

October 18, 2011

Shashi Bhusan  
shashibhusan@plindia.com  
+91-22-66322300

Rating	<b>BUY</b>
Price	Rs440
Target Price	Rs550
Implied Upside	25.0%
Sensex	17,083

(Prices as on October 17, 2011)

### Trading data

Market Cap. (Rs bn)	272.3
Shares o/s (m)	670.3
3M Avg. Daily value (Rs m)	580.7

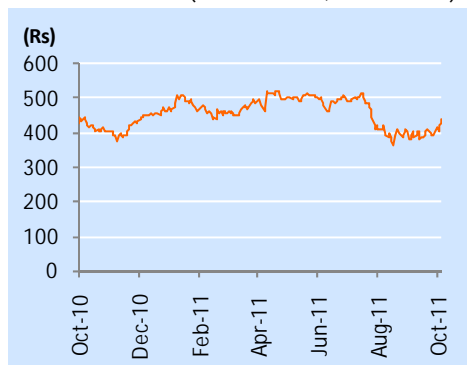
### Major shareholders

Promoters	64.37%
Foreign	21.35%
Domestic Inst.	6.13%
Public & Other	8.15%

### Stock Performance

(%)	1M	6M	12M
Absolute	11.4	(11.4)	0.4
Relative	9.2	1.8	17.0

Price Performance (RIC: HCLT.BO, BB: HCLT IN)



Source: Bloomberg

HCL Tech reported mixed-bag, lower than expected revenue growth of 4.1% QoQ in USD terms for Q1FY12, but better than expected margin. We reiterate our “BUY” with a target price of **Rs550**.

- HCLT Q1FY12 results – Mixed-Bag, revenue below, margins ahead:** HCLT revenue grew by 4.1% QoQ to Rs46.51bn for Q1FY12 (PLe Rs46.7bn, Cons: Rs47.1bn) in INR term, whereas revenue in USD terms grew by 4.1% QoQ to \$1002m. EBITDA margin eroded by 138bps (PLe: 190bp, Cons: 159bp) QoQ to 17.1%. The company reported EPS of Rs7.21 (PLe: Rs6.67, Cons.: Rs7.12), a de-growth of -3% QoQ.
- Geography, Services and Verticals – US, R&D Services, Custom Application and Hi-Tech shine:** Revenue for US and Europe grew by 6.8% and 2.5% QoQ respectively. In terms of services, R&D Svcs and Custom Application grew by 8.8% and 6.0% QoQ respectively. Retail and Hi-Tech grew by 12% and 7.8% QoQ respectively ahead of its larger peer’s growth.
- Volume and pricing growth, attrition spiral-down, Strong client addition:** The pricing improved by 0.5% QoQ (onsite: -0.2%, offshore: 0.3%) whereas volume growth was 4.0%. The company hired 9311 employees (Q4FY11: 9572, Q3FY11: 7534, Q2FY11: 8379) for the quarters and added 66 new clients (Q4FY11: 70) in Q1FY12. Attrition spiraled down to 15.9% (from 16.5% previous quarter)
- Valuation and Recommendation: Reiterate BUY, target price Rs550:** We may see stock giving an uptick movement on the back of strong result. We reiterate our “BUY” recommendation post Q1FY12 result with a target price of **Rs550**. We wait for the management commentary to get more input on demand pipeline.

