

# HCL Infosystems (HCLI.BO)

Results

## Buy: Weak Quarter; Good Order Wins

- Weaker than expected quarter** — HCLI reported Q4FY08 revenues at Rs31.2b while profits came in at Rs651m (CIR: Rs30.4b & Rs821m respectively). EBITDA margin of 3.4% was below estimates of 3.9%. Weakness was primarily seen in the hardware business (particularly system integration (SI) and the consumer PC business).
- Hardware business** — SI revenues were down ~23% YoY, which management attributed to significant milestones falling in Q1FY09 (rather than Q4FY08). However, SI more than doubled in FY08 (Rs6.0b vs. Rs2.5b). PC sales were up ~10% YoY – mostly contributed by the commercial segment as the consumer segment degrew YoY. Margins were down ~240bp YoY due to INR weakness (swing of ~Rs140m), lower SI mix and lower than expected overall revenues.
- Telecom business** — This segment fared relatively better than expectations. Revenue growth was ~4% QoQ vs. GSM wireless subscriber net add degrowth of ~3% QoQ (Q2CY08 vs. Q1CY08). Management attributed better sales primarily to increased replacement demand and better ASPs.
- Significant order wins** — The SI business had order wins of ~Rs12b in the last 5-months (Apr–Aug'08). Wins included (1) 5-year deal to create a VPN network for a stock exchange; and (2) Infrastructure outsourcing contract from one of the leading financial services and real estate development companies, for its retail venture to provide pan India ICT Infrastructure.
- Stock factors in weak results** — Stock is down 25% since April largely factoring in weak results due to: (1) higher interest rate regime and (2) INR weakness. HCLI trades at ~6x FY09E EPS with ~7% dividend yield. Maintain Buy (1M).

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (02 Sep 08)	Rs119.75
Target price	Rs165.00
Expected share price return	37.8%
Expected dividend yield	6.7%
<b>Expected total return</b>	<b>44.5%</b>
Market Cap	Rs20,497M
	US\$464M

### Price Performance (RIC: HCLI.BO, BB: HCLI IN)



### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
30 Jun							
2006A	2,805	16.45	21.9	7.3	2.9	44.8	6.7
2007A	3,158	18.56	12.8	6.5	2.4	40.6	6.7
2008E	3,151	18.52	-0.2	6.5	2.0	33.5	6.7
2009E	3,648	21.44	15.8	5.6	1.6	32.4	6.7
2010E	4,542	26.69	24.5	4.5	1.3	32.9	6.7

Source: Powered by dataCentral

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### Other Order Wins

- Pan-African e-Network Project to build IT infrastructure across 53 African countries in Tele-Medicine and Tele-Education.
- Providing end-to-end ICT infrastructure support to the telecom sector by setting up IT, Networking infrastructure & Applications in the OSS & BSS space.
- “PAWAN” from the Punjab Government for setting up a statewide area network and orders for automation of a Municipal Corporation.
- The Infrastructure SI vertical saw wins for designing, supply and implementation of security & command and control centers from two of the major airports of the country.

**Figure 1. Key Financials, Rs m**

	4Q07	4Q08	Change
Net Sales	30,645	31,148	1.6%
Gross profit	2,565	2,617	2.0%
Gross margin	8.4%	8.4%	3bp
Operating costs	1,409	1,553	10.2%
EBITDA	1,156	1,064	-7.9%
EBITDA margin	3.8%	3.4%	-35bp
Depreciation	42	49	17.4%
EBIT	1,114	1,015	-8.9%
EBIT margin	3.6%	3.3%	-38bp
Profit before taxes	1,235	956	-22.6%
Tax Expense	387	304	-21.3%
Profit after Tax	848	651	-23.2%
Basic EPS	5.02	3.81	-24.1%

Source: Company Reports

**Figure 2. Segmental Financials, Rs m**

	4Q07	4Q08	Change
<b>Hardware business</b>			
Net Sales	8,000	8,359	4.5%
Operating expenses	7,437	7,968	7.1%
EBIT	563	391	-30.5%
EBIT margin	7.0%	4.7%	-236bp
<b>Telecom business</b>			
Net Sales	22,595	22,782	0.8%
Operating expenses	21,853	22,073	1.0%
EBIT	742	709	-4.4%
EBIT margin	3.3%	3.1%	-17bp

