

HCL Technology

CMP: ₹ 513
TP: ₹ 620
Buy

View: We believe the robust volume/pricing growth of about 1.8%/2.8% QoQ indicates sustained business traction. Also strong gains in OPM of 250bps indicate improved efficiency and productivity gains despite sustained S&M investments. The company has been delivering strong revenue growth compared to its peers with improved profitability profile. We maintain our **positive** stance on the stock in view of its optimistic commentary on the environment and confidence on sustenance on performance.

Opportunities and not challenges: Management continues to remain confident on business outlook in coming period. It said that the most of the new wins are coming at the cost of global MNC players (2 in US and 1 European peer) and are restructuring deals. These deals are 20% higher in TCV as compared for 50% dip in overall TCV announced in H1CY12.

Right mix supporting the deal momentum: It has said that it is benefitted from the right portfolio mix of service offerings coupled with integrated service mix leading to strong upsell/cross sell opportunities. It has signed 7 new MSAs in troubled BFSI sector alone, most of these are vendor consolidation deal. It has signed as preferred supplier and may see traction in these deals as it would sign multiple RFPs in coming period.

BPO on recovery track: It is witnessing improved portfolio mix in its BPO verticals as non strategic voice business is getting out systemically. It expect transition to continue for another 2-3 years for the segment to deliver company level profitability.

Margins gain to mellow down: It expect OPM to slide down in H2 as it would reshift its focus back to aggressive S&M spend compared for execution priorities set at the moment. Also salary hikes of 2%/8% for onsite/offshore employees would impact OPM by 200+ bps in H1FY13.

High Points

- **Results ahead of estimates**
- **OPM improves by 370bps QoQ at 19.4%**
- **8 new transformation deals win**
- **Maintain Buy with a target of ₹ 620**

Scrip Details

Equity	₹ 1358mn
Face Value	₹ 2/-
Market Cap	₹ 358bn
	USD 6.4bn
52 week High / Low	₹ 524 / 360
Avg. Volume (no)	1052006
BSE Sensex	16,846
NSE Nifty	5,110
Bloomberg Code	HCLT IN
Reuters Code	HCLT.BO

Q1FY13 Result (₹ mn)

Particulars	Q1FY13	Q4FY12	QoQ (%)	Q1FY12	YoY (%)	FY12	FY11	YoY (%)
USD Revenues (mn)	1,079	1,048	3.0	962.9	12.1	4,152	3,545.3	17.1
Revenues	59,191	52,156	13.5	42995	37.7	210,312	160342	31.2
Cost of services	38,367	35,179	9.1	29061	32.0	140,558	109140	28.8
Gross Profits	20,824	16,977	22.7	13934	49.4	69,754	51202	36.2
SG&A Expenses	7,815	7,386	5.8	5992	30.4	29,503	23714	24.4
EBIDTA	13,009	9,591	35.6	7942	63.8	40,251	27488	46.4
Depreciation	1,524	1,413	7.9	1288	18.3	5,641	4976	13.4
EBIT	11,485	8,178	40.4	6654	72.6	34,610	22512	53.7
Other Income	153	227	(32.6)	71	115.5	706	257	174.7
Forex gain/ (loss)	(576)	(363)	58.7	83	(794.0)	(1,857)	-819	126.7
PBT	11,062	8,042	37.6	6808	62.5	33,459	21950	52.4
Income tax	2,525	2,016	25.2	1699	48.6	8,180	4854	68.5
PAT	8,541	6,025	41.8	5111	67.1	25,260	17095	47.8
EPS (Diluted)	12.2	8.6	41.2	7.29	66.9	36.3	24.55	47.7
EBITDA Margin	22.0	18.4		18.5		19.1	17.1	
EBIT Margins(%)	19.4	15.7		15.5		16.5	14.0	
Net Margins (%)	14.4	11.6		11.9		12.0	10.7	

Financials

Year	Net Sales	growth(%)	EBIT	OPM(%)	PAT	PAT Mg	EPS(₹)	growth(%)	PER(x)	ROANW(%)	ROACE(%)
FY11	160,342	27.4	27,488	17.1	17,095	10.7	24.5	27.2	20.9	22.1	21.0
FY12	210,312	31.2	40,252	19.1	25,260	12.0	36.1	47.0	14.2	26.4	28.0
FY13E	255,491	21.5	46,217	18.1	29,210	11.4	41.7	15.6	12.3	24.7	26.7
FY14E	294,787	15.4	54,386	18.4	34,807	11.8	49.7	19.2	10.3	24.4	27.3