Key financials (Y/e June)	2010	2011	2012E	2013E
Revenues (Rs m)	125,650	160,342	195,925	247,805
Growth (%)	18.2	27.6	22.2	26.5
EBITDA (Rs m)	25,728	27,488	32,253	39,102
PAT (Rs m)	13,001	17,099	20,838	25,159
EPS (Rs)	19.4	25.5	31.1	37.5
Growth (%)	2.2	31.5	21.9	20.7
Net DPS (Rs)	4.7	4.7	4.7	4.7

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	20.5	17.1	16.5	15.8
RoE (%)	20.4	22.2	22.4	22.3
RoCE (%)	13.1	15.4	16.8	18.3
EV / sales (x)	2.5	1.9	1.5	1.2
EV / EBITDA (x)	12.3	11.3	9.3	7.4
PE (x)	22.7	17.3	14.2	11.7
P / BV (x)	4.2	3.5	2.9	2.4
Net dividend yield (%)	1.1	1.1	1.1	1.1

Source: Company Data; PL Research

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**Exhibit 1: Mixed-bag, revenue below margin ahead (Rs m)**

Y/e June	Q1FY12	Q4FY11	QoQ	Q1FY11	YoY	Cons(e)	PL(e)	Var VS PL (e)
Sales (\$ m)	1,002	962.9	4.1%	803.8	24.7%	NA	1,020.8	-1.8%
Sales	46,513	42,995	8.2%	37,081	25.4%	47,068	46,700.9	-0.4%
Operating Profit	7,949	7,942	0.1%	6,034	31.7%	7,944	7,739.0	2.7%
<i>OPM</i>	<i>17.1%</i>	<i>18.5%</i>	<i>-138 bps</i>	<i>16.3%</i>	<i>82 bps</i>	<i>16.9%</i>	<i>16.6%</i>	<i>52 bps</i>
PBT	6,698	6,808	-1.6%	4,135	62.0%	6,377	6,153.5	8.8%
Tax	1,728	1,699	1.7%	824	109.7%	1,428	1,476.8	17.0%
<i>Tax Rate</i>	<i>25.8%</i>	<i>25.0%</i>	<i>84 bps</i>	<i>19.9%</i>	<i>587 bps</i>	<i>22.4%</i>	<i>24.0%</i>	<i>180 bps</i>
PAT	4,970	5,109	-2.7%	3,311	50.1%	4,949	4,676.6	6.3%
EPS	7.21	7.44	-3.0%	4.77	51.3%	7.12	6.81	5.9%
Average (USD rate)	46.41	44.7	3.9%	46.1	0.6%	NA	45.75	1.4%

Source: Company Data, Bloomberg, PL Research

**Exhibit 2: Details by service-line**

Software Services	Q1FY12	Q4FY11	QoQ	Q1FY11	YoY
Revenue	709.4	679.0	4.5%	575.7	23.2%
Gross Profit	238.3	235.3	1.3%	198.8	19.9%
<i>Gross Margin</i>	<i>33.6%</i>	<i>34.7%</i>	<i>-106 bps</i>	<i>34.5%</i>	<i>-94 bps</i>
EBITDA	127.5	132.4	-3.7%	103	23.8%
<i>EBITDA Margin</i>	<i>18.0%</i>	<i>19.5%</i>	<i>-153 bps</i>	<i>17.9%</i>	<i>8 bps</i>
<b>IMS</b>					
Revenue	246.3	236.2	4.3%	180	36.8%
Gross Profit	67.7	67.6	0.1%	46.8	44.7%
<i>Gross Margin</i>	<i>27.5%</i>	<i>28.6%</i>	<i>-113 bps</i>	<i>26.0%</i>	<i>149 bps</i>
EBITDA	44.5	46.4	-4.1%	32	39.1%
<i>EBITDA Margin</i>	<i>18.1%</i>	<i>19.6%</i>	<i>-158 bps</i>	<i>17.8%</i>	<i>29 bps</i>
<b>BPO</b>					
Revenue	46.5	47.7	-2.5%	48.1	-3.3%
Gross Profit	9.6	9.2	4.3%	8.7	10.3%
<i>Gross Margin</i>	<i>20.6%</i>	<i>19.3%</i>	<i>136 bps</i>	<i>18.1%</i>	<i>256 bps</i>
EBITDA	-0.7	(0.9)	-22.2%	-4.2	-83.3%
<i>EBITDA Margin</i>	<i>-1.5%</i>	<i>-1.9%</i>	<i>38 bps</i>	<i>-8.7%</i>	<i>723 bps</i>

