)	51.4%	8.0%
PER (x)	9.2x	8.5x
EV/ Sales (x)	1.5x	1.3x
EV/ EBITDA (x)	6.9x	5.9x

Shareholding Pattern (%)

Promoters	68
FIIs	18
Institutions	6
Public & Others	9

Relative Performance



HCL Technologies Limited — Buy

Fundamentals remain stable

HCL Technologies (HCL) reported strong results for the quarter and the year ended June 2008. Top line recorded a sequential growth of 11.5% to Rs. 21.7 bn driven by appreciating dollar and the modest volume growth. EBITDA margin increased by 117 bps qoq to 23.4%, led by an improved operational efficiency and a decrease in the cost of revenue, which helped in offsetting the increase in SG&A expenses. We maintain our Buy rating on the stock because of the followings:

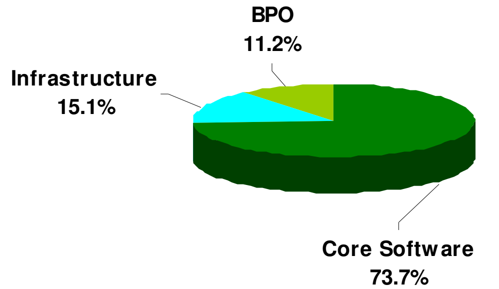
- **Volume to lead revenue growth:** The Company witnessed a strong deal inflow during Q4'08 (USD 310 mn) and signed a total contract worth USD 1 bn during the year. Although in a weak macro-economic environment pricing will continue to remain under pressure, we expect revenues to grow at ~21.4% in USD terms for FY09, largely driven by volumes. Besides, gain from the appreciating dollar against rupee will also help in improving revenues to grow at around 27.2% in rupee terms for FY09E.
- **Stable operational performance:** Despite a slowdown in the US, it remained the highest revenue contributor and showed a decent growth throughout the year. Besides, the Company steadily improved its utilisation rate from 69.2% in Q1'08 to 73.9% in Q4'08, which helped the margins to improve.
- **Trading at a substantial discount:** The stock has depreciated by 23% since our last quarterly update. Despite having stable fundamentals, the stock is trading at a heavy discount of 29% to the average industry multiple. Moreover, our DCF valuation gives a fair value of Rs. 316. Hence, we believe that the stock gives an upside of around 37%.

Key Figures (Consolidated)

Quarterly Data	Q4'07	Q3'08	Q4'08	YoY%	QoQ%	FY07	FY08	YoY%
(Figures in Rs. mn, except per share data)								
Net Sales	16,120	19,448	21,688	34.5%	11.5%	60,687	76,394	25.9%
EBITDA	3,474	4,331	5,084	46.3%	17.4%	12,340	16,939	37.3%
Net Profit	4,867	3,425	1,410	(71.0%)	(58.8%)	13,183	11,247	(14.7%)
Margins (%)								
EBITDA	21.6%	22.3%	23.4%			20.3%	22.2%	
NPM	30.2%	17.6%	6.5%			21.7%	14.7%	
Per Share Data (Rs.)								
EPS	7.1	5.0	2.1	(71.0%)	(59.0%)	19.5	16.6	(15.2%)

Result Highlights

Segment-wise revenue contribution



Source: Company data

CS growing robustly; Acquisition of LFS will help in improving BPO revenues

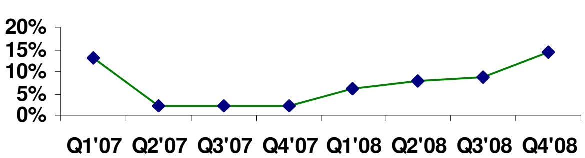
Decent growth across all segments

HCL registered an 11.5% qoq growth, driven by a robust performance across all the business segments. The Company registered a growth of 11.7% qoq to Rs. 15.9 bn for Core Software (CS), the highest in the last eight quarter. Although the net employee addition was flat for the segment, the Company gained from the strategy of output-based pricing. Besides, the infrastructure business registered a growth of 14.1% qoq to Rs. 3.3 bn, despite the reduction in material-related revenues. As there are new strategies in the infrastructure business, it sustains the growth momentum that is already there on the board. Moreover, in spite of a slowdown in the hiring, BPO grew by 7.4% qoq to Rs. 2.4 bn and registered the highest improvement in the operating margins (up 257 bps qoq) among other segments. In addition, the Company's recent acquisition of Liberata Financial Services (LFS), the UK-based BPO, will help it in growing further revenues for the segment.

