

January 17, 2012

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

Rating	BUY
Price	Rs406
Target Price	Rs530
Implied Upside	30.5%
Sensex	16,189
Nifty	4,874

(Prices as on January 17, 2012)

Trading data

Market Cap. (Rs bn)	272.1
Shares o/s (m)	670.3
3M Avg. Daily value (Rs m)	575.1

Major shareholders

Promoters	64.27%
Foreign	20.51%
Domestic Inst.	6.71%
Public & Other	8.51%

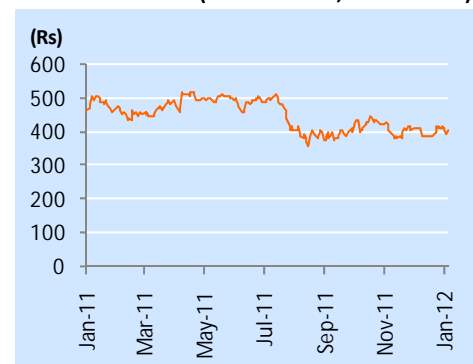
Stock Performance

(%)	1M	6M	12M
Absolute	(1.6)	(18.0)	(13.3)
Relative	(6.1)	(5.2)	0.8

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2012	35.2	32.0	10.0
2013	42.0	37.2	12.9

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



Source: Bloomberg

HCL Technologies' (HCLT's) performance was largely in-line with expectation. However, margin performance, which was better than consensus (lower than PLe), was driven by higher currency depreciation. Moreover, strong client addition, TCv in excess of US\$1bn (Infosys-US\$300m) and onsite volume growth was ahead of consensus expectation. We reiterate our **'BUY'** rating, with a target price of **Rs530**.

■ **In-line with expectation, volume growth better than peers:** HCLT reported volume growth of 4.9% QoQ (PLe: 4.2%), but better than peers (INFO: 3.1%, TCS: 3.2%). EBITDA margin expanded by 141bps (PLe: 211bps, Cons: 81bps) QoQ to 18.5% and was better than the consensus driven by currency depreciation. Moreover, onsite volume growth was 5.7% QoQ, with 36 net new client additions (highest since Q3FY09), hinting at better-than-expected H2FY12. We expect performance to get stronger in H2FY12.

■ **Deal funnel healthy – vendor churn and consolidation provide opportunity:** According to the management, in CY12, ~US\$48bn (249 deals) are up for renewal. With 30% churn in vendors, ~US\$15bn (with 20-30% discount ~US\$10bn of TCv) worth of contracts is up for grabs (50% of that is from Europe). We expect cost-conscious clients to opt for value players. We expect pricing discount compared to peers to swing deals in HCLT's favour.

■ **No-cut IT budget for CY12:** The management indicated no cuts in the IT budget from the clients. Moreover, the deal signing is likely to be weak in the JFM quarter because of the seasonality. But the deal pipeline is likely to swell towards the end of CY12. Also, the increased focus on G1000/F500 clients is likely to help weather some negative surprises. The increased offshoring from the flat IT budget is likely to drive the growth.

■ **Valuation & Recommendation – Reiterate 'BUY', with TP of Rs530:** We expect HCLT to deliver stronger-than-peer performance in FY12. We reiterate **'BUY'** rating, with a TP of **Rs530**, 13x Mar-12e earnings estimates.

Key financials (Y/e June)	2010	2011	2012E	2013E
Revenues (Rs m)	125,650	160,342	208,118	248,415
Growth (%)	18.2	27.6	29.8	19.4
EBITDA (Rs m)	25,728	27,488	38,442	43,375
PAT (Rs m)	13,001	17,099	23,608	28,169
EPS (Rs)	19.4	25.5	35.2	42.0
Growth (%)	2.2	31.5	38.1	19.3
Net DPS (Rs)	4.7	4.7	4.7	4.7

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	20.5	17.1	18.5	17.5
RoE (%)	20.4	22.2	25.0	24.1
RoCE (%)	13.1	15.4	18.8	19.8
EV / sales (x)	2.3	1.8	1.3	1.0
EV / EBITDA (x)	11.4	10.5	7.2	6.0
PE (x)	20.9	15.9	11.5	9.7
P / BV (x)	3.9	3.2	2.6	2.1
Net dividend yield (%)	1.2	1.2	1.2	1.2