Source: Company Data, PL Research

**Exhibit 3: Realization details**

Billing Rate	Q1FY12	Q4FY11	QoQ	Q1FY11	YoY
Offshore	3,743	3,749	-0.2%	3,616	3.5%
Onshore	13,611	13,569	0.3%	13,106	3.8%
<b>Total</b>	<b>6,435</b>	<b>6,405</b>	<b>0.5%</b>	<b>6,257</b>	<b>2.8%</b>

Source: Company Data, PL Research

**Exhibit 4: Revenue by Geography**

Geographic Split (\$ mn)	Q1FY12	Q4FY11	QoQ	Q1FY11	YoY
US	559.2	523.8	6.8%	466.2	20.0%
Europe	267.6	260.9	2.5%	214.6	24.7%
Asia Pacific	175.4	178.1	-1.5%	123.0	42.6%
<b>% Total</b>					
US	55.8%	54.4%	140 bps	58.0%	-220 bps
Europe	26.7%	27.1%	-40 bps	26.7%	0 bps
Asia Pacific	17.5%	18.5%	-100 bps	15.3%	220 bps

Source: Company Data, PL Research

**Exhibit 5: Revenue by Service offerings**

Service Offering Split	Q1FY12	Q4FY11	QoQ	Q1FY11	YoY
Enterprise Application Services	198.4	201.2	-1.4%	174.4	13.8%
Engineering and R&D Services	186.4	171.4	8.8%	150.3	24.0%
Custom Application (Industry Solutions)	324.7	306.2	6.0%	251.6	29.1%
Infrastructure Services	246.5	235.9	4.5%	179.2	37.5%
BPO Services	46.1	48.1	-4.2%	48.2	-4.4%
<b>% Total</b>					
Enterprise Application Services	19.8%	20.9%	-110 bps	21.7%	-190 bps
Engineering and R&D Services	18.6%	17.8%	80 bps	18.7%	-10 bps
Custom Application (Industry Solutions)	32.4%	31.8%	60 bps	31.3%	110 bps
Infrastructure Services	24.6%	24.5%	10 bps	22.3%	230 bps
BPO Services	4.6%	5.0%	-40 bps	6.0%	-140 bps

Source: Company Data, PL Research

**Exhibit 6: Continue to drive towards FPP**

Revenue by Contract Type	Q1FY12	Q4FY11	QoQ	Q1FY11	YoY
Time & Material	590.3	553.7	6.6%	473.4	24.7%
Fixed Price Projects	411.9	409.2	0.7%	330.4	24.7%
<b>% of total Revenue</b>					
Fixed Price Projects	41.1%	42.5%	-140 bps	41.1%	0 bps
Time & Material	58.9%	57.5%	140 bps	58.9%	0 bps

Source: Company Data, PL Research

**Exhibit 7: Revenue by Vertical Split**

<b>Vertical Split</b>	<b>Q1FY12</b>	<b>Q4FY11</b>	<b>QoQ</b>	<b>Q1FY11</b>	<b>YoY</b>
Financial Services	251.6	250.4	0.5%	202.6	24.2%
Hi-Tech - Manufacturing	290.6	269.6	7.8%	218.6	32.9%
Telecom	85.2	87.6	-2.8%	88.4	-3.7%
Retail	85.2	76.1	12.0%	68.3	24.7%
Media Publishing & Entertainment (MPE)	68.1	68.4	-0.3%	55.5	22.9%
Life Sciences	76.2	76.1	0.1%	67.5	12.8%
Others	145.3	134.8	7.8%	102.9	41.2%
<b>% of Total Revenue</b>					
Financial Services	25.1%	26.0%	-90 bps	25.2%	-10 bps
Hi-Tech - Manufacturing	29.0%	28.0%	100 bps	27.2%	180 bps
Telecom	8.5%	9.1%	-60 bps	11.0%	-250 bps
Retail	8.5%	7.9%	60 bps	8.5%	0 bps
Media Publishing & Entertainment (MPE)	6.8%	7.1%	-30 bps	6.9%	-10 bps
Life Sciences	7.6%	7.9%	-30 bps	8.4%	-80 bps
Others	14.5%	14.0%	50 bps	12.8%	170 bps