Figures in ₹ mn

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Key highlights

US GAAP (numbers are on average quarter rate basis; USD 1 = ₹ 54.83)

- HCL Tech's revenue for Q4 FY12 grew 13.5% QoQ at ₹ 59bn – ahead of our estimates of ₹ 56bn. Revenue in constant currency grew 4.6%, led by sustained volume traction (up 1.8% QoQ).
- Revenues for FY12 grew by 17% in USD terms (4.1bn) and by 31% in reported currency terms (₹ 210bn)
- In constant currency terms, the company saw broad-based growth across geographies (ROW up 6.9%, Europe up 7.1% QoQ) and verticals (Utilities – 13%, healthcare – 23%).
- Top 5 and Top 10 customers have shown a sequential revenue growth of 6.6% and 5.4% which is above the company's overall growth. It added 50 new client relationships and won about 8 transformational deals during the quarter across verticals.
- Net added about 1855 to the Headcount taking the total count to 84,319 employees. High Attrition in BPO sustains at 31% (Quarterly annualized) but cools off in IT Services to 14% (15% in previous quarter).
- EBITDA grew by 35% QoQ at ₹ 13 bn (OPM up 360 bps to 22%) well ahead of our estimate of 9.5% growth. All the cost line items are lower in absolute basis in the quarter; seemingly on better efficiency (management confirmed no exceptional). I think management stance on sustainable rate of profitability would be the key determinants on a possible rerate on the stock.
- PAT grew 41% QoQ (48% for FY12) at ₹ 8.5bn (DE at ₹ 6.4bn) further aided by lower tax rate of 22.8% versus 25.1% in Q3. PAT margins have improved by 280 bps at 14.4% (12% for FY12).

Valuation

We expect the company to maintain strong revenue growth outperformance with a revenue/EPS CAGR of 18/17% over FY12-14E (revised up by 3% on Rev/PAT for FY14), driven by sustained deal win momentum. We maintain our positive view on the stock based on attractive valuations of 10(x) of FY14E earnings with a target price of ₹ 620 (valued at 12.5x of its FY14E earnings in line with its current discounting)

INCOME STATEMENT

₹ mn

Particulars	Mar11	Mar12	Mar13E	Mar14E
Net Sales	160,342	210,312	255,491	294,787
Total Income	160,342	210,312	255,491	294,787
Total Expenditure	132,854	170,060	209,274	240,400
Cost of Revenues	109,140	140,558	172,954	199,446
SG&A	23,714	29,502	36,320	40,954
EBIDTA (Excl. Other Income)	27,488	40,252	46,217	54,386
EBIDTA (Incl. Other Income)	26,926	39,082	46,592	54,986
Depreciation	4,976	5,641	6,578	7,305
EBIT	22,512	34,611	39,639	47,081
Other Income	(562)	(1,170)	375	600
PBT	21,950	33,441	40,014	47,681
Extra Ordinary Exps/(Income)				
Tax Expenses	4,854	8,180	10,804	12,874
Net Profit	17,096	25,261	29,210	34,807
Minority Interest	1	0	0	0
Net Profit	17,097	25,261	29,210	34,807

BALANCE SHEET

Particulars	Mar11	Mar12	Mar13E	Mar14E
Sources of Funds				
Equity Capital	1,358	1,358	1,358	1,358
Other Reserves	82,987	105,956	128,018	154,724
Net Worth	84,345	107,314	129,376	156,083
Loan Funds	28,127	32,568	32,118	31,668
Total Capital Employed	112,472	139,882	161,494	187,751

Applications of Funds

Net Block	32,557	42,827	48,849	54,044
Other Non Current Assets	41,878	49,404	49,404	49,404
Investments	7,606	6,805	6,805	6,805
Current Assets, Loans & Advances				
Sundry Debtors	34,065	53,440	65,440	82,440
Cash and Bank Balance	17,583	21,588	28,391	36,953
Other Current Assets	12,546	15,212	15,212	15,212
<i>sub total</i>	64,194	90,240	109,043	134,605
Less : Current Liabilities & Provisions				
Current Liabilities	33,763	49,394	52,607	57,107
<i>sub total</i>	33,763	49,394	52,607	57,107
Net Current Assets	30,431	40,846	56,436	77,498
Total Assets	112,472	139,882	161,494	187,751

