

16th April 2008**BUY**

Price	Target Price
Rs 245	Rs 345

Sensex	16,154
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Price Performance

(%)	1M	3M	6M	12M
Absolute	(8)	(14)	(19)	(21)
Rel. to Sensex	(10)	11	(5)	(33)

Source: Capitaline

Stock Details

Sector	IT Services
Reuters	HCLT.BO
Bloomberg	HCLT@IN
Equity Capital(Rs mn)	1330
Face Value(Rs)	2
52 Week H/L	366/180
Market Cap(Rs bn//US\$ mn)	163/4,078
Daily Avg Volume (No of shares)	999169
Daily Avg Turnover (US\$)	6.5

Shareholding Pattern (%)

(31 st Dec'07)	
Promoters	67.5
FII/NRI	18.1
Institutions	6.0
Private Corp.	2.8
Public	5.6

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HCL TechnologiesResult
Update**On song for FY08; See some red flags for FY09**

HCL Technologies reported revenues of US\$ 485 mn (+5.2% QoQ), Rs 19.4 bn (+7.1% sequential growth), ahead of expectations. EBITDA margins were up ~100 bps QoQ (**V/s our expectations of flat margins sequentially**) while adjusted net profits came in significantly higher than expectations at Rs 3.2 bn (+3.8% QoQ), helped by higher operating margins and lower forex losses (**our assumption of ~Rs 350 mn of forex losses V/s reported losses of ~Rs 271 mn**). Revenues in IMS and BPO were muted at <2% QoQ growth (**Infrastructure revenues ex H/W sales increased by ~11.5% sequentially**) while Core Software exhibited 6.5% QoQ growth. DSO days moved up from 72 days at the end of Dec quarter to 77 days at the end of March quarter. (**we note that the two majors to report numbers until now, both Infosys and HCL Tech have reported increase in DSO days**). The employee addition during the quarter was 1,848 (Core S/w reported a net decline of 97 employees) with the company cutting down the net addition target for FY08 from 12,000 to 9,000 (**employee addition during 9MFY08 is ~7,800**) The company indicated that it was on track to achieve 35% revenue growth target for FY08 (**implied June quarter growth of ~3.3%**), however FY09 could be slightly challenging on account of budget freezes at 2 major BFSI clients (**which could impact both Core S/w and IMS growth during the next few quarters, with some concern on FY09 growth supported further by lower employee addition target**). We note that HCL Tech is the cheapest large cap IT services stocks at 11.7x FY09E adjusted earnings of Rs 21 (**with further support from ~3.3% dividend yield**), **thereby we see a limited downside from current levels and would be buyers on any signs of weakness.**

In Rs mn	Q3FY08	Q2FY08	QoQ(%)	Q3FY07	YoY (%)
Net sales	19,449	18,166	7.1%	15,770	23.3%
Total Income	19,449	18,166		15,770	
Operating expenses	15,337	14,521		12,416	
EBITDA	4,112	3,645	12.8%	3,354	22.6%
Margins (%)	21.1	20.1		21.3	
Depreciation	773	723		658	
EBIT	3,339	2,922	14.3%	2,696	23.8%
Margins (%)	17.2	16.1		17.1	
Other income	228	542		615	
Pre-tax profit	3,567	3,464	3.0%	3,311	7.7%
Tax provided	364	355		274	
Profit after tax	3,203	3,109		3,037	
Emkay Net profit	3,206	3,088	3.8%	3,014	6.4%
EPS, Rs	4.8	4.7		4.6	

Source: Company, Emkay Research

Other result highlights**Revenues grow by 5.2% QoQ, margins expand by ~100 bps**

HCL Tech reported revenues of US\$ 485 mn (+5.2% QoQ), a tad ahead of expectations. The EBITDA margins (including ESOP charge) expanded sequentially by ~100 bps to 21.1% driven by margin expansion of ~90 bps in both Core S/W as well as IMS businesses. We note that a favorable Rs movement along with higher offshore mix and SG&A leverage has contributed to higher operating margins..

Core S/W growth remains in line, IMS and BPO growth remains muted.