Source: Company Data, PL Research

**Exhibit 8: Client additions across bucket**

<b>Number of million dollar clients LTM)</b>	<b>Q1FY12</b>	<b>Q4FY11</b>	<b>QoQ</b>	<b>Q1FY11</b>	<b>YoY</b>
US\$ 100mn +	1	1	0.0%	1	0.0%
US\$ 50mn +	9	9	0.0%	6	50.0%
US\$ 40mn +	11	10	10.0%	7	57.1%
US\$ 30mn +	23	22	4.5%	14	64.3%
US\$ 20mn +	37	35	5.7%	26	42.3%
US\$ 10mn +	79	73	8.2%	64	23.4%
US\$ 5mn +	135	126	7.1%	112	20.5%
US\$ 1mn +	349	332	5.1%	292	19.5%

Source: Company Data, PL Research



**Exhibit 9: Revenue by top clients**

<b>Client Contribution to revenue (LTM)</b>	<b>Q1FY12</b>	<b>Q4FY11</b>	<b>QoQ</b>	<b>Q1FY11</b>	<b>YoY</b>
Top 5 Clients	153.3	148.3	3.4%	142.3	7.8%
Top 10 Clients	241.5	236.9	2.0%	208.2	16.0%
Top 20 Clients	342.8	339.9	0.8%	294.2	16.5%
<b>% of Total Revenue</b>					
Top 5 Clients	15.3%	15.4%	-10 bps	17.7%	-240 bps
Top 10 Clients	24.1%	24.6%	-50 bps	25.9%	-180 bps
Top 20 Clients	34.2%	35.3%	-110 bps	36.6%	-240 bps
Number of Clients	480	467	2.8%	426	12.7%
New Client Relationship	66	70	-5.7%	48	37.5%
Accounting for > 5% of revenue	1	1	0.0%	1	0.0%

Source: Company Data, PL Research

**Exhibit 10: Employee Details**

<b>Headcount</b>	<b>Q1FY12</b>	<b>Q4FY11</b>	<b>QoQ</b>	<b>Q1FY11</b>	<b>YoY</b>
Utilization offshore (incl. trainees)	69.7%	72.5%	-280 bps	70.1%	-40 bps
Utilization offshore (excl. trainees)	76.5%	76.1%	40 bps	74.1%	240 bps
Utilization onsite	96.0%	96.2%	-20 bps	95.7%	30 bps
<b>Efforts billed</b>					
Efforts billed offshore	80171	77333	3.7%	66,396	20.7%
Efforts billed onsite	30074	28673	4.9%	25,609	17.4%
Total Billed Effort	110,245	106,006	4.0%	92,005	19.8%
<b>Attrition LTM - IT Services</b>					
Attrition LTM - IT Services	15.9%	16.5%	-60 bps	16.7%	-80 bps
<b>Gross Addition</b>					
Gross Addition	9311	9572	-2.7%	11785	-21.0%
<b>Net Addition</b>					
Net Addition	3474	3626	-4.2%	5661	-38.6%
<b>Gross Laterals Addition</b>					
Gross Laterals Addition	6170	6267	-1.5%	6344	-2.7%

Source: Company Data, PL Research

**Exhibit 11: IT Services - Marching ahead**

<b>Revenue</b>	<b>Q1FY12</b>	<b>Q4FY11</b>	<b>QoQ</b>	<b>Q1FY11</b>	<b>YoY</b>
Offshore	300.1	289.9	3.5%	240.1	25.0%
Onsite	409.3	389.1	5.2%	335.6	22.0%
IT Services Revenue	709	679.0	4.5%	575.7	23.2%
<b>% of total Revenue</b>					
Offshore	42.3%	42.7%	-40 bps	41.7%	60 bps
Onsite	57.7%	57.3%	40 bps	58.3%	-60 bps

