

HCL-Technologies

1QFY12 revenue performance misses consensus expectation

- HCLT reported US\$ revenue growth of 4.1% Q/Q, which is in line with our estimate of 4.0%, but modestly below consensus expectation of about 5.0% Q/Q. Revenues have increased at a CQGR of 5.7% over the last four quarters. However, we were more concerned about HCLT margin decomposition and its movement. We are relatively satisfied with the margin performance in 1QFY12. Gross margins declined 90 bps despite salary hike during the quarter, while EBIT margins were down 110 bps (vs. our expectation of 150 bps) to 13.9% (after deducting option charges). SG&A as a percentage of sales increased to 14.4% from 13.9% last quarter which we believe is a positive as the company is investing in sales and marketing.
- HCL Technologies reported 1QFY12 revenues of US\$1,002mn, in line with our expectation of US\$1,001 mn but meaningfully below consensus expectation of ~\$1,011 mn. Constant currency revenue growth was 5.1% Q/Q. Software services' volume growth was 4.0% Q/Q.
- Enterprise Application Services revenues declined 0.6% (in constant currency terms (CC)), which is concerning in our view. It suggests that AXON is struggling to grow revenues.** We have analyzed AXON acquisition in detail in our report "*Trouble if you do, trouble if you don't - this is largely the story of "big" acquisitions in Indian IT*" dated Oct 5, 2011. Infrastructure Services' revenue growth remained healthy at 5.8% Q/Q (CC), while Custom Applications revenues increased 7.3% (CC) sequentially. Engineering and R&D Services growth was impressive at 8.6% Q/Q. BPO revenues declined about 1.3% sequentially in constant currency terms.
- On constant currency basis, Europe revenues grew 4.5% Q/Q (despite macro concerns), while Americas' revenues increased 6.8%.** Revenue growth from ROW was weak for the second straight quarter at 0.7% (CC).
- Retail & CPG and Manufacturing were the two verticals driving overall revenue growth as revenues for these increased 12.0% and 8.2% Q/Q (CC), respectively. BFSI growth was tepid at 2.1%, while Telecom revenues declined 2.0% Q/Q on constant currency basis.** Healthcare and Media Publishing & Entertainment revenues were flat.
- Quarterly annualized attrition moderated modestly but still on the higher side.** Quarterly annualized attrition decreased to 18.2% for Software Services from 19.6% in 4QFY11. Infra Management's quarterly annualized attrition also moderated to 19.7% from 21.4% in 4QFY11.

Bloomberg HCLT IN, Reuters HCLT.BO

(Year-end Jun, Rs mn)	FY10	FY11	FY12E	FY13E	FY10	FY11	FY12E	FY13E			
Revenue	126,500	158,559	196,135	218,794	ROE(%)	19.1	20.7	21.4	20.7	52-Week range	528.40 - 360.00
Operating Profit	19,976	21,390	26,903	29,969	CORE ROIC(%)	17.2	16.7	17.7	17.8	Share Out. (Com)	690MN
EBITDA	24,978	26,309	32,543	35,915	Quarterly EPS (Rs)	1Q	2Q	3Q	4Q	Market Cap	303.58BN
Net profit (Reported)	12,236.4	16,034.8	20,303.1	23,739.9	EPS (12) E	6.86	6.79	7.35	7.76	Market Cap(US)	US\$6,193MN
EPS	17.95	22.96	28.76	33.25	EPS (13) E	7.28	7.81	8.51	9.64	Free float	28.7%
P/E (x)	24.5	19.2	15.3	13.2	Local	1M	3M	12M		Avg daily val (Rs)	50MN
EV/EBITDA (x)	14.0	13.1	10.4	9.2	Abs. Perf.(%)	11.4%	-10.5%	0.4%		Dividend Yield	0.9%
Cash	24,446	22,428	31,396	40,072	Rel. Perf.(%)	9.0%	(2.2%)	17.3%		Index	5,132
Equity	70,450	84,410	105,681	123,795	Target Price (30 Jun 12)					Exchange rate	49.02

Source: Company data, Bloomberg, J.P. Morgan estimates.

