

Technology
IT Services
Equity – India

Neutral

Target price (INR)	345.00
Share price (INR)	301.15
Potential total return (%)	17.1

Performance	1M	3M	12M
Absolute (%)	0.8	-6.8	-4.9
Relative ^A (%)	-8.0	-3.2	-19.4

Index^A BOMBAY SE IDX

RIC HCLT.BO
Bloomberg HCLT IN

Market cap (USDm) 4,670
Market cap (INRm) 196,021

Enterprise value (INRm) 192497
Free float (%) 23.2

Note: (V) = volatile (please see disclosure appendix)

18 April 2007

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Issuing office: Mumbai

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HCL Technologies

Higher other income drives better than expected performance; maintain Neutral

- ▶ **Strong revenue growth driven by infrastructure and BPO businesses (28% of revenues)**
- ▶ **Significantly higher other income (20% of net profit) due to forex and treasury gains helped better than expected net profit in Mar2007 quarter**
- ▶ **Maintain Neutral rating on HCLT; target price raised to INR345 (from INR335) due to forecast revisions**

Overview

Overall: HCLT reported a better than expected Mar2007 quarter. Though we are raising our revenue estimates for FY07-09, performance at EBIT level has been largely in line with our estimates for 9mFY2007. Higher other income due to Fx gains drives better than expected net income in Mar2007 quarter. Consequently we are raising our net profit estimates for FY07-09 by c8% largely due to higher other income.

Mar07 results: Revenues at INR15.7bn (+7.6%q-o-q, +40.6%y-o-y) were higher than expected. EBIT was at INR2.8bn (+15.3%q-o-q, +51% y-o-y) with EBIT margins at 17.9% (+119bps q-o-q, +126bps y-o-y). Higher other income due to Fx gains helped net profits at INR3.1bn (+16.3%q-o-q, +71.4%y-o-y) adjusting for the charge on stock grants to employees. HCLT has a forward cover of over USD900m (at INR44-45), which is the highest as a proportion of its revenues in the industry.

Key highlights: HCLT added 1832 employees during the quarter and expects capex of USD100m in FY2007. Management was confident on sustaining pricing improvements but was sceptical on margins. HCLT also mentioned that the outlook for Infrastructure business remains strong though the win rate in infrastructure is declining as peers catch up. Performance of large deals won last year is on track and margins on large deals are better than the company average.

Financials: We expect HCL Tech to grow revenues and profits at CAGRs of 27% and 20% for FY2007-09 with Infrastructure and BPO business growing faster than the company average. Though margins for HCLT have recovered, it continues to grow slower than large companies with significantly lower profitability despite its smaller revenue base. The stock currently trades at 16x FY08e EPS for earnings growth of 21% y-o-y. Maintain Neutral and raise target price to INR345.

Results Summary

Performance in Software business performance(INR Million, Percent)

Particulars	Mar-06	Dec-06	Mar-07	% qoq	%yoy	Comments
Gross Revenues	8,348	10,739	11,421	6.4%	36.8%	Vol (+4%); Px (+3.4%); Fx(-1.6%)
Direct Costs	5,071	6,543	6,914	5.7%	36.3%	
Gross Profits	3,277	4,196	4,507	7.4%	37.5%	
Margin (%)	39.3%	39.1%	39.5%	39bps	21bps	
SG&A	1,317	1,741	1,799	3.3%	36.6%	
% of sales	15.8%	16.2%	15.8%	-46bps	-2bps	
EBDITA	1,960	2,455	2,708	10.3%	38.2%	
Margin (%)	23.5%	22.9%	23.7%	85bps	23bps	
Depreciation	306	358	389	8.7%	27.0%	
EBIT	1,654	2,097	2,319	10.6%	40.2%	util(+20bps); SG&A(+50bps); Px(+74bps); INR(-64bps)
Margin (%)	19.8%	19.5%	20.3%	78bps	49bps	

Source: Company, HSBC

Performance in Infrastructure business performance (INR Million, Percent)

