

**HCL Technologies**Rs301  
**OUTPERFORMER**

## RESULT NOTE

Mkt Cap: Rs210bn; US \$5bn

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**Result:** Q3FY07

**Comment:** Results beat modest expectations

**Last report:** 08 January 2007 (Price Rs288; Recommendation: Outperformer)

## Key financials

Year end 31 June (Rs mn)	Net Sales	% Change yoy	Net Profits	EPS (Rs)	% Change yoy	PER(x)
2006	44,007	30.6	7,746	12.1	26.9	25.0
2007E	61,141	38.9	11,244	16.3	35.2	18.5
2008E	78,326	28.1	13,711	19.6	20.6	15.3
2009E	96,765	23.5	16,670	23.6	20.2	12.8

HCLT's Q3FY07 results were ahead of street expectations both revenue growth (7.6% qoq) as well as EBITDA margin expansion (+120bp). While the volume growth in core software business was muted at 3.9% qoq (7.1% qoq) the overall revenue growth of 7.6% qoq was driven by a seasonally strong quarter for BPO services. Though, the contribution of BPO services in revenues grew to 13.7% of overall revenues from 12.7% in the previous quarter, the share at the EBITDA level rose to 15.7% from 13.1% in the previous quarter. Employee addition in core software at 1,273 was higher than the 580 in the previous quarter. It announced 6 large deal wins for the quarter but the number of million dollar clients only increased from 145 to 147. We believe, the overall performance seems better since expectations were quite modest. We are raising our earnings forecast by 8.3% and 13.6% for FY07E (June year-end) and FY08 respectively. On the revised forecast, it is trading at 15.3x FY08 and 12.8x FY09 earnings, which is a 15% discount to Satyam (results yet to be announced). Given that expectations were low, the results surprised positively and valuations appear attractive. We maintain Outperformer.

#### □ Revenues grew 7.6% qoq, EBITDA margin improved 120bp qoq

HCL Tech has reported revenues of Rs15.77bn in Q3FY07 (up 7.6% qoq in rupee terms and 9.5% in \$ terms) – much higher than our estimate of a 4.8% rise. Core software services (72% of revenues) witnessed an increase of 6.4% qoq. Infrastructure services (14%) grew 6.5% qoq. Overall growth was driven by a sharp 16.4% qoq growth in BPO (14% of revenues). About 56% of the overall growth was accounted by increase in efforts, 21% was on account of better realization, 13% was due to higher offshore share and 10% was from bonus and expense reimbursements.

EBIT margins increased by 120bp to 19.1% on account of lower SG&A (+72bp impact), lower depreciation (+10bp), higher realization (+75bp) and better utilization (+29bp). The impact of which was partly offset by rupee appreciation (-54) and increments given in BPO (-15bp). Company informed that 1% rupee appreciation impacts EBIT margins by 35bp. EBIT increased by 14.9% qoq to Rs3bn.

Foreign exchange gain of Rs418m (against Rs347m in last quarter) coupled with higher other income (Rs197m against Rs134m in last quarter) resulted in 16% qoq growth in PAT to Rs3bn against 14.9% qoq growth in EBIT. Tax rate was higher at 7.8% v/s 6.6% last quarter.

### ❑ Core software services – good expansion in margins.

Core software services division reported a growth of 6.4% qoq (8.1% in USD terms) in Q3FY07 to Rs11.4bn – the \$ terms growth was driven by volume growth of 3.9% qoq, better realization (+1.7% impact), change in mix to onsite (1.7%), and other non effort based reasons (0.8%).

EBIT margins improved by 80bp qoq on account of higher utilization (20bp impact), higher realization (74bp), lower SG&A (50bp); partly offset by rupee appreciation (-64bp). Utilization including trainee (offshore) increased to 69.8% from 69.4% in last quarter, while onsite utilization increased to 95.6% from 95.2% in last quarter. Onsite revenues increased to 52.3% of total during Q3FY07 from 51% in last quarter.

Employee base increased by 1,273 to 23,796 (+28% yoy) in the quarter.

### ❑ BPO – blockbuster quarter

BPO witnessed a sharp revenue growth of 16.4% qoq (18.4% in USD terms) – revenue increased to Rs2.16bn. The \$ terms revenue growth was underpinned by 7% effort based growth, better utilization (4%), improved realization (4.8%) and non effort based reasons like bonus etc (2.6%). Manpower increased only by 173 people – a 7.2% growth on average basis.

EBIT margins increased by 490bp to 19.7% driven by better utilization (+160bp impact), improved realization (+197bp), SG&A leverage (+207bp); partly offset by rupee appreciation (-37bp) and increments given in Jan 07 (-100bp).

Employee base increased by 173 in the quarter to 12,354 (39% increase yoy).

### ❑ Infrastructure services business– margin improvement continues

Infrastructure services witnessed a moderate growth of 6.5% qoq (8.2% in USD terms) – revenues increased to Rs2.19bn. The \$ terms revenue growth was driven by 7.3% increase in efforts.

EBIT margins increased by 20bp to 12.1% on account of SG&A leverage (+120bp) getting partly offset by decrease in utilization (-100bp).

Employee base increased by 386 in the quarter to 3,999 (+65% yoy).