Source: Company Data; PL Research

Exhibit 1: Conference call highlight

Positives	Verdict
Strong client addition of 57, with 18 multi-year multi-million dollar deals, excluding HCLT contract renewals TCV signed in the quarter exceeded \$1bn	HCLT added 57 new clients (Q1FY12: 66, Q4FY11: 70), with net new clients addition of 36 (highest ever except Q3FY09 – 39). The company managed to win 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). However, we continue to believe that the company is on the path of winning market share by displacing incumbents. 81% of total TCV signed were in BFSI, Healthcare and Manufacturing, with 57% in the US and 42% in Europe.
Total hedge book has been increased to US\$1,151m (Q1FY12: US\$713m)	The company has increased hedge book with balance sheet hedge of US\$171m (Q1FY12: US\$180m) and cash flow hedge of US\$980m (Q1FY12: US\$533m). Less than one year hedges has been increased to US\$545m (Q1FY12: US\$509m) and more than one year hedges increased to US\$435m (Q1FY12: US\$24m). Most of the increased hedge position is in USD.
Volume growth of 4.8% QoQ despite seasonally weak quarter	Although, volume growth for quarter was lower than TCS (6.25%), it was higher than Infosys (4.5%). We believe that the heightened expectation from consecutively strong quarters has raised the bar. The management has guided for soft Q1FY12.
Top 5 clients grew by 5.3% QoQ	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 5 out of 10 clients are G200. We expect the growth in top 20 clients to be more consistent, going forward. Rol of F500/G1000 clients are better.
Negatives	Verdict
Pricing decline of 1% QoQ	Despite growth from EAS (4.5% QoQ and 6.5% @cc), pricing in constant currency has been muted. Despite strong currency tailwinds, the margin expansion has been lower than Infosys and TCS. We expect pricing for HCLT to remain weak compared to peers. However, volume growth is likely to help deliver stronger growth at the bottom-line
DSO came went up to 76 days(billed receivables stable at 55 days from 53, unbilled moved up from 21 to 21 days compared to previous qtr)	We believe that the management has taken cognizant of the fact that DSO needs to better and over the last 4 quarters, improved by 1 day. We expect DSO to remain stable at this level. Moreover, current level of DSO is comparable to that of peers

Source: PL Research

Exhibit 2: In-line with expectation (Rs m)

Y/e June	Q2FY12	Q1FY12	QoQ	Q2FY11	YoY	Cons(e)	PL(e)	Var VS PL (e)
Sales (\$ m)	1,022	1002.2	2.0%	864.1	18.3%	NA	1,025.3	-0.3%
Sales	52,452	46,513	12.8%	38,884	34.9%	52,022	52,114.8	0.6%
Operating Profit	9,702	7,949	22.1%	6,347	52.9%	9,310	10,006.0	-3.0%
<i>OPM</i>	<i>18.5%</i>	<i>17.1%</i>	<i>141 bps</i>	<i>16.3%</i>	<i>217 bps</i>	<i>17.9%</i>	<i>19.2%</i>	<i>-70 bps</i>
PBT	7,638	6,699	14.0%	5,028	51.9%	6,826	7,986.1	-4.4%
Tax	1,911	1728	10.6%	1031	85.4%	1,350	2,076.4	-8.0%
<i>Tax Rate</i>	<i>25.0%</i>	<i>25.8%</i>	<i>-77 bps</i>	<i>20.5%</i>	<i>451 bps</i>	<i>19.8%</i>	<i>26.0%</i>	<i>-98 bps</i>
PAT	5,727	4,971	15.2%	3,997	43.3%	5,475	5,909.7	-3.1%
EPS	8.31	7.21	15.2%	5.73	44.9%	7.97	8.63	-3.7%
Average (USD rate)	51.33	46.4	10.6%	45.0	14.1%	NA	50.83	1.0%

Source: Company Data, Bloomberg, PL Research

Income Statement (Rs m)

Y/e June	2010	2011	2012E	2013E
Net Revenue	125,650	160,342	208,118	248,415
Raw Material Expenses	81,957	109,140	138,679	168,116
Gross Profit	43,693	51,202	69,439	80,299
Employee Cost	—	—	—	—
Other Expenses	17,965	23,714	30,997	36,924
EBITDA	25,728	27,488	38,442	43,375
Depr. & Amortization	5,009	4,974	5,882	6,299
Net Interest	—	—	—	—
Other Income	(5,302)	(561)	(657)	734
Profit before Tax	15,417	21,953	31,903	37,810
Total Tax	2,404	4,854	8,295	9,642
Profit after Tax	13,013	17,099	23,608	28,169
Ex-Od items / Min. Int.	12	—	—	—
Adj. PAT	13,001	17,099	23,608	28,169
Avg. Shares O/S (m)	670.3	670.3	670.3	670.3
EPS (Rs.)	19.4	25.5	35.2	42.0

Cash Flow Abstract (Rs m)

Y/e June	2010	2011	2012E	2013E
C/F from Operations	17,806	17,493	25,187	30,930
C/F from Investing	(11,824)	(8,017)	(9,990)	(11,676)
C/F from Financing	(5,499)	(3,149)	(9,166)	(9,166)
Inc. / Dec. in Cash	483	6,327	6,031	10,088
Opening Cash	4,203	4,686	11,013	17,044
Closing Cash	4,686	11,013	17,044	27,133
FCFF	7,540	14,071	20,400	24,968
FCFE	4,401	14,071	14,400	18,968