Source: Company Data, PL Research



**Income Statement (Rs m)**

Y/e June	2010	2011	2012E	2013E
<b>Net Revenue</b>	<b>125,650</b>	<b>160,342</b>	<b>195,925</b>	<b>247,805</b>
Raw Material Expenses	81,957	109,140	133,815	171,014
Gross Profit	43,693	51,202	62,110	76,791
Employee Cost	—	—	—	—
Other Expenses	17,965	23,714	29,857	37,689
<b>EBITDA</b>	<b>25,728</b>	<b>27,488</b>	<b>32,253</b>	<b>39,102</b>
Depr. & Amortization	5,009	4,974	5,578	6,285
Net Interest	—	—	—	—
Other Income	(5,302)	(561)	743	952
<b>Profit before Tax</b>	<b>15,417</b>	<b>21,953</b>	<b>27,419</b>	<b>33,770</b>
Total Tax	2,404	4,854	6,581	8,611
<b>Profit after Tax</b>	<b>13,013</b>	<b>17,099</b>	<b>20,838</b>	<b>25,159</b>
Ex-Od items / Min. Int.	12	—	—	—
<b>Adj. PAT</b>	<b>13,001</b>	<b>17,099</b>	<b>20,838</b>	<b>25,159</b>
<b>Avg. Shares O/S (m)</b>	<b>670.3</b>	<b>670.3</b>	<b>670.3</b>	<b>670.3</b>
<b>EPS (Rs.)</b>	<b>19.4</b>	<b>25.5</b>	<b>31.1</b>	<b>37.5</b>

**Cash Flow Abstract (Rs m)**

Y/e June	2010	2011	2012E	2013E
C/F from Operations	17,806	17,493	24,256	25,860
C/F from Investing	(11,824)	(8,017)	(9,404)	(11,647)
C/F from Financing	(5,499)	(3,149)	(9,166)	(9,166)
Inc. / Dec. in Cash	483	6,327	5,686	5,048
Opening Cash	4,203	4,686	11,013	16,699
Closing Cash	4,686	11,013	16,699	21,747
FCFF	7,540	14,071	19,750	19,913
FCFE	4,401	14,071	13,750	13,913

**Key Financial Metrics**

Y/e June	2010	2011	2012E	2013E
<b>Growth</b>				
Revenue (%)	18.2	27.6	22.2	26.5
EBITDA (%)	9.7	6.8	17.3	21.2
PAT (%)	2.2	31.5	21.9	20.7
EPS (%)	2.2	31.5	21.9	20.7
<b>Profitability</b>				
EBITDA Margin (%)	20.5	17.1	16.5	15.8
PAT Margin (%)	10.3	10.7	10.6	10.2
RoCE (%)	13.1	15.4	16.8	18.3
RoE (%)	20.4	22.2	22.4	22.3

**Balance Sheet**

Net Debt : Equity	0.3	0.2	—	(0.1)
Net Wrkng Cap. (days)	—	—	—	—

**Valuation**

PER (x)	22.7	17.3	14.2	11.7
P / B (x)	4.2	3.5	2.9	2.4
EV / EBITDA (x)	12.3	11.3	9.3	7.4
EV / Sales (x)	2.5	1.9	1.5	1.2

**Earnings Quality**

Eff. Tax Rate	15.6	22.1	24.0	25.5
Other Inc / PBT	(34.4)	(2.6)	2.7	2.8
Eff. Depr. Rate (%)	27.1	22.7	21.1	19.4
FCFE / PAT	33.9	82.3	66.0	55.3

Source: Company Data, PL Research.