E-estimates

CASH FLOW

Particulars	Mar11	Mar12	Mar13E	Mar14E
Profit before tax	21,351	33,440	40,014	47,681
Depreciation & w.o.	4,597	5,641	6,578	7,305
Net Interest Expense	(106)	1	0	0
Direct taxes paid	(3,285)	(8,180)	(10,804)	(12,874)
Chg. in Working Capital	(5,520)	0	(8,787)	(12,500)
Other	591			
(A) CF from Opt. Activities	17,629	30,902	27,001	29,612
Capex	(8,425)	0	(12,600)	(12,500)
Inc./ (Dec.) in Investments	680	(801)	0	0
Other	839			
(B) CF from Invt. Activities	(6,906)	(801)	(12,600)	(12,500)
Issue of Equity/ Preference	896	0	0	0
Inc./ (Dec.) in Debt	(4,990)	0	(450)	(450)
Interest exp net	(1,269)	0	0	0
Dividend Paid (Incl. Tax)	(5,179)	(6,512)	(7,148)	(8,101)
Fx differences on translation of cash equivalents	336			
(C) CF from Financing	(10,207)	(6,512)	(7,598)	(8,551)
Net Change in Cash	516	23,589	6,803	8,561
Opening Cash balances	4,833	17,583	21,588	28,391
Closing Cash balances	5,349	41,172	28,391	36,953
Deposits with fin. inst.	(11,946)	19,584		

E-estimates

IMPORTANT RATIOS

Particulars	Mar11	Mar12	Mar13E	Mar14E
(A) Measures of Performance (%)				
Contribution Margin				
EBIDTA Margin (excl. O.I.)	17.1	19.1	18.1	18.4
EBIT Margin	14.0	16.5	15.5	16.0
Tax/PBT	22.1	24.5	27.0	27.0
Net Profit Margin	10.7	12.0	11.4	11.8

(B) As Percentage of Net Sales

Cost of revenues	68.1	66.8	67.7	67.7
SG&A	14.8	14.0	14.2	13.9

(C) Measures of Financial Status

Debtors Period (days)	77.5	92.7	93.5	102
Fixed Assets Turnover (x)	2.2	2.3	2.6	2.8
Working Capital Turnover (x)	5.3	5.1	4.5	3.8
Non Cash Working Capital (₹ Mn)	12,848	19,258	28,045	40,545

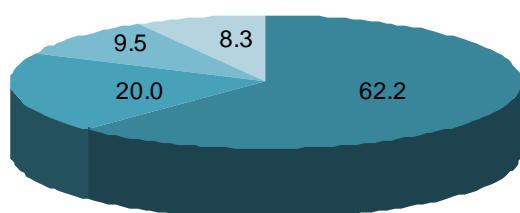
(D) Measures of Investment

EPS (₹)	24.7	36.6	42.3	50.4
CEPS (₹)	31.7	44.1	51.1	60.1
DPS (₹)	7.4	7.9	8.7	9.9
Dividend Payout (%)	35.0	25.8	24.5	23.3
Book Value (₹)	121.7	155.3	187.2	225.9
RoANW (%)	22.1	26.4	24.7	24.4
RoACE (%)	20.2	26.5	26.6	27.3
RoAIC (%) (Excl Cash & Invest.)	26.4	33.6	33.7	35.3

(E) Valuation Ratios

CMP (₹)	513	513	513	513
P/E (x)	20.8	14.0	12.1	10.2
Market Cap. (₹ Mn.)	357,612	359,433	359,433	359,433
MCap/ Sales (x)	2.2	1.7	1.4	1.2
EV (₹ Mn.)	360,550	363,608	356,355	347,344
EV/Sales (x)	2.2	1.7	1.4	1.2
EV/EBDITA (x)	13.1	9.0	7.7	6.4
P/BV (x)	4.2	3.3	2.7	2.3
Dividend Yield (%)	1.4	1.5	1.7	1.9

E-estimates

Shareholding Pattern as on June'12 (%)


■ Promoter ■ FII ■ DII ■ Public / Others

BUY	Upside above 20%
ACCUMULATE	Upside above 5% and up to 20%
REDUCE	Upside of upto 5% or downside of upto 15%
SELL	Downside of more than 15%

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