## OTHER HIGHLIGHTS

- Net addition of 2,832 employees, of which 1,273 in software services, 173 added in BPO and 386 in Infrastructure services.
- Total manpower (including subsidiaries) stands at 40,149, up from 38,317 in the previous quarter. In Q3FY07, 23,796 employees were employed in software services, 12,354 in BPO, and 3,999 in infrastructure services.
- Cash and cash equivalent including treasury investments at Rs20,893m (~Rs30 per share). Unrealized gains on treasury investments at Rs789m as on 31 March 2007.
- Quarterly dividend payout of another 200%. Dividend yield is 2.7%.
- Revenue contribution of 47.7% from offshore business compared to 49% of revenues in the previous quarter.
- Non-cash stock option charge (not included in the results) of Rs308m for Q3FY07.
- Attrition (LTM excluding involuntary attrition) at 17.5% in the quarter against 17.8% in the previous quarter in software services, 16.4% in infrastructure services (16.8%), and 19.5% in BPO (18.9%).
- Revenue contribution from top 5 clients declined to 29.2% from 29.7% in the last quarter, while top 10 and top 20 clients declined from 39% and 51.5% to 38.5% and 50.9%, respectively.
- \$1m+ clients increased from 145 to 147 during the quarter, \$20m+ clients increased from 8 to 10 and \$30m+ clients increased from 4 to 5.

## Valuations and view

HCLT's Q3FY07 results were ahead of street expectations both revenue growth (7.6% qoq) as well as EBITDA margin expansion (+120bp). While the volume growth in core software business was muted at 3.9% qoq (7.1% qoq) the overall revenue growth of 7.6% qoq was driven by a seasonally strong quarter for BPO services. Though, the contribution of BPO services in revenues grew to 13.7% of overall revenues from 12.7% in the previous quarter, the share at the EBITDA level rose to 15.7% from 13.1% in the previous quarter. Employee addition in core software at 1,273 was higher than the 580 in the previous quarter. It announced 6 large deal wins for the quarter but the number of million dollar clients only increased from 145 to 147. We believe, the overall performance seems better since expectations were quite modest. We are raising our earnings forecast by 8.3% and 13.6% for FY07E (June year-end) and FY08 respectively. On the revised forecast, it is trading at 15.3x FY08 and 12.8x FY09 earnings, which is a 15% discount to Satyam (results yet to be announced). Given that expectations were low, the results surprised positively and valuations appear attractive. We maintain Outperformer.

### Change in earning estimates

	Old			New		
	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Revenues (Rs m)	59,738	74,081	90,977	61,141	78,326	96,765
Revision (%)				2.3	5.7	6.4
EPS (Rs)	15.0	17.3	20.3	16.3	19.6	23.6
Revision (%)				8.3	13.6	16.0

### Quarterly results

(Rs m)	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	FY06	FY07E
<b>Revenues</b>	<b>11,220</b>	<b>12,538</b>	<b>13,795</b>	<b>14,651</b>	<b>15,771</b>	<b>44,007</b>	<b>61,141</b>
Direct costs	6,978	7,946	8,708	9,107	9,738	27,579	37,963
Gross Profits	4,242	4,592	5,087	5,544	6,033	16,428	23,178
SG&A	1,744	1,777	2,098	2,303	2,366	6,580	9,337
<b>EBDITA</b>	<b>2,498</b>	<b>2,815</b>	<b>2,989</b>	<b>3,241</b>	<b>3,667</b>	<b>9,848</b>	<b>13,841</b>
Other Income Net	268	222	278	134	197	919	909
Foreign Exchange gains	(13)	(166)	12	347	418	(341)	1,227
Depreciation & ammortisation	530	562	557	623	659	2,032	2,577
PBT	2,223	2,309	2,722	3,099	3,623	8,394	13,401
Provision for tax	277	(23)	219	206	283	626	1,025
Profit	1,946	2,332	2,503	2,893	3,340	7,768	12,376
Share from equity invest.	(6)	7	4	(7)	(3)	(6)	(9)
Minority Interest	(11)	(8)	(5)	(23)	(20)	(16)	(68)
<b>PAT (before stock option charges)</b>	<b>1,929</b>	<b>2,331</b>	<b>2,502</b>	<b>2,863</b>	<b>3,317</b>	<b>7,746</b>	<b>12,299</b>
<b>QoQ Growth(%)</b>							
Revenues	6.4	11.7	10.0	6.2	7.6		
EBIDTA	5.1	12.7	6.2	8.4	13.1		
PAT	6.5	20.8	7.3	14.4	15.9		
<b>YoY Growth(%)</b>							
Revenues	30.7	35.2	42.1	39.0	40.6	30.6	38.9
EBIDTA	27.9	33.3	38.5	36.3	46.8	27.5	40.6
PAT	22.6	43.9	49.4	58.1	72.0	26.9	58.8
<b>Operational Parameters</b>							
EBIDTA Margins(%)	22.3	22.5	21.7	22.1	23.3	22.4	22.6
Net Margins(%)	17.2	18.6	18.1	19.5	21.0	17.6	20.1
Tax Rate(%)	12.5	-1.0	8.0	6.6	7.8	7.5	7.6

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