

HCL Technologies Ltd.

Accumulate
Current Price: Rs290
Target price: Rs346
Quarterly Performance

| Y/E to 30 th June | FY06 | | | | FY07 | | | | (Rs mn) | |
|------------------------------|-------|--------|--------|--------|--------|--------|--------|--------|---------|--------|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | FY07 | FY08E |
| Net Sales | 9,707 | 10,542 | 11,220 | 12,538 | 13,795 | 14,651 | 15,771 | 16,120 | 60,336 | 78,953 |
| Change % (QoQ) | | 8.6 | 6.4 | 11.7 | 10.0 | 6.2 | 7.6 | 2.2 | - | - |
| Change % (YoY) | 24.1 | 31.5 | 30.7 | 35.2 | 42.1 | 39.0 | 40.6 | 28.6 | 37.5 | 30.9 |
| Total Expenditure | 7,549 | 8,165 | 8,722 | 9,723 | 10,806 | 11,410 | 12,104 | 12,646 | 46,967 | 61,712 |
| EBITDA | 2,158 | 2,377 | 2,498 | 2,815 | 2,989 | 3,241 | 3,667 | 3,474 | 13,369 | 17,241 |
| EBITDA margin (%) | 22.2 | 22.5 | 22.3 | 22.5 | 21.7 | 22.1 | 23.3 | 21.6 | 22.2 | 21.8 |
| Change % (QoQ) | | 10.1 | 5.1 | 12.7 | 6.2 | 8.4 | 13.1 | -5.3 | - | - |
| Change % (YoY) | 19.2 | 28.8 | 27.9 | 33.3 | 38.5 | 36.3 | 46.8 | 23.4 | 37.8 | 29.0 |
| Depreciation | 447 | 494 | 530 | 562 | 557 | 623 | 659 | 693 | 2,536 | 3,288 |
| EBIT | 1,711 | 1,883 | 1,968 | 2,253 | 2,432 | 2,618 | 3,008 | 2,781 | 10,833 | 13,953 |
| EBIT margin (%) | 17.6 | 17.9 | 17.5 | 18.0 | 17.6 | 17.9 | 19.1 | 17.3 | 18.0 | 17.7 |
| Other Income/(expenses), Net | 154 | 276 | 268 | 222 | 278 | 134 | 197 | 369 | 4,424 | 1,579 |
| PBT | 1,729 | 1,867 | 2,036 | 2,110 | 2,520 | 2,833 | 3,318 | 5,456 | 15,258 | 15,532 |
| Tax | 169 | 203 | 277 | (23) | 219 | 206 | 283 | 777 | 1,520 | 1,689 |
| Effective tax rate (%) | 9.8 | 10.9 | 13.6 | -1.1 | 8.7 | 7.3 | 8.5 | 14.2 | 10.0 | 10.9 |
| Extraordinary exp/(Inc) | | | | | | | | | | |
| PAT | 1,560 | 1,664 | 1,759 | 2,133 | 2,301 | 2,627 | 3,035 | 4,679 | 12,770 | 12,869 |
| PAT margin (%) | 16.1 | 15.8 | 15.7 | 17.0 | 16.7 | 17.9 | 19.2 | 29.0 | 21.2 | 16.3 |
| Change % (QoQ) | | 6.7 | 5.7 | 21.3 | 7.9 | 14.2 | 15.5 | 54.2 | - | - |
| Change % (YoY) | -16.0 | 7.4 | 16.0 | 29.5 | 47.5 | 57.9 | 72.5 | 119.4 | 96.4 | 0.8 |
| Adjusted PAT | 1,569 | 1,651 | 1,742 | 2,132 | 2,300 | 2,597 | 3,012 | 4,669 | 12,705 | 12,797 |
| Adj PAT margin (%) | 16.2 | 15.7 | 15.5 | 17.0 | 16.7 | 17.7 | 19.1 | 29.0 | 21.1 | 16.2 |
| Change % (QoQ) | | 5.2 | 5.5 | 22.4 | 7.9 | 12.9 | 16.0 | 55.0 | - | - |
| EPS | 2.5 | 2.6 | 2.7 | 3.3 | 3.6 | 4.0 | 4.6 | 7.0 | 19.5 | 19.4 |
| Adj EPS | 2.5 | 2.6 | 2.7 | 3.1 | 3.4 | 3.8 | 4.4 | 6.8 | 18.8 | 18.7 |

* Numbers below operating line reflect the ESOP charges.

| Key data | | | |
|-------------------------------|---------------------|-----------|--------|
| Sector | IT | | |
| Market Cap | Rs192bn / US\$4.6bn | | |
| 52 Wk H/L (Rs) | 366/271 | | |
| Avg. daily vol. (6 month) | 1,373,015 | | |
| BSE Code | 532281 | | |
| NSE Code | HCLTECH | | |
| Bloomberg | HCLT@IN | | |
| Reuters | HCLT.BO | | |
| Sensex | 13,989 | | |
| Nifty | 4,075 | | |
| Shareholding pattern (%) | | | |
| | 31-Dec-06 | 31-Mar-07 | |
| FII's NRI, ADR/GDR | 16.7 | 16.6 | |
| MFs and institutions | 7.5 | 6.0 | |
| Promoters | 69.0 | 67.6 | |
| Others | 6.7 | 9.9 | |
| Absolute returns (%) | | | |
| | 1 mth | 3 mth | 12 mth |
| HCL TECH | (11.2) | (17.0) | (0.8) |
| Sensex | (10.1) | (3.0) | 21.5 |
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| +91 22 6655 0116 | | | |

Financial highlights

The results were broadly in line with the Street's expectations

- Net Sales** grew 2.2% QoQ and 28.6% YoY to Rs16.12bn. The QoQ topline growth was driven by a 6.6% volume growth, 1.7% improvement in the billing rates and 0.9% non effort revenue. This was partially offset by a ~7% appreciation in INR vis-à-vis USD.
- EBITDA** margins decline by 170bps QoQ to 21.6% from 23.3%. Cost of revenue increased by 3.1%, operating expenses increased by 10.2% leading to a decline of 5.3% in the EBITDA. The Rupee appreciation and lower margin business hurt margins by 300bps which was partially offset by better utilizations & better realizations.
- Adj. PAT** margins for Q4FY07 came in at 29.0% compared to 19.1% in Q3FY07 and 17% in Q4FY06. This expansion in the Net profit margin was because of the Rs2,504mn that the company earned as the foreign exchange gains. These gains mean that the headline growth in EPS in FY08 looks low. Real growth however will be 24%.