**Balance Sheet Abstract (Rs m)**

Y/e June	2010	2011	2012E	2013E
Shareholder's Funds	70,352	84,025	101,698	123,691
Total Debt	26,632	26,632	20,632	14,632
Other Liabilities	7,402	7,402	7,402	7,402
<b>Total Liabilities</b>	<b>104,386</b>	<b>118,059</b>	<b>129,732</b>	<b>145,725</b>
Net Fixed Assets	18,486	21,944	26,451	32,398
Goodwill	43,122	42,467	41,787	41,202
Investments	707	707	707	707
Net Current Assets	32,431	43,301	51,147	61,777
<i>Cash &amp; Equivalents</i>	<i>4,686</i>	<i>11,013</i>	<i>16,699</i>	<i>21,747</i>
<i>Other Current Assets</i>	<i>59,074</i>	<i>80,391</i>	<i>90,810</i>	<i>104,528</i>
<i>Current Liabilities</i>	<i>31,329</i>	<i>48,103</i>	<i>56,362</i>	<i>64,497</i>
Other Assets	9,640	9,640	9,640	9,640
<b>Total Assets</b>	<b>104,386</b>	<b>118,059</b>	<b>129,732</b>	<b>145,725</b>

**Quarterly Financials (Rs m)**

Y/e June	Q2FY11	Q3FY11	Q4FY11	Q1FY12E
<b>Net Revenue</b>	<b>38,884</b>	<b>41,382</b>	<b>42,995</b>	<b>46,701</b>
<b>EBITDA</b>	<b>6,347</b>	<b>7,165</b>	<b>7,942</b>	<b>7,739</b>
<i>% of revenue</i>	<i>16.3</i>	<i>17.3</i>	<i>18.5</i>	<i>16.6</i>
Depr. & Amortization	1,062	1,046	1,121	1,261
Net Interest	—	—	—	—
Other Income	(80)	15	154	(145)
<b>Profit before Tax</b>	<b>5,028</b>	<b>5,982</b>	<b>6,808</b>	<b>6,153</b>
Total Tax	1,031	1,300	1,699	1,477
<b>Profit after Tax</b>	<b>3,997</b>	<b>4,682</b>	<b>5,109</b>	<b>4,677</b>
<b>Adj. PAT</b>	<b>3,997</b>	<b>4,682</b>	<b>5,109</b>	<b>4,677</b>

**Key Operating Metrics**

Y/e June	2010	2011	2012E	2013E
Volume (persons months)	305,662	398,854	502,556	623,169
Pricing (US\$ / Hr)	35.7	35.9	36.7	37.4
Currency (INR/USD)	46.5	45.3	43.0	43.0
SW. Devp. Cost (% of sales)	65.2	68.1	68.3	69.0
SG&A (% of sales)	14.3	14.8	15.2	15.2
Revenue (US\$ m)	2,705	3,545	4,556	5,763
EBITDAM Expansion/(Erosion) (bps)	(159)	(333)	(68)	(68)
Tax Rate (%)	15.6	22.1	24.0	25.5

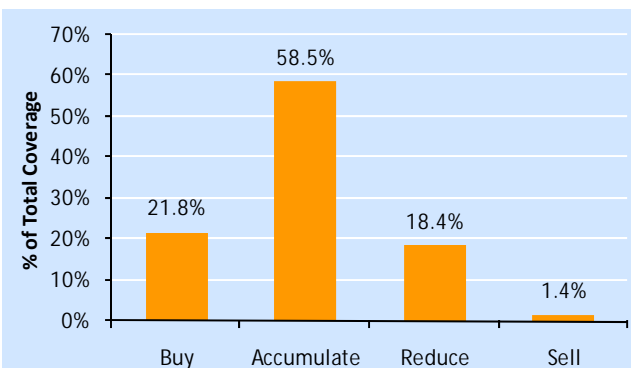
Source: Company Data, PL Research.

Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

#### Rating Distribution of Research Coverage



#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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