Particulars	Mar-06	Dec-06	Mar-07	% qoq	%yoy	Comments
Gross Revenues	1,307	2,053	2,186	6.5%	67.3%	Vol (+7.3%); Px (+1%); Fx(-1.6%)
Direct Costs	886	1,383	1,495	8.1%	68.7%	
Gross Profits	421	670	691	3.1%	64.1%	
Margin (%)	32.2%	32.6%	31.6%	-102bps	-60bps	
SG&A	220	311	306	-1.6%	39.1%	
% of sales	16.8%	15.1%	14.0%	-115bps	-283bps	
EBDITA	201	359	385	7.2%	91.6%	
Margin (%)	15.4%	17.5%	17.6%	13bps	224bps	
Depreciation	100	114	122	7.0%	22.0%	
% of sales	7.7%	5.6%	5.6%	3bps	-207bps	
EBIT	101	245	263	7.4%	160.7%	
Margin (%)	7.7%	11.9%	12.0%	10bps	431bps	SG&A(+120bps), Util(-100bps)

Source: Company, HSBC

Performance in BPO (INR Million, Percent)

Particulars	Mar-06	Dec-06	Mar-07	% qoq	%yoy	Comments
Gross Revenues	1,565	1,859	2,164	16.4%	38.3%	Vols(13%), Px (5%), Fx (-1.6%),
Direct Costs	1,022	1,182	1,329	12.4%	30.0%	
Gross Profits	543	677	835	23.3%	53.8%	
Margin (%)	34.7%	36.4%	38.6%	217bps	389bps	
SG&A	206	251	261	4.0%	26.7%	
% of sales	13.2%	13.5%	12.1%	-144bps	-110bps	
EBDITA	337	426	574	34.8%	70.4%	
Margin (%)	21.5%	22.9%	26.5%	361bps	499bps	
Depreciation	124	151	148	-2.0%	19.4%	
EBIT	213	275	426	54.9%	100.1%	Util(160bps), Px(+197bps), SG&A(270bps), INR(-37bps), Wage hikes (-100bps)
Margin (%)	13.6%	14.8%	19.7%	489bps	608bps	

Source: Company, HSBC

Summary profit and Loss (INR Million, Percent)

Year To Jun30	Mar-06	Dec-06	Mar-07	% qoq	% yoy	Comments
Revenues	11,220	14,651	15,771	7.6%	40.6%	Rupee appreciated by 1.6%
Costs	7,083.00	9,282	9,929	7.0%	40.2%	1% rupee appreciation impacts EBIT margins by
Gross Profits	4,137	5,369	5,842	8.8%	41.2%	35bps for HCL
Gross margin (%)	36.9%	36.6%	37.0%	40bps	17bps	
SG&A	(1,744)	(2,303)	(2,366)	2.7%	35.7%	
% of Revenues	15.5%	15.7%	15.0%	-72bps	-54bps	
EBITDA	2,393	3,066	3,476	13.4%	45.3%	
EBITDA margin (%)	21.3%	20.9%	22.0%	111bps	71bps	
Depreciation	(530)	(623)	(659)	5.8%	24.3%	
EBIT	1,863	2,443	2,817	15.3%	51.2%	helped by lower SG&A(-90bps); Px(+75bps) ; Util (+29bp)
EBIT margin (%)	16.6%	16.7%	17.9%	119bps	126bps	and INR(-54bps); BPO wage hikes (-15bps)
Non-operating income	255	481	615	27.9%	141.2%	Higher other income due to gains on treasury investments and forward covers treasury yield up by 100bps to 7.7%
Profit Before tax	2,118	2,924	3,432	17.4%	62.0%	
PBT margin (%)	18.9%	20.0%	21.8%	180bps	288bps	
Provision for income taxes	(277)	(206)	(283)	37.4%	2.2%	
Effective Tax rate	13.1%	7.0%	8.2%	120bps	-483bps	
EAT	1,841	2,718	3,149	15.9%	71.0%	
Margin (%)	16.4%	18.6%	20.0%	142bps	356bps	
Income from Equity Affilits	(6)	(7)	(3)	-57.1%	-50.0%	
Minority Interest	(11)	(23)	(20)	-13.0%	81.8%	
RECRG NET PROFIT	1,824	2,688	3,126	16.3%	71.4%	
Net margin (%)	16.3%	18.3%	19.8%	147bps	356bps	
Basic	2.8	4.1	4.8	16.0%	69.2%	Outstanding options to further dilute equity base by
FD EPS	2.7	3.9	4.6	15.7%	69.2%	Up to 2%every year for 5years