Other business highlights

Figure 1: Segment Highlights

| (Rs mn) | Q1FY05 | Q2FY05 | Q3FY05 | Q4FY05 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Core Software- Revenue | 6,348 | 6,286 | 6,494 | 7,072 | 7,434 | 8,001 | 8,348 | 9,301 | 10,206 | 10,739 | 11,421 | 11,505 |
| IMS- Revenue | 606 | 667 | 827 | 951 | 969 | 1,202 | 1,307 | 1,565 | 1,825 | 2,053 | 2,186 | 2,417 |
| BPO- Revenue | 948 | 1,094 | 1,290 | 1,291 | 1,307 | 1,339 | 1,565 | 1,672 | 1,763 | 1,859 | 2,164 | 2,198 |
| Company Revenue | 7,902 | 8,047 | 8,611 | 9,314 | 9,710 | 10,542 | 11,220 | 12,538 | 13,794 | 14,651 | 15,771 | 16,120 |
| QoQ Growth (%) | | | | | | | | | | | | |
| Core Software- Revenue | 6.0 | -1.0 | 3.3 | 8.9 | 5.1 | 7.6 | 4.3 | 11.4 | 9.7 | 5.2 | 6.4 | 0.7 |
| IMS- Revenue | -13.9 | 10.1 | 24.0 | 15.0 | 1.9 | 24.0 | 8.7 | 19.7 | 16.6 | 12.5 | 6.5 | 10.6 |
| BPO- Revenue | 10.2 | 15.4 | 17.9 | 0.1 | 1.2 | 2.4 | 16.9 | 6.8 | 5.4 | 5.4 | 16.4 | 1.6 |
| Company Revenue | 4.6 | 1.8 | 7.0 | 8.2 | 4.3 | 8.6 | 6.4 | 11.7 | 10.0 | 6.2 | 7.6 | 2.2 |
| Segment Contribution to Revenue (%) | | | | | | | | | | | | |
| Core Software | 80.3 | 78.1 | 75.4 | 75.9 | 76.6 | 75.9 | 74.4 | 74.2 | 74.0 | 73.3 | 72.4 | 71.4 |
| IMS | 7.7 | 8.3 | 9.6 | 10.2 | 10.0 | 11.4 | 11.6 | 12.5 | 13.2 | 14.0 | 13.9 | 15.0 |
| BPO | 12.0 | 13.6 | 15.0 | 13.9 | 13.5 | 12.7 | 13.9 | 13.3 | 12.8 | 12.7 | 13.7 | 13.6 |
| EBIT Margins (%) | | | | | | | | | | | | |
| Core Software- EBIT | 20.8 | 20.3 | 20.0 | 18.9 | 19.0 | 19.3 | 19.8 | 19.8 | 19.2 | 19.5 | 20.3 | 18.2 |
| Infrastructure- EBIT | 5.9 | 6.6 | 5.7 | 5.9 | 6.6 | 7.7 | 7.7 | 10.5 | 11.7 | 11.9 | 12.0 | 11.3 |
| BPO- EBIT | 14.2 | 15.0 | 15.2 | 19.8 | 18.0 | 18.6 | 13.6 | 14.9 | 14.6 | 14.8 | 19.7 | 19.2 |
| Company EBIT Margin | 19.1 | 18.5 | 18.0 | 17.8 | 17.6 | 17.9 | 17.5 | 18.0 | 17.6 | 17.9 | 19.1 | 17.3 |
| Segment Contribution to EBIT (%) | | | | | | | | | | | | |
| Core Software | 88.5 | 86.0 | 84.2 | 81.0 | 82.5 | 81.8 | 84.0 | 81.6 | 80.6 | 80.1 | 77.1 | 75.1 |
| IMS | 2.4 | 3.0 | 3.0 | 3.4 | 3.7 | 4.9 | 5.1 | 7.3 | 8.8 | 9.4 | 8.7 | 9.8 |
| BPO | 9.0 | 11.1 | 12.7 | 15.5 | 13.7 | 13.2 | 10.8 | 11.1 | 10.6 | 10.5 | 14.2 | 15.1 |

Source: Company

- **Core Software**

- ☞ In Q4FY07, core software revenue was Rs11.51bn and the QoQ growth was almost flat. The Core software business contributed 71.4% to the company's topline. The segment reported EBIT margin of 18.2% (declined by 210bps QoQ). Core Software's contribution to the topline and EBIT has declined over last 12 quarters mainly as the other segments viz. Infrastructure Management Services and BPO are picking up.
- ☞ The Company added a net of 2,530 employees taking its employee headcount to 26,326.
- ☞ Attrition rates declined slightly to 17.3% from 17.5% in the last quarter.

- **Infrastructure Management Services (IMS)**

- ☞ IMS revenue has grown at a quarterly annualized CAGR of 48% in last 12 quarters from Rs606mn in Q1FY05 to Rs2,417mn in Q4FY07. Its contribution to HCLT's topline has increased to 15% from 7.7% in Q1FY05. This segment has also witnessed an improvement in EBIT margins from 5.9% in Q1FY05 to 11.3% in Q4FY07. This improvement in the EBIT margin was due improvements in the S, G&A expenses. IMS' contribution to the company's EBIT has increased from 2.4% in Q1FY05 to 9.8% in Q4FY07.
- ☞ **HCL Tech's IMS practice is the third largest (by revenue size) among the top 5 Indian IT services vendor**

