

# HCL Technologies Ltd (Q2 F6/08)

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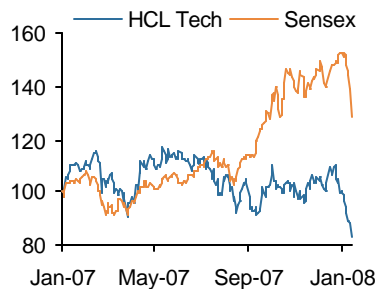
## Stock data

Sensex:	16,730
CMP (Rs):	229
Target price (Rs):	294
Upside (%):	28.4
52 Week h/l (Rs):	365/180
Market cap (Rs cr)	16,651
6m Avg vol BSE&NSE ('000 nos):	1,146
No of o/s shares (mn):	671
FV (Rs):	2
Bloomberg code:	HCLT IN
Reuters code:	HCLT.BO
BSE code:	532281
NSE code	HCLTECH

## Shareholding pattern

<b>December 2007</b>	<b>(%)</b>
Promoters	67.0
Foreign	16.0
Indian institutions	5.0
Public & others	12.0

## Share price trend



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- HCL reports eight consecutive quarter of 7%+ dollar revenue growth displaying good consistency. Volume growth remains strong while pricing improvements continue.
- Growth was driven by Core Software and IMS while BPO revenues were flat as expected.
- EBITDA margin was stable qoq as higher SG&A and rupee appreciation offset benefits of better pricing and offshore shift.
- Higher other income pushes net profit growth past that of EBIDTA.
- Given a consistent display of better performance than peers and the steep correction in price, we upgrade HCL to BUY with one-year price target of Rs294 implying 28% upside.

## Result table

Period to	Q1 FY08	Q2 FY08	QoQ	YoY
(Rs mn)	(3)	(3)	(%)	(%)
Net sales	17,092	18,166	6.3	24.0
Total expenditure	(13,453)	(14,281)	6.2	25.2
EBIDTA	3,639	3,885	6.8	19.9
EBITDA margin (%)	21.3	21.4	-	-
Depreciation	(686)	(724)	5.5	16.2
Interest	-	-	-	-
Other income	504	542	7.5	12.7
PBT	3,457	3,703	7.1	19.5
Tax	(346)	(355)	2.6	72.3
Income from equity affiliates	-	-	-	-
Minority interest	(28)	(21)	(25.0)	-
PAT	3,083	3,327	7.9	16.2
ESOP charge	(227)	(222)	(2.2)	(25.0)
APAT	2,856	3,105	8.7	19.6
Number of shares (Mn)	663.4	663.4	-	-
EPS (Rs)	4.6	5.0	7.9	16.2

Source: Company, India Infoline Research

## Q2 F6/08 Snapshot

Particulars	Highlights
<b>Revenue growth</b>	Strong revenue growth momentum continues with dollar growth of 7.4% qoq
	Volume growth was healthy at 6.6% qoq; 7.3% in core software and 8.4% in IMS
	Overall pricing improved by 1.6% qoq with rate improvement in all the segments
	Segmental dollar growth qoq: core software - 8.3%, IMS - 9% & BPO - 0.4%
<b>EBITDA %</b>	EBIDTA margin remains stable qoq at 21.4%
	Pricing improvement and hedging income offset impact of higher SG&A and rupee rise
<b>Profit growth</b>	Other income increases qoq by 8% due to better returns and increase in investments
	Net profit grows above expectations by 8.7% qoq

### **Revenue growth momentum continues**

HCL reported an eighth consecutive quarter of 7%+ qoq growth in dollar revenues. In Q2 F6/08, dollar revenues grew by 7.5% driven by 6.6% volume growth and 1.6% pricing improvement. The large deals won over the past 12-15 months continue to drive growth with their share in revenue increasing. The growth was broad based amongst clients with Top 20 customers recording a growth of 8.1% qoq. On a convenience translation basis, rupee revenues grew by 6.3% qoq.

### **Core software and IMS continue to drive growth**

Dollar revenue growth in core software was robust at 8.3% qoq contributed by 7.3% qoq volume growth and modest billing rate improvement. Within core software, offshore revenues grew by strong 9.9% driven by 8.4% growth in volumes. Revenue mix shifted towards offshore by 110 bps to 50.5%. IMS continues to grow at brisk pace with 9% qoq growth. BPO revenues were flat due to slowdown in business from one of its key clients who contributed 5% of segmental revenues in Q1 F6/08. However, the actual performance was better than guidance in the segment.

### **US and financial services post strong growth unlike peers**

Revenues from the US region grew by strong 9% despite higher holidays and indications of economy slowdown. Moreover, BFSI vertical grew at robust 9.3% qoq which was well supported by retail, media & entertainment and life sciences that grew by 8.7%, 15.3% and 15.7% qoq respectively. Amongst services, custom application, engineering (R&D) and infrastructure services grew ahead of the company at 11.1%, 7.9% and 8.9% respectively.

### **EBIDTA margin remains flat qoq**

EBITDA margin improved by just 10 bps qoq to 21.4% as the benefits of better pricing, offshore shift, hedging gains were offset by higher SG&A and appreciation of rupee. SG&A was pushed by the expenses of the global customer meet which was organized during the quarter. Margins have been stable or improved in all the segments.

### **Higher other income increase net profit growth to 8.7% qoq**

Other income was higher by Rs40mn over previous quarter driven by an increase in investment corpus and better returns realized on it. As a result, net profit grew at higher than EBIDTA rate at 8.7%.

### **Modest manpower addition in core software while continued decline in attrition is commendable**

During the quarter, company added net 2,492 people about 5.5% of Q1 F6/08 ending workforce. Net manpower addition in core software was modest at 1,327, 4.5% of previous quarter base. People addition in BPO bounced back at 603 after negligible addition in Q1 F6/08, indicating that the segment is confident about successfully overcoming the client loss. Attrition for the company declined for the fifth consecutive quarter. It was at 15.5% for IT services (core software + IMS) and at 12.3% (quarterly) in BPO.

### **Upgrade to BUY with a price target of Rs 294 implying 28% upside**

HCL has been consistently delivering better performance than the industry thereby reflecting the success of the various business model transformation initiatives that it had taken. Keeping this in mind and the recent sharp stock price correction, we are upgrading HCL to BUY with a one-year price target of Rs294 (based on 13x march-adjusted FY09 EPS of Rs22.6) implying 28% upside.

**Projected financials**

y/e June (Rs mn)	FY06	FY07	FY08E	FY09E	FY10E
Revenues	43,882	60,336	75,044	95,060	118,926
yoy growth (%)	32.1	37.5	24.4	26.7	25.1
EBITDA	9,729	13,370	16,111	19,553	23,331
EBITDA margin (%)	22.2	22.2	21.5	20.6	19.6
PAT	7,077	12,592	12,729	14,996	16,632
PAT	7,077	12,592	12,729	14,996	16,632
yoy growth (%)	17.8	77.9	1.1	17.8	10.9
EPS (Rs)	10.9	19.0	19.0	22.1	24.5
P/E (x)	27.5	15.9	15.9	13.6	12.3
P/BV (x)	4.8	4.2	3.8	3.3	2.8
EV/EBITDA (x)	18.1	13.1	10.9	8.9	7.2
ROE (%)	17.4	26.3	23.6	24.1	23.1
ROCE (%)	23.4	35.0	30.9	32.0	32.5

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