Source: Company Reports

## HCL Infosystems

### Company description

HCL Infosystems is a leading player in the PC (personal computer) and enterprise hardware space in India. It has market share of ~15-16% in the desktop market and ~6-7% in the notebooks market in India. Its range of offerings includes systems integration services to Indian corporates, with a strong presence in BFSI, telecom and e-governance verticals. The company also distributes technology and telecom products. It is the primary distributor of Nokia's GSM handsets in India.

### Investment strategy

We rate HCLI Buy/Medium Risk with a target price of Rs165. HCLI is a play on the Indian government's and domestic industry's tech spending. With a focus on the system integration (SI) space, the company's hardware revenues should grow at a c.20% CAGR over FY07-10E on stable margins. The Nokia business has been a drag on HCLI's growth over the past few quarters. With re-distribution of the addressable market complete, we expect its Nokia handset business to recover after 4Q08 and grow at a c.14% CAGR over FY08-11E.

### Valuation

We value HCLI at Rs165 using a sum-of-the-parts methodology: 1) Computer System (hardware) at Rs107 using an FY09E EV/EBIT of 8x; 2) Office Automation at Rs44 - a NPV of current Nokia contract without any terminal value, and 3) cash per share of Rs14. We believe 8x is fair for the hardware business against our estimate of a c.20% EBIT CAGR over FY07-10E. The multiple is in-line with the current peer-group average for HCLI's Asian peers. We value the office automation and telecom (primarily Nokia handset distribution) business conservatively at net present value of current Nokia contract (with no terminal value). We believe an SOTP-based target price is appropriate as the two business segments have different dynamics.

### Risks

We rate HCLI Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price include: 1) delays in system integration business execution; 2) market share losses in desktop and laptop market; 3) rupee depreciation leading to margin pressures; 4) slowdown in PC growth in domestic market; 5) tepid growth in non-Nokia business in office automation and distribution segment; 6) margin pressures leading to lower earnings growth; and 7) Nokia contract getting re-negotiated mid-way.

# Appendix A-1

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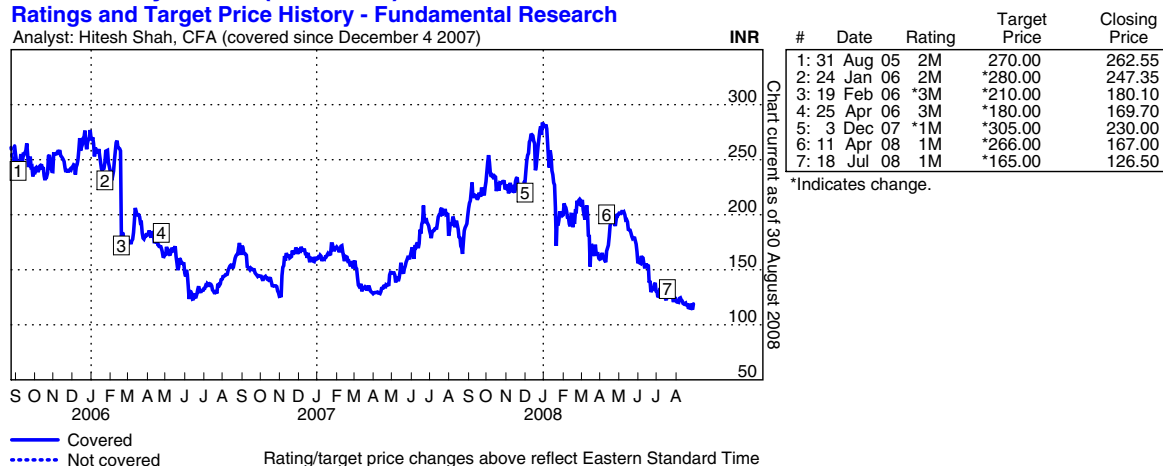
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Analyst: Hitesh Shah, CFA (covered since December 4 2007)



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