Figure 2: Technology Infrastructure Services- Revenue: A Comparison

| IMS Business Contribution | Q1FY05 | Q2FY05 | Q3FY05 | Q4FY05 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 | Q1FY08 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Infosys | NA | NA | NA | NA | NA | NA | NA | NA | 4.1% | NA | NA | 4.8% | 5.1% |
| TCS | NA | NA | NA | NA | NA | 4.1% | 13.4% | 13.4% | 6.8% | 6.0% | 5.5% | 6.0% | 5.7% |
| Satyam | 4.2% | 4.3% | 4.1% | 4.0% | 4.2% | 3.9% | 4.1% | 3.7% | 5.2% | 5.2% | 3.9% | 4.0% | 4.9% |
| Wipro Technologies | 6.0% | 6.3% | 7.9% | 7.6% | 7.7% | 8.0% | 8.5% | 8.5% | 9.6% | 10.0% | 11.1% | 11.5% | 11.1% |
| HCL Tech * | 9.3% | 7.7% | 8.3% | 9.6% | 10.2% | 10.0% | 11.4% | 11.6% | 12.5% | 13.2% | 14.0% | 13.9% | 15.0% |
| IMS Business Revenue (\$mn) | | | | | | | | | | | | | |
| Infosys | NA | NA | NA | NA | NA | NA | NA | NA | 27 | NA | NA | 41 | 47 |
| TCS | NA | NA | NA | NA | NA | 28 | 97 | 89 | 61 | 59 | 61 | 72 | 74 |
| Satyam | 10 | 11 | 8 | 9 | 10 | 10 | 12 | 11 | 17 | 18 | 15 | 16 | 22 |
| Wipro Technologies | 18 | 21 | 28 | 28 | 31 | 34 | 40 | 44 | 52 | 59 | 71 | 79 | 81 |
| HCL Tech * | 15 | 13 | 15 | 19 | 22 | 22 | 27 | 29 | 34 | 40 | 46 | 50 | 59 |

* HCL Tech numbers are from Q4FY04 to Q4FY07. HCL Tech year end is 30th of June.

Source: Company, Religare Institutional Equity Research

Wipro Technologies followed by TCS are the clear leaders in the Infrastructure Management Services (IMS)/ Technology Infrastructure Services (TIS) with revenues for the recent ended quarter at \$81mn and \$74mn respectively. HCL Tech is with revenue of \$59mn in Q4FY07. Satyam's IMS comes in last with revenue of \$22mn in Q1FY08 which contributes 4.9% to its topline.

In the last 7 quarters, HCL Tech's and TCS' IMS revenue have grown at the highest quarterly annualized CAGR of 61% each where as Wipro and Satyam IMS revenues have grown at 52% and 46% respectively.

• Business Process Outsourcing

HCL Tech's BPO business has grown at a quarterly annualized growth rate of 37% since last 3 years. While its contribution to the company's topline has been in the range of 12-15%, its contribution to EBIT has significantly increased from 9% in Q1FY05 to 15% in Q4FY07. This was due to the fact that the HCLT BPO EBIT margin has improved significantly by 500bps to 19.2% in Q4FY07 from 14.2% in Q1FY05.

Figure 3: BPO Businesses- A Comparison

| (US\$ mn) | Q1FY05 | Q2FY05 | Q3FY05 | Q4FY05 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 | Q1FY08 |
|--------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Infosys | 7 | 9 | 12 | 14 | 18 | 20 | 22 | 24 | 28 | 34 | 41 | 45 | 50 |
| TCS | NA | NA | NA | NA | NA | 9 | 9 | 9 | 51 | 57 | 64 | 72 | 77 |
| Wipro Technologies | 31 | 37 | 40 | 41 | 43 | 41 | 43 | 47 | 45 | 49 | 53 | 59 | 64 |
| HCL Tech * | 19 | 21 | 25 | 29 | 30 | 30 | 30 | 35 | 36 | 38 | 42 | 50 | 54 |

* HCL Tech numbers are from Q4FY04 to Q4FY07. HCL Tech year end is 30th of June.

Source: Company, Religare Institutional Equity Research

Infosys and TCS have been the fastest growing companies in the last 7 quarters in the business. In the same period, TCS, Infosys, HCL Tech and Wipro Technologies have grown at a quarterly annualized CAGR of 148%, 54%, 36% and 26% respectively. A part of TCS' rapid growth can be attributed to the inorganic growth strategies that it has adopted in the last several quarters. In terms of size TCS continues to be the largest, followed by Wipro Technologies and HCLTech.

Future outlook

- We believe that Infrastructure Management Services business is the big opportunity in the coming years. HCL Tech has a significant presence in IMS and we believe IMS along with BPO will drive the business at HCL Tech in the coming years. Core Software will however continue to contribute the highest portion of the revenue.
- HCLT's initiatives of focusing on multi-year, multi-services large deals, risk-reward pricing models and its positioning as the Complete Services Outsourcing vendor seem to be working well HCL Tech. This is quite evident from the fact that HCLT has been able to crack 7 deals in Q4FY07 and some deals in the recent past as well.
- Demand continues to be robust. For the first time, the company has guided for the first time 30% growth in revenue USD terms. The company expects margins to be almost flat. Infrastructure Services and BPO continue to be the growth areas.
- We have estimated that Net Sales and diluted EPS for HCL Technologies to be Rs78.95bn and Rs18.8 for FY08. The EBIDTA margin estimates for FY08 are 21.8%. Margins will be under pressure due to salary hikes and continued higher spending on S, G&A expenses. Q1FY08 will be weaker as the company gives the salary hikes in this quarter. Also, due to company's reverse hedging policy, the company may suffer hedging losses if the INR depreciation continues.

Valuations and Recommendation

- **HCLTech Net sales growth lower than Industry; Market Share[®] has declined**

Figure 4: US\$ Revenues

| (US\$ mn) | FY01 | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 | CAGR 01-07 |
|---|--------------|--------------|--------------|--------------|--------------|--------------|---------------|--------------|
| Infosys | 414 | 545 | 754 | 1,063 | 1,592 | 2,152 | 3,089 | 39.8% |
| TCS | 690 | 880 | 1,040 | 1,560 | 2,240 | 2,970 | 4,175 | 35.0% |
| Satyam | 310 | 414 | 459 | 566 | 794 | 1,096 | 1,461 | 29.5% |
| Wipro-Technologies | 377 | 459 | 628 | 1,002 | 1,392 | 1,815 | 2,459 | 36.7% |
| HCL Tech * | 297 | 331 | 415 | 568 | 762 | 976 | 1,390 | 29.4% |
| Patni * | 143 | 188 | 251 | 327 | 450 | 575 | 695 | 30.2% |
| Total | 2,231 | 2,818 | 3,548 | 5,085 | 7,230 | 9,584 | 13,269 | 34.6% |
| Indian IT-BPO Exports (US\$ bn)# | 6.2 | 7.7 | 9.6 | 12.9 | 17.7 | 23.4 | 31.3 | 31.0% |

* HCL Tech and Patni have June and December as year end respectively. Patni FY07 numbers are estimates.

#Source NASSCOM.

- 🔗 In the last 6 years, Indian IT-BPO exports have grown at a CAGR of 31% to \$31.3bn. Leaders Infosys, TCS and Wipro Technologies have grown at 39.8%, 35% and 36.7% (above average growth rate), HCLT, Satyam grown at 29.5%, 29.4% respectively. In terms of total revenue, Satyam and HCL Tech have shown almost similar growth rates and the revenue gap has been range bound.