Overweight

HCLT.BO, HCLT IN

Price: Rs440.10

Price Target: Rs480.00

India

Technology, Software & IT services

Viju K George ^{AC}

(91-22) 6157-3597

viju.k.george@jpmorgan.com

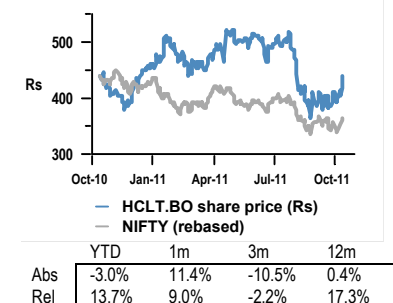
Amit Sharma

(91-22) 6157 3598

amit.d.sharma@jpmorgan.com

J.P. Morgan India Private Limited

Price Performance



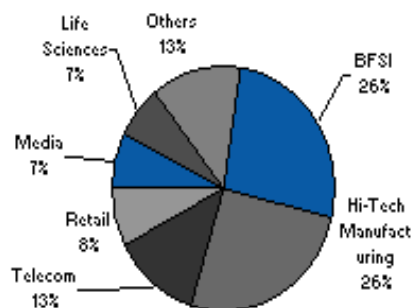
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Company Description

HCL Technologies (HCLT) is one of India's largest IT services vendors, with a good presence in R&D services, infrastructure management, and BPO. HCLT has several Fortune 500 names as its top clients. The company has 70,000+ employees working for 450+ clients. HCL Tech recently acquired Axon, which operates in the package implementation space. HCL Tech has good leverage to high-growth services, with 23% of its revenues coming from Infrastructure management.

Revenue breakdown (FY11)



Source: Company data

EPS: J.P. Morgan vs. consensus

Rs, YE Jun.	J.P. Morgan	Consensus
FY12E	28.8	30.5
FY13E	33.2	36.2

Source: Bloomberg, J.P. Morgan.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
Sales volume growth assumption 18%(FY11)		
Impact of each 5%	3.1%	5.0%
Gross margin assumption 32%(FY11)		
Impact of each 1%	4.6%	7.5%
Capacity utilization assumption 82%(FY11)		
Impact of each 5%	4.7%	7.7%
Debt/equity assumption 0%(FY11)		
Impact of each 10%	0%	0.4%

Source: J.P. Morgan estimates.

Price target and valuation analysis

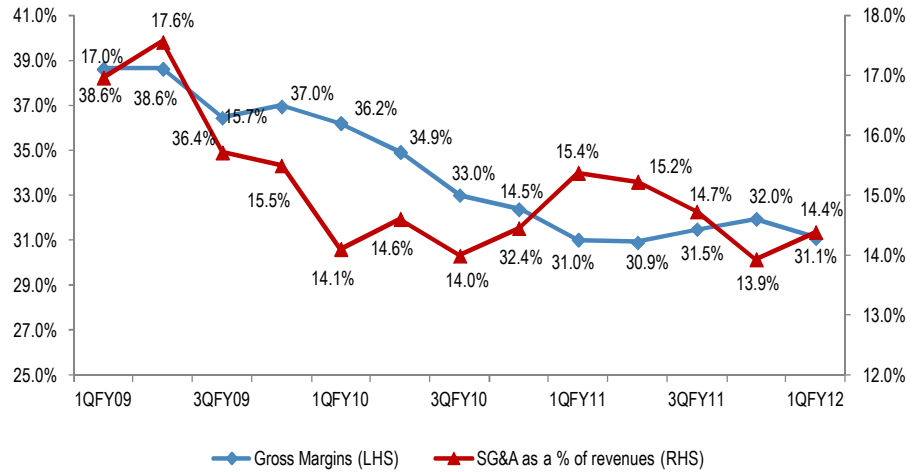
Our Jun-12 PT of Rs480 is based on a one-year forward P/E multiple of 14.3x. This embeds a one-year forward valuation discount of 25% to TCS, which we believe is fair and warranted, given the weaker margin profile and return ratios of HCLT.

Risk free rate:	6.50%
Market risk premium:	8.00%
Beta:	0.87
Debt/equity:	10.00%
Cost of debt:	8.00%
Terminal "g":	4%

Source: J.P. Morgan estimates.

Key risks to our price target are a slowdown in deal ramp-ups and appreciation of the rupee against the US\$. Taking on a higher-than normal share of lower-margin and/or asset heavy deals can impact operating margins and return ratios impacting HCLT's valuation.