Key Financial Metrics

Y/e June	2010	2011	2012E	2013E
Growth				
Revenue (%)	18.2	27.6	29.8	19.4
EBITDA (%)	9.7	6.8	39.8	12.8
PAT (%)	2.2	31.5	38.1	19.3
EPS (%)	2.2	31.5	38.1	19.3
Profitability				
EBITDA Margin (%)	20.5	17.1	18.5	17.5
PAT Margin (%)	10.3	10.7	11.3	11.3
RoCE (%)	13.1	15.4	18.8	19.8
RoE (%)	20.4	22.2	25.0	24.1
Balance Sheet				
Net Debt : Equity	0.3	0.2	—	(0.1)
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	20.9	15.9	11.5	9.7
P / B (x)	3.9	3.2	2.6	2.1
EV / EBITDA (x)	11.4	10.5	7.2	6.0
EV / Sales (x)	2.3	1.8	1.3	1.0
Earnings Quality				
Eff. Tax Rate	15.6	22.1	26.0	25.5
Other Inc / PBT	(34.4)	(2.6)	(2.1)	1.9
Eff. Depr. Rate (%)	27.1	22.7	22.0	19.3
FCFE / PAT	33.9	82.3	61.0	67.3

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e June	2010	2011	2012E	2013E
Shareholder's Funds	70,352	84,025	104,467	129,470
Total Debt	26,632	26,632	20,632	14,632
Other Liabilities	7,402	7,402	7,402	7,402
Total Liabilities	104,386	118,059	132,501	151,504
Net Fixed Assets	18,486	21,944	26,731	32,693
Goodwill	43,122	42,467	41,787	41,202
Investments	707	707	707	707
Net Current Assets	32,431	43,301	53,636	67,262
<i>Cash & Equivalents</i>	<i>4,686</i>	<i>11,013</i>	<i>17,044</i>	<i>27,133</i>
<i>Other Current Assets</i>	<i>59,074</i>	<i>80,391</i>	<i>96,461</i>	<i>104,785</i>
<i>Current Liabilities</i>	<i>31,329</i>	<i>48,103</i>	<i>59,870</i>	<i>64,656</i>
Other Assets	9,640	9,640	9,640	9,640
Total Assets	104,386	118,059	132,501	151,504

Quarterly Financials (Rs m)

Y/e June	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	41,382	42,995	46,513	52,452
EBITDA	7,165	7,942	7,949	9,702
<i>% of revenue</i>	<i>17.3</i>	<i>18.5</i>	<i>17.1</i>	<i>18.5</i>
Depr. & Amortization	1,046	1,121	1,178	1,178
Net Interest	—	—	—	—
Other Income	15	154	59	846
Profit before Tax	5,982	6,808	6,699	9,253
Total Tax	1,300	1,699	1,728	1,911
Profit after Tax	4,682	5,109	4,971	7,342
Adj. PAT	4,682	5,109	4,971	7,342

Key Operating Metrics

Y/e June	2010	2011	2012E	2013E
Volume (persons months)	305,662	398,854	470,648	550,658
Pricing (US\$ / Hr)	35.7	35.9	36.1	36.5
Currency (INR/USD)	46.5	45.3	49.5	50.0
SW. Devp. Cost (% of sales)	65.2	68.1	66.6	67.7
SG&A (% of sales)	14.3	14.8	14.9	14.9
Revenue (US\$ m)	2,705	3,545	4,204	4,968
EBITDAM Expansion/(Erosion) (bps)	(159)	(333)	133	(101)
Tax Rate (%)	15.6	22.1	26.0	25.5

Source: Company Data, PL Research.

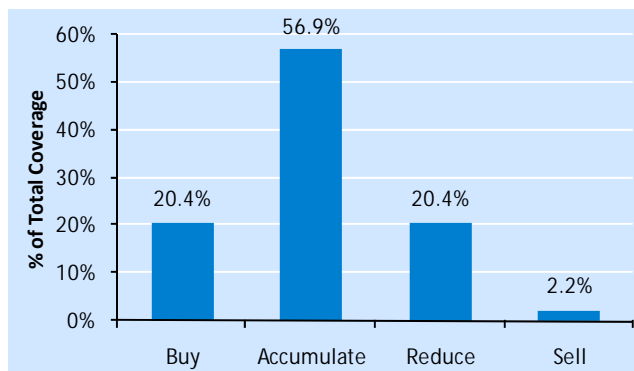


Prabhudas Lilladher Pvt. Ltd.

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

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