Figure 5: Market Share[@]

| (%) | FY01 | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 |
|--------------------|------|------|------|------|------|------|------|
| Infosys | 18.6 | 19.3 | 21.2 | 20.9 | 22.0 | 22.5 | 23.3 |
| TCS | 30.9 | 31.2 | 29.3 | 30.7 | 31.0 | 31.0 | 31.5 |
| Satyam | 13.9 | 14.7 | 12.9 | 11.1 | 11.0 | 11.4 | 11.0 |
| Wipro Technologies | 16.9 | 16.3 | 17.7 | 19.7 | 19.3 | 18.9 | 18.5 |
| HCL Tech * | 13.3 | 11.7 | 11.7 | 11.2 | 10.5 | 10.2 | 10.5 |
| Patni# * | 6.4 | 6.7 | 7.1 | 6.4 | 6.2 | 6.0 | 5.2 |

[@] Industry revenue is the sum of the revenue of the companies under consideration. # Patni numbers are estimates. * HCL Tech and Patni have June and December as year end respectively.

Source: Company, Religare Institutional Equity Research

- ☞ Infosys, Wipro Technologies market share has increased over the years. TCS market share remained the almost the same where as Patni, HCL Tech and Satyam have lost some wallet of revenue over the years to the peers.

- **HCL Tech EBIDTA margins range bound in last 13 quarters**

Figure 6: EBIDTA Margin

| (%) | Q1FY05 | Q2FY05 | Q3FY05 | Q4FY05 | Q1FY06 | Q2FY06 | Q3FY06 | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 | Q1FY08 | Change bps |
|---------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|------------|
| Infosys | 32.2 | 32.1 | 32.9 | 33.5 | 32.0 | 32.0 | 34.0 | 31.7 | 29.5 | 32.1 | 32.7 | 31.7 | 28.7 | -351 |
| TCS | 29.6 | 29.3 | 30.0 | 28.3 | 29.4 | 29.1 | 28.3 | 26.4 | 24.4 | 27.4 | 28.3 | 28.3 | 25.5 | -412 |
| Wipro | 25.4 | 26.8 | 25.8 | 23.9 | 24.2 | 23.9 | 25.1 | 23.9 | 24.5 | 23.8 | 22.8 | 22.4 | 20.2 | -518 |
| Satyam | 24.6 | 24.7 | 24.6 | 24.5 | 22.7 | 23.9 | 24.9 | 25.5 | 24.6 | 22.6 | 24.7 | 23.1 | 22.4 | -218 |
| Wipro Technologies# | 30.3 | 30.9 | 29.7 | 29.2 | 27.8 | 28.0 | 28.1 | 28.4 | 27.9 | 27.7 | 27.3 | 27.0 | 25.0 | -529 |
| HCL Tech* | 23.1 | 23.2 | 23.0 | 22.8 | 22.8 | 22.2 | 22.5 | 22.3 | 22.5 | 21.7 | 22.1 | 23.3 | 21.6 | -158 |
| TechMahindra | 11.3 | 14.4 | 10.7 | 20.5 | 17.5 | 16.8 | 25.9 | 23.3 | 22.3 | 25.4 | 26.9 | 25.4 | 22.1 | 1080 |

*HCL Tech numbers for Q4FY04 to Q4FY07. Patni numbers from Q2FY04 to Q2FY07. HCL Tech and Patni have June and December as year end respectively. Wipro Technologies numbers are computed from the depreciation numbers available in the US GAAP.

Source: Company, Religare Institutional Equity Research

- ☞ HCL Tech's EBIDTA margin had been range bound (between 21.6% to 23.3%) in the last 3 years. Over last three years, TechMahindra's margins have actually improved by 1080bps where as HCL Tech has witnessed the least decline of 158bps (although Infosys and TCS hiked the salaries this quarter which also had negative impact on their margins). On YoY basis, the company has actually improved its EBIDTA margins (excluding ESOP charges) from 19% in FY03 to 23.8% in FY07. This was on the back of the cost efficiencies achieved in the cost of revenue and also in S, G&A.

- **Limited levers for EBIDTA margin expansion**

- ☞ Core Software Services: In this segment, the EBIDTA margins will be under pressure and will remain flat or declining.
- ☞ BPO, IMS EBIDTA margins will be range bound and no immediate surprise can be seen on these fronts except the INR movement
- ☞ HCLT continues to invest as it strengthens its position as a Complete Outsourcing Services provider, expands its presence across geographies, enters new verticals and aggressively pursues large deals. As HCL Technologies is still not big enough (\$1.4bn company vis-à-vis top 3 Indian IT players), it will take little more time for the scale benefits to actually start trickling in.

- ☞ Non-linear growth initiatives, billing rates continue to be the margin levers. But Non-linear revenue contributes a smaller portion of the revenue and for it to actually bring in benefits will require more than a year's time.
- ☞ HCL Tech had Utilization (excluding trainee) rates as high as 78% in the past and from current levels (75-77%), we believe that there is further scope for improvement on that front.
- ☞ Billing rate improvement will further help the company to sustain margins.

• **Corporate governance at the company improving**

Since the last few quarters the company has improved its disclosure norms and a lot of efforts are visible for improving the transparency in its operations. This we believe is a very positive sign and helps getting better revenue visibility and business perspective.