Figure 1: EBIT margins declined 110 bps vs. our expectation of 150 bps decline; EBIT margins decline was driven by 90 bps decrease in gross margins due to wage hikes; SG&A as a % of revenue increased 50 bps suggesting that the company is investing in S&M expenses



Source: Company reports, J.P. Morgan

Our numbers are under review post-earnings. We will publish a detailed note with revised numbers after conference call

JPM Q-Profile

HCL Technologies Ltd. (INDIA / Information Technology)

As Of: 13-Oct-2011

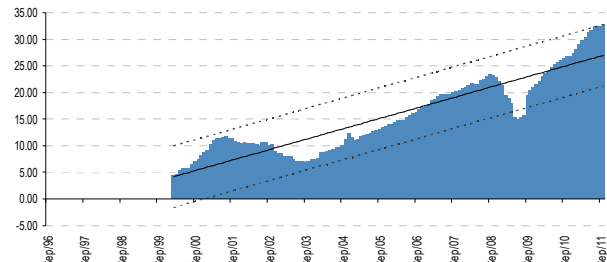
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

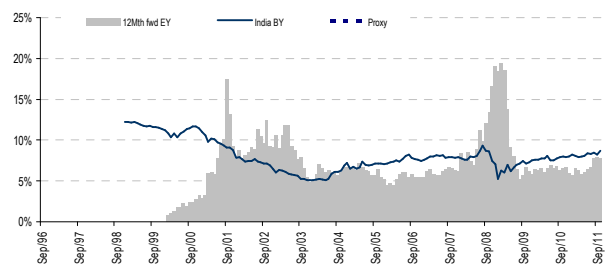
Local Share Price Current: **420.25**



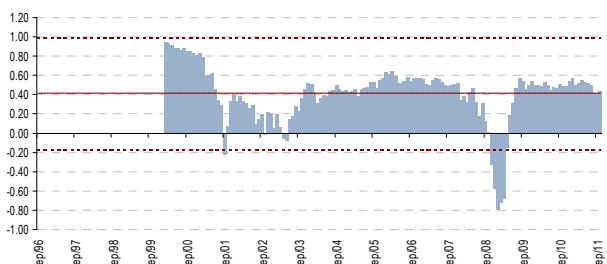
12 Mth Forward EPS Current: **32.67**



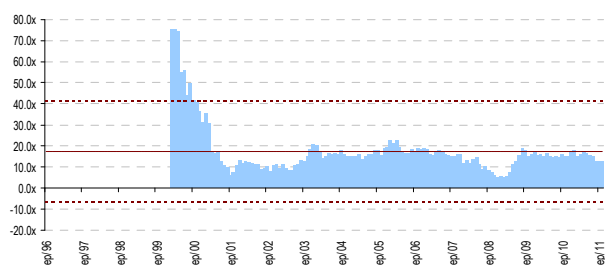
Earnings Yield (& local bond Yield) Current: **8%**



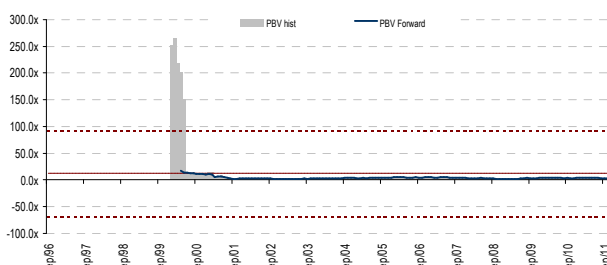
Implied Value Of Growth* Current: **43.36%**