Source: Company, HSBC

Financials

Earnings revision

Revenues	FY07E	FY08E	FY09E
New	60,802	78,515	97,646
Old	59,850	74,683	90,528
Change (%)	1.6%	5.1%	7.9%
EBITDA	FY07E	FY08E	FY09E
New	13,030	16,455	19,608
Old	13,017	16,052	18,828
Change (%)	0.1%	2.5%	4.1%
Net Profit	FY07E	FY08E	FY09E
New	11,099	13,524	16,061
Old	10,310	12,399	14,680
Change (%)	8%	9%	9%

Source: HSBC

Valuation

We rate HCL Tech Neutral with a new price target of INR345 (previously INR335). Our price target continues to be based on a PE of 18x Jun2008 earnings. Our target PE was derived by an analysis of the historical trading pattern of the stock and its historical premium range to Infosys. Over the last three years, HCL Tech has traded in a range of 13-23x its one-year rolling forward PE with an average of 17x. Its PE discount with reference to Infosys has been in the range of 0-40% over the last two years with an average of 25%.

Risks

These are the key risk factors that may prevent HCL Tech from achieving our target price: 1) Any slowdown/uncertainty in IT spend in the US, which is the largest market for Indian IT services companies; 2) Any significant rupee appreciation will be detrimental to margins of IT services companies; 3) Country risks, terrorist attacks, acquisition and investment portfolio related risks. Geopolitical risks may delay travel plans for clients leading to a disruption in flow of volumes. Upside risks for HCL include: Any significant large deals, rupee depreciations and better management execution.

Financials & valuation

Financial statements

Year to Jun	06/2006a	06/2007e	06/2008e	06/2009e
Profit & loss summary (INRm)				
Revenue	44,007	60,802	78,515	97,646
EBITDA	9,536	13,030	16,455	19,608
Depreciation & amortisation	-2,033	-2,578	-3,076	-3,316
Operating profit/EBIT	7,503	10,452	13,379	16,292
Net interest	579	1,717	1,803	1,893
PBT	8,076	12,165	15,198	18,201
HSBC PBT	8,076	12,165	15,198	18,201
Taxation	-626	-1,011	-1,609	-2,067
Net profit	7,434	11,099	13,524	16,061
HSBC net profit	7,434	11,099	13,524	16,061

Cash flow summary (INRm)

Cash flow from operations	9,408	9,267	12,094	14,293
Capex	-4,180	-4,563	-5,523	-6,309
Cash flow from investment	-3,418	-4,550	-5,523	-6,309
Dividends	-5,148	-5,200	-6,587	-8,000
Change in net debt	-1,359	-1,070	0	0
FCF equity	5,229	4,704	6,571	7,984

Balance sheet summary (INRm)

Intangible fixed assets	8,394	8,103	8,103	8,103
Tangible fixed assets	8,742	10,727	13,174	16,167
Current assets	32,192	38,156	45,409	53,309
Cash & others	2,438	3,500	3,500	3,500
Total assets	50,445	58,204	67,905	78,797
Operating liabilities	8,952	9,384	12,083	14,842
Gross debt	83	75	75	75
Net debt	-2,355	-3,425	-3,425	-3,425
Shareholders funds	40,558	48,589	55,527	63,588
Invested capital	37,938	44,101	51,103	59,236