Figure 7: Valuations

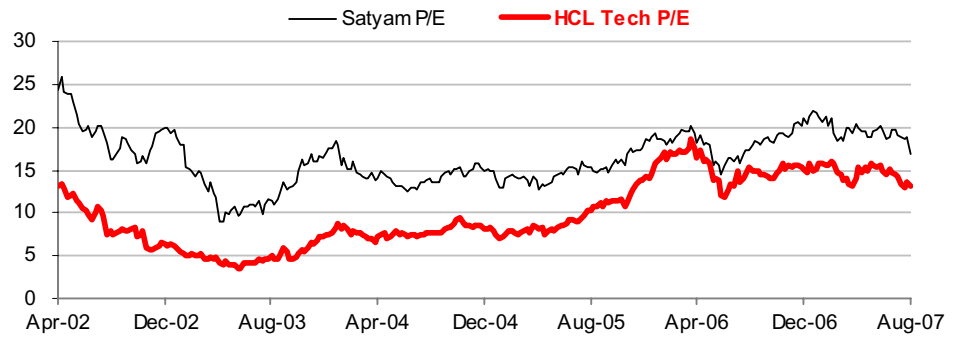
| Company | Price (Rs) | Rating | Mkt Cap (Rs bn) | Sales | | EBITDA | | Adj PAT | | Adj EPS | | FY08E | | FY09E | |
|------------------|---------------|------------|--------------------|---------|------|---------|------|---------|-------|---------|-------|---------|------|---------|------|
| | | | | Q1Y08E | YoY | Q1FY08E | YoY | Q1FY08E | YoY | Q1FY08E | YoY | Adj EPS | P/E | Adj EPS | P/E |
| | | | | (Rs mn) | (%) | (Rs mn) | (%) | (Rs mn) | (%) | (Rs mn) | (%) | (Rs) | (x) | (Rs) | (x) |
| Infosys | 1,761 | Accumulate | 1,006 | 37,730 | 25.1 | 10,840 | 21.9 | 10,329 | 30.0 | 18.02 | 28.3 | 78.7 | 22.4 | 97.7 | 18.0 |
| TCS | 1,016 | Buy | 995 | 52,028 | 25.5 | 13,264 | 31.0 | 11,855 | 37.4 | 12.11 | 37.5 | 51.2 | 19.8 | 63.4 | 16.0 |
| Wipro | 447 | Reduce | 652 | 42,774 | 35.3 | 8,639 | 11.4 | 7,256 | 17.0 | 5.01 | 16.4 | 23.8 | 18.7 | 29.3 | 15.3 |
| Satyam Computers | 416 | Accumulate | 278 | 18,302 | 26.8 | 4,103 | 15.6 | 3,783 | 6.8 | 5.53 | 5.5 | 23.4 | 17.8 | 28.6 | 14.6 |
| HCL Tech | 290 | Accumulate | 192 | 16,120 | 28.6 | 3,474 | 23.4 | 4,669 | 119.4 | 6.83 | 117.3 | 18.7 | 15.5 | 22.2 | 13.0 |

Source: Religare Securities Estimates

* HCL Tech year end is 30th June

- ☞ HCLT is currently trading at P/Ex of 15.5x and 13.0x its FY08E and FY09E diluted EPS of Rs18.8 and Rs22.2 respectively.
- ☞ HCL Tech has, for most of the period in the past has traded at discount to Satyam. While both companies HCL Tech and Satyam have exhibited similar margins and revenue growth over the years, there has been the valuation gap. The average discount HCLT traded vis-à-vis Satyam had been 40%.
- ☞ But going ahead, considering HCL Tech's strong presence in Infrastructure Management Services and the BPO segment, increasing transparency, we believe that the valuation gap between HCL Tech and Satyam will reduce. Currently the valuation gap between the two companies is 13%. In the last four months HCL Tech has outperformed Satyam. We have valued HCL Tech at 15x (18% at discount to what we have valued Satyam) its two year forward rolling EPS of 23.8. It gives us target of Rs346 implying an upside of 19%. We initiate coverage on HCL Technologies with an **Accumulate** rating.

Figure 8: HCLT and Satyam: Forward P/Ex charts



Source: Company, Religare Institutional Equity Research

Key Matrices

HCL Technologies Ltd

Revenue Across Geographies (%)

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|--------------|--------|--------|--------|--------|--------|
| US | 58 | 60 | 57 | 54 | 54.20 |
| Europe | 29 | 29 | 29 | 30 | 29.70 |
| Asia Pacific | 13 | 12 | 14 | 16 | 15.30 |

Revenue By Industry (%)

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|-------------------------|--------|--------|--------|--------|--------|
| Financial Services | 26.0 | 22.8 | 27.2 | 27.5 | 28.7 |
| Manufacturing & Hi-Tech | 36.0 | 31.3 | 29.7 | 28.9 | 28.7 |
| Telecom | 11.0 | 16.9 | 16.2 | 17.2 | 17.2 |
| Retail | 7.0 | 12.0 | 10.6 | 9.4 | 9.2 |
| Life Science | 4.0 | 3.5 | 4.0 | 4.5 | 4.9 |
| Media | 6.0 | 5.9 | 5.9 | 5.6 | 5.6 |

Revenue by Services Offerings (%)

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|----------------------------------|--------|--------|--------|--------|--------|
| Technology Led Services | 23.9 | 24.0 | 24.2 | 23.3 | 23.9 |
| Enterprise Consulting Services | 15.5 | 13.7 | 12.7 | 13.2 | 12.0 |
| Applications Consulting Services | 34.8 | 36.2 | 36.3 | 35.8 | 35.5 |
| Infrastructure Services | 12.5 | 13.3 | 14.0 | 13.8 | 15.0 |
| BPO Services | 13.3 | 12.8 | 12.7 | 13.7 | 13.6 |

Revenue By Contract Type (%)

| | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|-----|--------|--------|--------|--------|
| T&M | 70.8 | 70.7 | 71.6 | 70.0 |
| FPP | 29.2 | 29.3 | 28.4 | 30.0 |

Onsite-Offshore Revenue Mix (%)

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|----------|--------|--------|--------|--------|--------|
| Onsite | 69.2 | 48.2 | 49.0 | 47.7 | 47.9 |
| Offshore | 30.8 | 51.8 | 51.0 | 52.3 | 52.1 |

Employee Data

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|------------------------------------|--------|--------|--------|--------|--------|
| Core Software | 20,332 | 21,943 | 22,523 | 23,796 | 26,326 |
| Infrastructure Management Services | 2,951 | 3,397 | 3,613 | 3,999 | 4,439 |
| BPO | 9,343 | 11,112 | 12,181 | 12,354 | 11,252 |
| Total | 32,626 | 36,452 | 38,317 | 40,149 | 42,017 |

Utilization & Attrition rates (%)

| | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|-----------------------------|--------|--------|--------|--------|
| Offshore including trainees | 67.9 | 69.4 | 69.8 | 71.1 |
| Offshore excluding trainees | 77.7 | 74.6 | 74.8 | 76.7 |
| Onsite | 92.2 | 95.2 | 95.6 | 95.6 |
| Attrition (Core Software) | 16.5 | 17.8 | 17.5 | 17.3 |

Client Concentration & Size Distribution

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|----------------|--------|--------|--------|--------|--------|
| Top 5 clients | 28 | 29 | 30 | 29 | 28.40 |
| Top 10 clients | 37 | 38 | 39 | 39 | 38.20 |
| Top 20 clients | 49 | 50 | 52 | 51 | 51.10 |