Core S/w revenues grew by 6.5% QoQ, slightly higher than expectations however the BPO and IMS revenue growth remained muted at <2% QoQ. The IMS revenues (ex H/W sales) grew by 11.4%. Although the core s/w revenue growth during the quarter was strong we note that volume growth at 5.3% QoQ was the lowest in the past 4 quarters. Besides the budget freeze in 2 of the major BFSI clients could impact revenues in Core Software and IMS over the next few quarters.

Revenues(in US\$ mn)	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08	Q3FY08
Core Software services	242.7	262.4	282.4	309.1	334.9	356.8
QoQ growth, %		8.1	7.6	9.5	8.3	6.5
IMS	46.4	50.2	59.3	64.7	70.6	71.7
QoQ growth, %		8.2	18.1	9.1	9.1	1.6
BPO	42	49.7	54	55.1	55.4	56.5
QoQ growth, %		18.3	8.7	2.0	0.5	2.0
Overall Revenues	331.1	362.3	395.7	428.9	460.9	485.0
QoQ growth, %		9.4	9.2	8.4	7.5	5.2

Source: Company, Emkay Research

US revenues continue to be strong, BFSI, Enterprise Apps disappoint

Revenues from the US grew by 7% QoQ during the quarter however the revenues from the BFSI and Enterprise applications registered sequential growths of only ~2.3% and 1.4% respectively. The company indicated that revenues from the BFSI vertical could continue to face near term pressures as 2 of the BFSI clients have frozen their budget spend.

(in US\$ mn)	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08	Q3FY08
US	189.7	196.7	214.5	232.5	253.5	271.1
QoQ growth, %	5.9%	3.7%	9.0%	8.4%	9.0%	7.0%
BFSI	90.1	99.6	113.6	123.1	134.6	137.7
QoQ growth, %	31.4%	10.6%	14.0%	8.4%	9.3%	2.3%
Enterprise Apps	42.0	47.8	47.5	50.6	51.2	51.9
QoQ growth, %	2.1%	13.7%	-0.7%	6.6%	1.1%	1.4%

Source: Company, Emkay Research

Net profits up 3.8% QoQ; higher than expectations

HCLT reported adjusted net profits of Rs 3206 mn (adjusted for ESOP charge of US\$ 5.5 mn), higher than our expectations (we were expecting a QoQ decline) on account of higher operating margins and lower than anticipated forex losses (we estimates forex losses of ~Rs 350 mn, reported losses of only ~Rs 270 mn)

Maintains 35% revenue growth for FY08E, non committal on FY09E

HCLT management during the investor call maintained of a 35% growth in revenues for FY08 (**implying a mere 3.3% growth for the June quarter, we note that this also includes a 0.5% kicker from the contribution of Capital Stream**). Though the management commentary along with deal wins of ~ US\$ 500 mn of deals won during the quarter are confident signals, the implied muted growth for the June quarter accompanied by the fact that the employee addition target for FY08 has been reduced to 9,000 from 12,000 earlier, (**the management attributed it to lower attrition and higher employee productivity**) are a little cause of concern. We believe that HCLT's lower employee addition target as well as the budget freeze at 2 Top 10 BFSI clients could impact near term fortunes.

..but aren't valuations not already discounting that?

We have revised our FY09E earnings by ~3% to factor in a slower H1FY09 (*in line with our assumptions for the sector as a whole*) as well as change our exchange rate assumption to Rs 39/\$ (*as against Rs 38/\$ earlier*).

However we note that despite some near term concerns on our mind, at CMP of Rs 245, HCL Tech is quoting at <12x on FY09E earnings with further comfort in the form of 3.3% dividend. We maintain our 'BUY' rating with a revised price target of Rs 345, based on 15x FY10E earnings of Rs 23.

Our revised earnings estimates

(All fig in Rs mn except EPS)	FY09E			FY10E		
	Old	New	% change	Old	New	% change
Revenues	93287	89064	-4.5%	113354	108821	-4.0%
EBITDA	18883	18247	-3.7%	22886	22085	-3.5%
Net profits	14627	14354	-1.8%	17095	16454	-3.7%
EPS	21.4	21	-1.8%	24	23.1	-3.7%

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