Ratio, growth and per share analysis

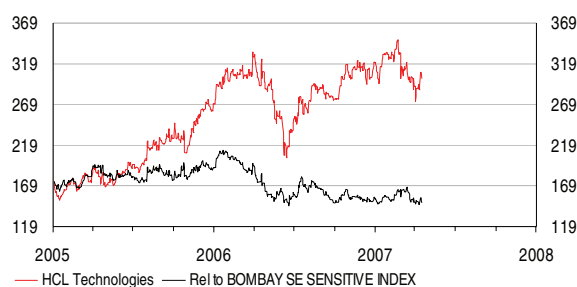
Year to Jun	06/2006a	06/2007e	06/2008e	06/2009e
Y-o-y % change				
Revenue	30.6	38.2	29.1	24.4
EBITDA	23.5	36.6	26.3	19.2
Operating profit	21.7	39.3	28.0	21.8
PBT	11.9	50.6	24.9	19.8
HSBC EPS	-42.8	47.4	20.5	17.4
Ratios (%)				
Revenue/IC (x)	1.2	1.5	1.6	1.8
ROIC	18.8	23.4	25.1	26.2
ROE	19.0	24.9	26.0	27.0
ROA	15.4	20.5	21.6	22.0
EBITDA margin	21.7	21.4	21.0	20.1
Operating profit margin	17.1	17.2	17.0	16.7
Net debt/equity	-5.8	-7.0	-6.1	-5.4
Net debt/EBITDA (x)	-0.2	-0.3	-0.2	-0.2
Per share data (INR)				
EPS reported (fully diluted)	11.49	17.02	20.44	23.98
HSBC EPS (fully diluted)	10.96	16.16	19.47	22.85
DPS	7.59	7.57	9.48	11.38
NAV	59.82	70.75	79.92	90.48

Valuation data

Year to	06/2006a	06/2007e	06/2008e	06/2009e
EV/sales	4.4	3.2	2.5	2.0
EV/EBITDA	20.3	14.8	11.7	9.8
EV/IC	5.1	4.4	3.8	3.2
PE*	27.5	18.6	15.5	13.2
P/NAV	5.0	4.3	3.8	3.3
FCF yield (%)	2.7	2.4	3.4	4.1
Dividend yield (%)	2.5	2.5	3.1	3.8

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 17 Apr 2007

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the views expressed herein accurately reflect their personal view(s) about the subject security(ies) and issuer(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Vipin Khare

Important disclosures

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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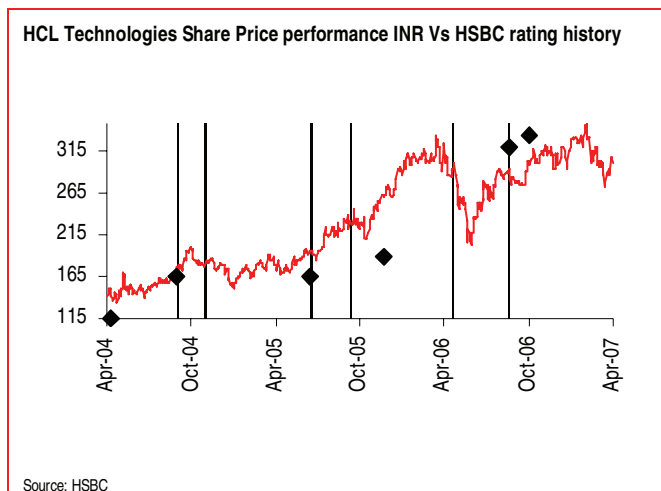
Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

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Overweight (Buy)	44%	(15% of these provided with Investment Banking Services)
Neutral (Hold)	36%	(16% of these provided with Investment Banking Services)
Underweight (Sell)	20%	(11% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
Sell	Hold	16 September 2004
Hold	N/R	15 November 2004
N/R	Overweight	30 June 2005
Overweight	Neutral	28 September 2005
Neutral	N/A	05 May 2006
N/A	Neutral	04 September 2006
Target Price	Value	Date
Price 1	115.00	27 April 2004
Price 2	165.00	16 September 2004
Price 3	N/R	15 November 2004
Price 4	165.00	30 June 2005
Price 5	190.00	07 December 2005
Price 6	320.00	04 September 2006
Price 7	335.00	18 October 2006

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
HCL TECHNOLOGIES	HCLT.NS	301.15	17-Apr-2007	4

Source: HSBC

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC is a market maker in securities issued by this company.
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- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.

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- 2 All market data included in this report are dated as at close 17 April 2007, unless otherwise indicated in the report.
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