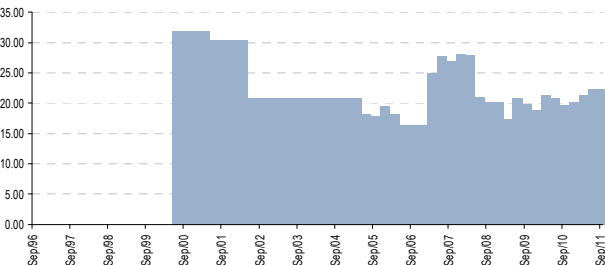
PE (1Yr Forward) Current: **12.9x**



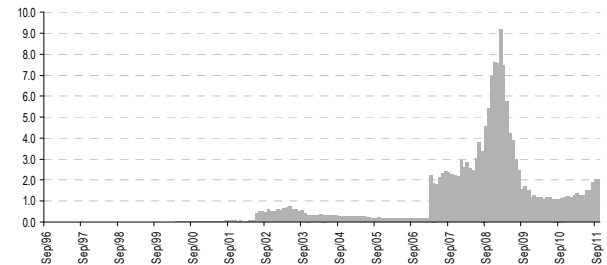
Price/Book Value Current: **3.1x**



ROE (Trailing) Current: **22.24**



Dividend Yield (Trailing) Current: **2.01**



Summary

HCL Technologies Ltd.		INDIA		SEDOL 6294896		As Of: 13-Oct-11		Local Price: 420.25		EPS: 32.67		
Information Technology		Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE		12.86x	5.14	75.00	15.47	17.46	41.25	-6.32	-60%	483%	20%	36%
P/BV (Trailing)		3.13x	1.26	265.11	3.75	11.70	92.20	-68.80	-60%	8362%	20%	273%
Dividend Yield (Trailing)		2.01	0.01	9.19	0.45	1.18	4.60	-2.24	-100%	358%	-78%	-41%
ROE (Trailing)		22.24	16.46	31.85	20.89	22.73	32.16	13.30	-26%	43%	-6%	2%
Implied Value of Growth		43.4%	-0.79	0.95	0.47	0.41	1.00	-0.17	-283%	119%	8%	-5%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

HCL-Technologies: Summary of Financials

Profit and Loss Statement					Ratio Analysis						
Rs in millions, year end Jun	FY09	FY10	FY11	FY12E	FY13E	Rs in millions, year end Jun	FY09	FY10	FY11	FY12E	FY13E
Revenues	106,087	126,500	158,559	196,135	218,794	Gross margin	37.6%	34.1%	31.4%	31.2%	30.8%
Cost of goods sold	69,420	75,670	87,975	134,861	151,373	EBITDA margin	21.2%	19.8%	16.6%	16.6%	16.4%
Gross Profit	39,864	43,098	49,750	61,274	67,421	Operating margin	17.0%	15.8%	13.5%	13.7%	13.7%
R&D expenses	0	0	0	0	0	Net margin	11.3%	9.7%	10.1%	10.4%	10.9%
SG&A expenses	-17,358	-18,081	-23,441	-28,734	-31,506	R&D/sales	0.0%	0.0%	0.0%	0.0%	0.0%
Operating profit (EBIT)	18,019	19,976	21,390	26,903	29,969	SG&A/Sales	16.4%	14.3%	14.8%	14.6%	14.4%
EBITDA	22,491	24,978	26,309	32,543	35,915	Sales growth	38.9%	19.2%	25.3%	23.7%	11.6%
Interest income	0	0	0	0	0	Operating profit growth	37.1%	10.9%	7.1%	25.8%	11.4%
Interest expense	0	0	0	0	0	Net profit growth	14.8%	1.7%	31.0%	26.6%	16.9%
Investment income (Exp.)	0	0	0	0	0	EPS (reported) growth	14.0%	(0.2%)	27.9%	25.2%	15.6%
Non-operating income (Exp.)	-3,457	-5,327	-544	168	862	Interest coverage (x)	-	-	-	-	-
Earnings before tax	14,561	14,648	20,846	27,071	30,831	Net debt to total capital	16.0%	2.4%	-1.2%	-7.2%	-11.8%
Tax	-2,550	-2,408	-4,813	-6,778	-7,091	Net debt to equity	19.0%	3.2%	-1.4%	-8.0%	-13.1%
Net income (reported)	12,031.7	12,236.4	16,034.8	20,303.1	23,739.9	Asset turnover	1.04	0.96	1.12	1.23	1.21
Net income (adjusted)	12,017	12,222	16,035	20,303	23,740	Working capital turns (x)	7.41	6.91	6.43	5.77	4.99
EPS (reported)	17.98	17.95	22.96	28.76	33.25	ROE	22.5%	19.1%	20.7%	21.4%	20.7%
EPS (adjusted)	17.96	17.93	22.96	28.76	33.25	ROIC	22.5%	17.2%	16.7%	17.7%	17.8%
BVPS	86.03	101.79	120.42	149.07	174.13	ROIC (net of cash)	-	-	-	-	-
DPS	7.06	3.98	7.34	4.00	4.00						
Shares outstanding	670	692	701	709	711						
Balance sheet					Cash flow statement						
Rs in millions, year end Jun	FY09	FY10	FY11	FY12E	FY13E	Rs in millions, year end Jun	FY09	FY10	FY11	FY12E	FY13E
Cash and cash equivalents	19,255	24,446	22,428	31,396	40,072	Net income	12,031.7	12,236.4	16,034.8	20,303.1	23,739.9
Accounts receivable	27,457	30,532	34,089	40,432	45,203	Depr. & amortization	4,473	5,003	4,919	5,640	5,946
Inventories	0	0	0	0	0	Change in working capital	2,643	-4,835	-1,132	-4,534	-4,587
Others	0	0	0	0	0	Other	0	0	0	0	0
Current assets	57,561	63,834	69,072	86,720	102,398	Cash flow from operations	19,212	12,330	19,829	21,438	25,099
LT investments	9,101	10,363	13,182	11,924	11,612	Capex	0	0	0	0	0
Net fixed assets	62,029	61,682	64,094	72,806	76,417	Disposal/(purchase)	0	0	0	0	0
Others	8,931	10,154	11,348	11,681	11,375	Cash flow from investing	-49,119	-5,918	-10,150	-13,095	-9,245
Total Assets	128,691	135,879	146,348	171,451	190,427	Free cash flow	19,212	12,330	19,829	21,438	25,099
Liabilities						Equity raised/(repaid)	0	0	0	0	0
ST Loans	0	0	0	0	0	Debt raised/(repaid)	32,257	-3,872	-5,916	2,023	679
Payables	33,124	31,364	33,789	35,598	35,782	Other	0	0	0	0	0
Others	33,124	31,364	33,789	35,598	35,782	Dividends paid	-4,726	-2,710	-5,126	-2,826	-2,856
Total current liabilities	33,124	31,364	33,789	35,598	35,782	Cash flow from financing	28,566	-3,214	-7,997	2,962	-4,948
Long-term debt	30,182	26,663	21,256	22,971	23,839	Net change in cash	-1,341	3,198	1,681	11,305	10,907
Other liabilities	7,741	7,392	6,893	7,200	7,012	Beginning cash	23,223	19,255	24,446	22,428	31,396
Total Liabilities	71,047	65,420	61,938	65,769	66,632	Ending cash	19,255	24,446	22,428	31,396	40,072
Shareholders' equity	57,629	70,450	84,410	105,681	123,795						