Slowdown impacts BFSI

The prevailing slowdown impacted the Company's BFSI segment. Consequently, revenue contribution from financial services went down by 1.1% qoq. However, the segment registered a decent growth of 7.2% qoq in absolute terms. But the uncertainty still looms over the sustained growth in the BFSI vertical. Other than this, manufacturing, retail, and life science businesses posted a strong growth of around 16% qoq, while telecom and media & entertainment registered a decent growth of around 9% qoq.

Revenue growth in the US



Source: Company data

Revenue growth in the tough scenario

Beating the slowdown in the US

We believe that HCL has been able to successfully tackle with the slowdown in the US by capturing a fair share of the discretionary IT spends. Despite the slowdown in the US economy, HCL managed to increase its revenue contribution from the region by 1.5% qoq to 57.4%. Besides, the Company recorded a back-to-back growth of 14.5% and 9.6% qoq, respectively, in the US and the European region. However, the Company reported a fall in revenue contribution from the APAC region by 1%, but registered a modest growth of 3.8% qoq.

Key Events

- HCL signed an agreement to acquire the entire stake of Control Point Solutions (CPS) in consideration of USD 20.8 mn. As a part of the transaction, the Company will acquire four delivery centres in the US.
- The Company opened a new global development centre in Sydney, Australia, which will accommodate around 500 employees.
- HCL signed an agreement to fully acquire Liberata Financial Services (LFS), a UK-based BPO provider.
- HCL formed an alliance with the US-based Echelon Corporation to bring Echelon's advanced networked energy services metering systems to India.

Key Risks

Key concerns to our rating include:

- Currency fluctuations
- A slowdown in the US and BFSI segment
- A more-than-anticipated hike in wages
- An increase in the attrition rate.

Outlook

HCL has been able to maintain consistency in its growth over the last few years on the back of the investment made in the past, in terms of new services, new markets, and forging global partnerships. Besides, the Company's recent acquisition of LFS will help it in sustaining growth momentum in the BPO segment, while the CPS acquisition will strengthen the Company's unique advantage of providing multi-service delivery platforms for customer complementing its remote infrastructure service offering.

Taking into account a weak macroeconomic environment, we have cut down our revenue estimates by around 1.5% to 27.2% for FY09E as the Company witnessed a strong deal inflow throughout the year. Besides, we expect the billing rate to remain stable for FY09. Moreover, with a stable operating performance including the utilisation rate, attrition levels, contribution from the US, we expect margins to remain around its historical level of 22% for FY09. However, in order to explore new markets and services, SG&A might increase, which may put margins under pressure.

We believe the Company's fundamentals remain stable in the backdrop of difficult macro-economic environment. Besides, due to the stock's sharp decline of ~23% since our last update, it trades at a large discount of ~29% to the average Industry multiple. Based on DCF valuation, we have arrived at a target price of Rs. 316, assuming a Rf of 9%, terminal growth of 5%, and a WACC of 15.1%, which provides an upside of 37% over the current levels. Therefore, we maintain our Buy rating.

Key Figures (Consolidated)

Year to June	FY06	FY07	FY08	FY09E	FY10E	CAGR%
(Figures in Rs. mn, except per share data)						(FY08-10E)
Net Sales	45,716	60,687	76,394	97,210	114,582	22.5%
EBITDA	9,113	12,340	16,939	21,478	24,770	20.9%
Net Profit	6,907	13,183	11,247	17,025	18,389	27.9%
Margins(%)						
EBITDA	19.9%	20.3%	22.2%	22.1%	21.6%	
NPM	15.1%	21.7%	14.7%	17.5%	16.0%	
Per Share Data (Rs.)						
EPS	10.1	19.5	16.6	25.1	27.1	27.9%
PER (x)	32.7x	14.9x	13.9x	9.2x	8.5x	

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