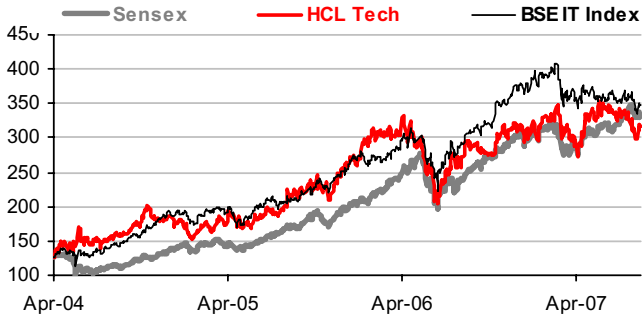
Customer size distribution

| | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|------------------------------|--------|--------|--------|--------|--------|
| No. of Million \$ Clients | 133 | 143 | 145 | 147 | 156 |
| No. of 5 Million \$ Clients | 35 | 41 | 46 | 48 | 52 |
| No. of 10 Million \$ Clients | 15 | 18 | 22 | 25 | 26 |
| No. of 20 Million \$ Clients | 6 | 8 | 8 | 10 | 13 |
| No. of 30 Million \$ Clients | 0 | 4 | 4 | 5 | 7 |
| No. of 40 Million \$ Clients | 0 | 3 | 4 | 4 | 4 |
| No. of 50 Million \$ Clients | 0 | 2 | 3 | 3 | 3 |