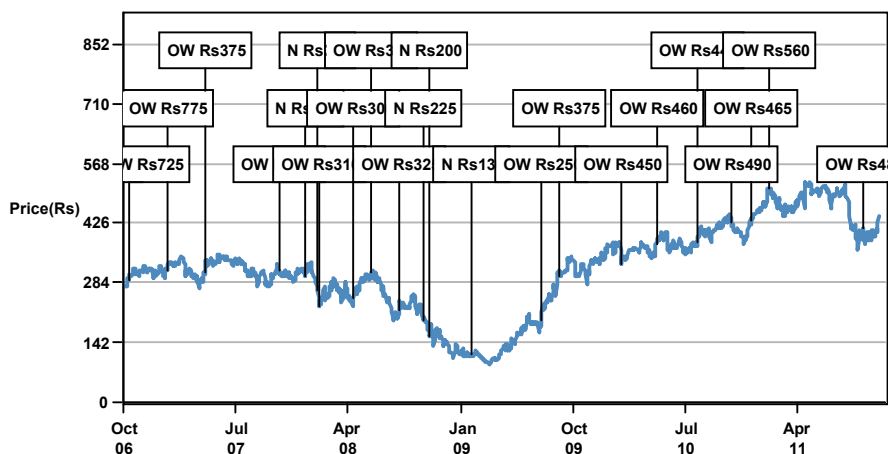
Source: Company reports and J.P. Morgan estimates.

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HCL-Technologies (HCLT.BO) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Oct 16, 2006.

Date	Rating	Share Price (Rs)	Price Target (Rs)
16-Oct-06	OW	292.30	725.00
16-Jan-07	OW	314.90	775.00
17-Apr-07	OW	308.75	375.00
16-Oct-07	OW	312.95	360.00
19-Dec-07	N	301.20	325.00
18-Jan-08	N	267.60	310.00
23-Jan-08	OW	228.60	310.00
15-Apr-08	OW	245.80	300.00
29-May-08	OW	306.80	380.00
05-Aug-08	OW	220.10	325.00
29-Sep-08	N	195.80	225.00
16-Oct-08	N	155.85	200.00
28-Jan-09	N	112.50	130.00
16-Jul-09	OW	194.80	250.00
26-Aug-09	OW	301.55	375.00
27-Jan-10	OW	330.20	450.00
22-Apr-10	OW	373.90	460.00
30-Jul-10	OW	378.05	440.00
21-Oct-10	OW	426.10	490.00
10-Dec-10	OW	433.05	465.00
20-Jan-11	OW	508.05	560.00
09-Sep-11	OW	411.35	480.00

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	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	47%	42%	11%
IB clients*	51%	44%	33%
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IB clients*	70%	60%	52%

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