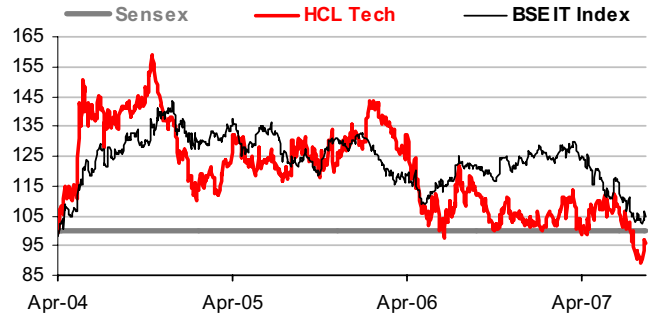
Stock performance

HCL Technologies Ltd

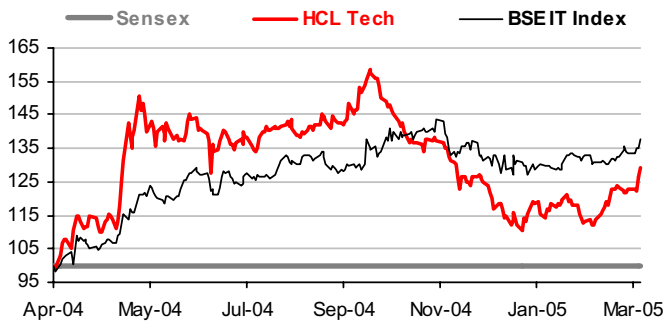
Absolute Perf. From Apr 04



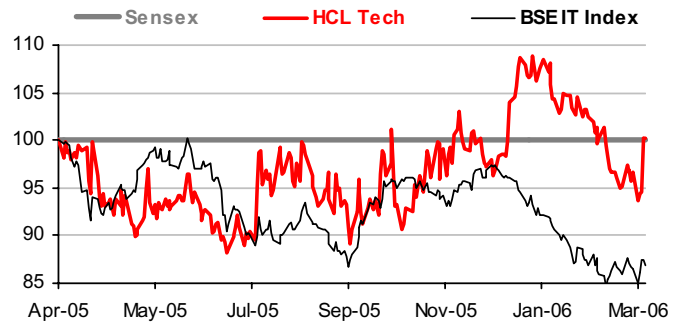
Relative Perf. From Apr 04



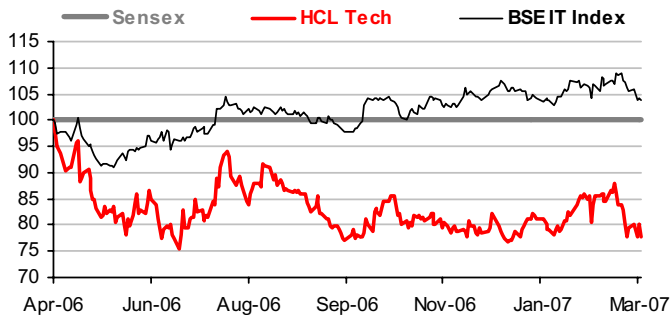
Relative Perf. From Apr 04 to Mar 05



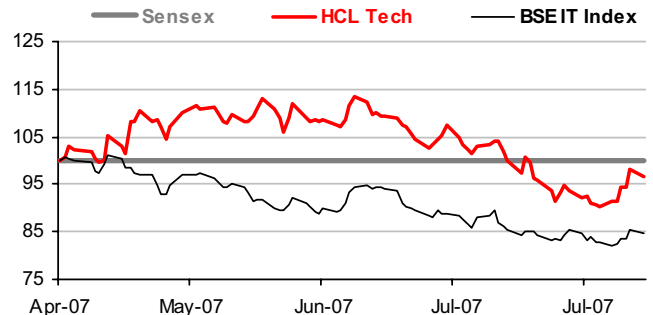
Relative Perf. From Apr 05 to Mar 06



Relative Perf. From Apr 06 to Mar 07



Relative Perf. From Apr 07

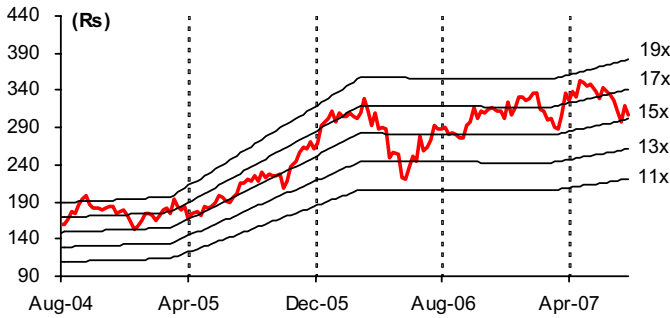


Source: Bloomberg, Religare Institutional Equity Research

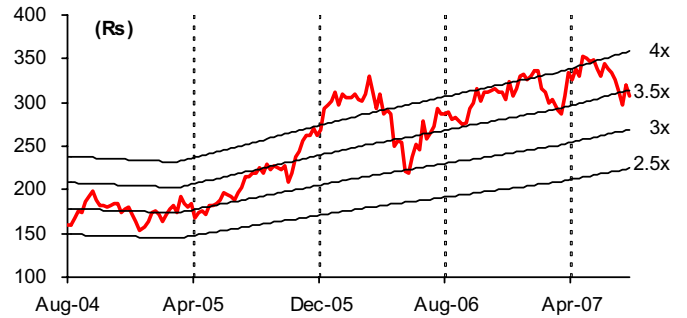
12 month forward rolling band charts

HCL Technologies Ltd

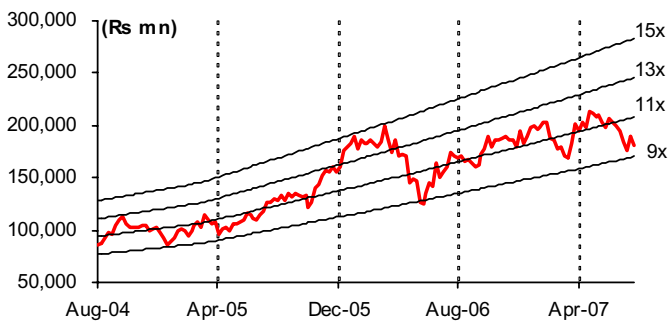
P/E Band



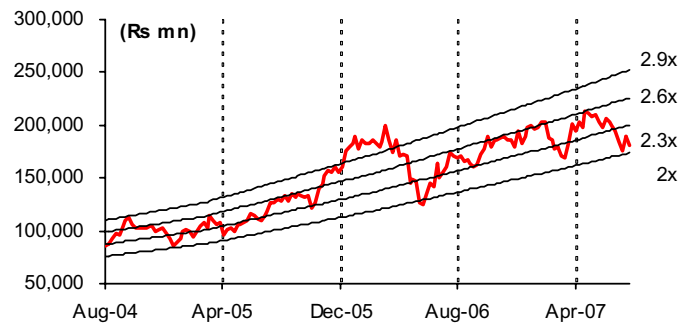
P/BV Band



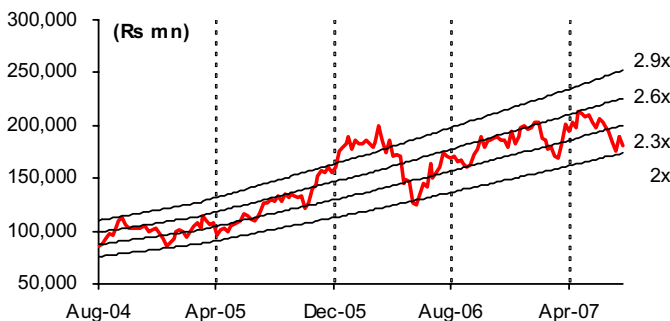
EV/EBITDA Band



EV/Sales Band



Mkt cap/Sales Band



Financials – US GAAP

Income statement

(Rs mn)

| Year to 30th June | FY05 | FY06 | FY07 | FY08E | FY09E |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Sales | 33,629 | 43,882 | 60,336 | 78,953 | 98,691 |
| EBITDA | 7,673 | 9,705 | 13,369 | 17,241 | 21,317 |
| EBITDA margin (%) | 22.8 | 22.1 | 22.2 | 21.8 | 21.6 |
| Depreciation | 1482 | 1916 | 2536 | 3288 | 4246 |
| EBIT | 6,190 | 7,789 | 10,833 | 13,953 | 17,071 |
| Other income/ (Expenses), Net | 519 | (835) | 1,920 | 1,579 | 1,974 |
| Interest exp/ (inc) | | | | | |
| PBT | 6,710 | 6,953 | 12,754 | 15,532 | 19,045 |
| PBT margin (%) | 20.0 | 15.8 | 21.1 | 19.7 | 19.3 |
| Taxes | 671 | 603 | 1,520 | 1,689 | 2,476 |
| Extra ord exp/ (inc) | 543 | 806 | 2,504 | - | - |
| ESOP Charges | 26 | 656 | 968 | 974 | 974 |
| PAT | 6,556 | 6,501 | 12,770 | 12,869 | 15,595 |
| PAT margin (%) | 19.5 | 14.8 | 21.2 | 16.3 | 15.8 |
| Adj PAT | 6,092 | 7,084 | 12,705 | 12,797 | 15,523 |
| Adj PAT margin (%) | 18.1 | 16.1 | 21.1 | 16.2 | 15.7 |

Quarterly – Financials

(Rs mn)

| (Rs mn) | Q4FY06 | Q1FY07 | Q2FY07 | Q3FY07 | Q4FY07 |
|-------------------|---------------|---------------|---------------|---------------|---------------|
| Net Sales | 12,538 | 13,795 | 14,651 | 15,771 | 16,120 |
| Change (%) | 35.2 | 42.1 | 39.0 | 40.6 | 28.6 |
| EBITDA | 2815 | 2989 | 3241 | 3667 | 3474 |
| Change (%) | 33.3 | 38.5 | 36.3 | 46.8 | 23.4 |
| Margin (%) | 22.5 | 21.7 | 22.1 | 23.3 | 21.6 |
| PAT | 2133 | 2301 | 2627 | 3035 | 4679 |
| PAT adjusted | 2132 | 2300 | 2597 | 3012 | 4669 |
| Change (%) | 31.6 | 46.6 | 57.3 | 72.9 | 119.0 |
| Margin (%) | 17.0 | 16.7 | 17.7 | 19.1 | 29.0 |
| EPS adjusted (Rs) | 3.32 | 3.55 | 4.00 | 4.63 | 7.03 |
| EPS diluted (Rs) | 3.14 | 3.40 | 3.80 | 4.39 | 6.83 |

Ratios

| Y/E, 30th June | FY05 | FY06 | FY07E* | FY08E | FY09E |
|----------------------|-------|------|--------|-------|-------|
| Growth | | | | | |
| Net sales (%) | 28.7 | 30.5 | 37.5 | 30.9 | 25.0 |
| EBITDA (%) | 45.1 | 26.5 | 37.8 | 29.0 | 23.6 |
| PAT (%) | -24.0 | -0.8 | 96.4 | 0.8 | 21.2 |
| PAT adjusted (%) | 18.5 | 15.8 | 79.3 | 0.7 | 21.3 |
| EPS adjusted (%) | 12.7 | 10.7 | 76.6 | -0.6 | 19.0 |
| EPS diluted (%) | 11.6 | 6.9 | 81.7 | -0.8 | 19.1 |
| Valuations | | | | | |
| P/E (x) | 29.9 | 28.0 | 15.4 | 15.5 | 13.0 |
| Price/BV (x) | 4.8 | 5.0 | 4.0 | 3.5 | 2.9 |
| EV/EBITDA (x) | 23.4 | 18.5 | 13.4 | 10.4 | 8.4 |
| EV/Sales (x) | 5.3 | 4.1 | 3.0 | 2.3 | 1.8 |
| Profitability | | | | | |
| EBITDA margin (%) | 22.8 | 22.1 | 22.2 | 21.8 | 21.6 |
| Adj PAT margin (%) | 18.2 | 16.1 | 21.1 | 16.2 | 15.7 |
| RoE (%) | 18.0 | 18.2 | 28.9 | 24.2 | 24.5 |
| RoCE (%) | 17.4 | 18.0 | 28.7 | 24.1 | 24.4 |
| RoIC (%) | 36.6 | 33.8 | 41.0 | 45.8 | 47.1 |
| B/S ratios | | | | | |
| Inventory days | 6 | 5 | 4 | 5 | 5 |
| Creditor days | 14 | 12 | 12 | 12 | 13 |
| Debtors days | 70 | 78 | 71 | 71 | 71 |
| Working Capital days | 42 | 52 | 43 | 36 | 37 |
| Net debt/equity | 0.02 | 0.00 | 0.00 | 0.00 | 0.00 |

Balance sheet

(Rs mn)

| Year to 30th June | FY05 | FY06 | FY07E* | FY08E | FY09E |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Liabilities | | | | | |
| Equity share capital | 760 | 782 | 802 | 819 | 844 |
| Total Res. & Surplus | 37,651 | 38,832 | 47,657 | 56,308 | 68,514 |
| Total Shareholders' funds | 38,411 | 39,614 | 48,459 | 57,127 | 69,359 |
| Convertible debt | | | | | |
| Others | 1,601 | 891 | 947 | 1,010 | 1,073 |
| Total loans | 1,601 | 891 | 947 | 1,010 | 1,073 |
| Deferred tax lia. (net) | 195 | 194 | 194 | 194 | 194 |
| Total liabilities | 40,207 | 40,700 | 49,601 | 58,332 | 70,627 |
| Assets | | | | | |
| Net fixed assets | 15,934 | 17,720 | 19,784 | 22,496 | 25,750 |
| Capital WIP | | | | | |
| Total non-current assets | 15,934 | 17,720 | 19,784 | 22,496 | 25,750 |
| Inv - non current | 554 | 117 | 117 | 117 | 117 |
| Current assets | | | | | |
| Inventories | 438 | 263 | 630 | 829 | 1,041 |
| Sundry debtors | 6,487 | 9,404 | 11,815 | 15,461 | 19,326 |
| Cash & cash equivalents | 20,488 | 18,327 | 24,592 | 29,220 | 36,833 |
| Cash | 20,156 | 18,218 | 24,483 | 29,110 | 36,723 |
| Liquid investments | 332 | 110 | 110 | 110 | 110 |
| Other current assets | 3,000 | 3,441 | 4,586 | 5,880 | 7,253 |
| Total current assets | 30,413 | 31,436 | 41,623 | 51,389 | 64,453 |
| Total current liabilities | 820 | 957 | 1,457 | 1,915 | 2,407 |
| Other current Liabilities | 5,874 | 7,616 | 10,466 | 13,755 | 17,287 |
| Net current assets | 23,719 | 22,862 | 29,700 | 35,718 | 44,759 |
| Misc. expenditure | | | | | |
| Total assets | 40,207 | 40,700 | 49,601 | 58,332 | 70,627 |

Cash flow

| Year to 30th June | FY05 | FY06 | FY07E* | FY08E | FY09E |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|
| Cash from operations | | | | | |
| PBT | 7,253 | 7,760 | 15,258 | 15,532 | 19,045 |
| Tax paid | 671 | 603 | 1,520 | 1,689 | 2,476 |
| Dep & amortization | 1,482 | 1,916 | 2,536 | 3,288 | 4,246 |
| Working capital changes | 1,657 | 1,304 | 572 | 1,391 | 1,427 |
| Others | (387) | 12 | 56 | 63 | 63 |
| Net cash from operations | 6,020 | 7,781 | 15,758 | 15,803 | 19,451 |
| Cash from investments | | | | | |
| Capital expenditure | 9,413 | 3,555 | 4,600 | 6,000 | 7,500 |
| Sale/purchase of investments | (150) | (660) | 0 | 0 | 0 |
| Net cash from investments | 9,263 | 2,895 | 4,600 | 6,000 | 7,500 |
| Cash from financing | | | | | |
| Issue of shares & sh. premium | 7,924 | 10 | 960 | 678 | 1,515 |
| Dividends paid | 5,590 | 5,963 | 5,853 | 5,853 | 5,853 |
| Debt change | (570) | (723) | 0 | 0 | 0 |
| Others | 76 | (148) | 0 | (0) | (0) |
| Net cash from financing | 1,840 | (6,824) | (4,893) | (5,176) | (4,338) |
| Net change in cash | (1,403) | (1,938) | 6,265 | 4,628 | 7,613 |

Per share data

| Year to 30th June | FY05 | FY06 | FY07 | FY08E | FY09E |
|--------------------------|------|------|-------|-------|-------|
| EPS basic adj. | 9.9 | 11.0 | 19.5 | 19.4 | 23.0 |
| EPS diluted Adj. | 9.6 | 10.4 | 18.8 | 18.7 | 22.2 |
| CEPS | 11.2 | 13.2 | 22.6 | 23.4 | 28.3 |
| Book value | 60.8 | 57.9 | 71.8* | 83.3 | 99.3 |
| Dividend | 8.8 | 8.7 | 8.7 | 8.5 | 8.4 |
| O/s shares.-actual (mn) | 615 | 643 | 653 | 661 | 674 |
| O/s shares.-diluted (mn) | 632 | 684 | 675 | 686 | 699 |

* All FY07 onwards balance sheet items are estimates

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| | | | |
|-------------------|---|---------------|---|
| Buy | : > 15% returns relative to Sensex | Reduce | : Upto (-) 15% returns relative to Sensex |
| Accumulate | : Upto + 15% returns relative to Sensex | Sell | : > (-)15% returns relative to Sensex |

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