

April 20, 2011

Reco	Previous Reco
Hold	Hold
CMP	Target Price
Rs523	Rs 540
EPS change FY11E/12E (%)	(1.5)/-
Target Price change (%)	NA
Nifty	5,852
Sensex	19,471

Price Performance

(%)	1M	3M	6M	12M
Absolute	16	7	23	51
Rel. to Nifty	6	5	26	35

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	IT Services
Bloomberg	HCLT@IN
Equity Capital (Rs mn)	1371
Face Value(Rs)	2
No of shares o/s (mn)	686
52 Week H/L	526/344
Market Cap (Rs bn/USD mn)	359/8,086
Daily Avg Volume (No of sh)	1101242
Daily Avg Turnover (US\$mn)	11.8

Shareholding Pattern (%)

	M'11	D'10	S'10
Promoters	64.7	64.8	65.2
FII/NRI	23.1	23.3	22.6
Institutions	6.0	5.8	5.7
Private Corp	2.9	3.0	3.3
Public	3.4	3.1	3.2

Source: Capitaline

Manik Taneja

manik.taneja@emkayglobal.com
+91 22 6612 1273

Priya Gajwani

priya.gajwani@emkayglobal.com
+91 22 6612 1385

- HCLT reported revenues at US\$ 914 mn (+5.8% QoQ), ahead of Emkay expectations driven by Apps business (+5.4% QoQ) and IMS business (+8.5% QoQ). BPO revenues were flat QoQ
- EBITDA margins at 16.7%, up ~100 bps QoQ a big relief after a long streak of disappointment in the past few quarters
- See downside risks to ~110 bps mgn expansion in FY12 as co faces stiffer supply side headwinds (lateral focused hiring) and aggressive client hunting strategy
- Retain FY12E/13E earnings of ~Rs 32/38.4 despite marginal increase in US\$ revenue estimates. Maintain HOLD with an unchanged TP of Rs 540, based on 14x FY13E earnings

Marginally ahead of expectations

HCLT reported rev at US\$914 mn (+5.8% QoQ, ahead of Emkay expectations of ~4.7% growth) driven by Applications business (+5.4% QoQ) and IMS business (+8.5% QoQ with revenues at US\$ 213 mn). **Revenue growth was led by Asia Pac geography with revenues growing by ~21% QoQ, accounting for >50% of incremental revenues during the quarter while US rev. were nearly flat sequentially.** Amongst verticals, Fin Services revenues were up by ~13% QoQ and manufacturing revenues were up by ~6.6% QoQ. EBITDA margins improved by ~100 bps sequentially to 16.7% (V/s expectations of 60 bps improvement) as company hired more modestly during the quarter (hiring ~1,150 people on a net basis as well improved offshore utilization by ~180 bps QoQ in the Core Applications business) however note that margins are still down by ~220 bps YoY. Profits at Rs 4.4 bn (+18% QoQ, +36% YoY) were marginally ahead of Emkay est. (Rs 4227mn) driven by higher rev/mgn performance.

Margins show better than expected after a long streak of disappointment

HCLT's margins improved by ~100 bps QoQ to 16.7% (V/s Emkay expectations of ~60 bps improvement, note that margins were still down by ~220 bps YoY) which comes as a relief after the sharp decline in margins over the past few quarters. HCL Tech management remains committed to improving margins in June'11 qtr by ~100 bps QoQ (we build in ~130 bps sequential improvement in March'11 qtr) and should be no surprise as BPO losses reduce along with improvement in utilization. However, we note that HCL Tech faces much higher supply side headwinds given it's recruitment policy (hiring more laterals as compared to a fresher loaded strategy at peers TCS and Infosys, **refer 'Stiffer supply side headwinds for HCL Tech V/s peers' below**) apart from need for higher S&M as company continues to hunt for higher new business (**refer section 'Given HCLT's bent for new clients/business, SG&A a lever?'**)

Sharp stock up move limits upside, retain HOLD

The street has been enthused by HCL Tech's March'11 results as (1) company has reported decent revenue growth along with improvement in margins, (2) cash generation has improved during the quarter with no deterioration in balance sheet health. However sharp stock up move post results today leaves little upside as we retain our FY12E/13E earnings of ~Rs 32/38 despite marginal increase in US\$ revenue assumptions. HCLT's results provide some support to the strong demand environment for the sector after a near disaster at bellwether Infosys. We retain HOLD on HCL Tech with an unchanged price target of Rs 540.

Financials

Y/E June (in Rs mn)	Net Sales	EBITDA	EBITDA %	PAT	EPS (Rs)	ROE %	P/E (x)	EV/ EBITDA	P/B (x)
FY09	106,084	22,441	21.2	11,976	17.4	22.0	30.1	16.5	6.3
FY10	125,650	24,813	19.7	12,149	17.6	19.1	29.7	14.6	5.1
FY11E	158,516	26,229	16.5	15,934	22.9	21.6	22.8	13.9	4.7
FY12E	197,450	34,819	17.6	22,303	32.0	26.2	16.3	10.0	3.9

Quarterly performance

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
Revenue	30,757	34,254	36,116	38,625	40,778	32.6	5.6	115,519	91,396	26.4
Operating Expenditure	24,913	28,116	30,482	32,574	33,970	36.4	4.3	97,026	72,721	33.4
Cost of revenues	20,609	23,167	24,740	26,471	27,736	34.6	4.8	78,946	59,708	32.2
as % of sales	67.0	67.6	68.5	68.5	68.0			68.3	65	
SG&A expenses	4,304	4,949	5,742	6,103	6,234	44.9	2.2	18,079	13,013	38.9
as % of sales	14.0	14.4	15.9	15.8	15.3			15.7	14	
EBITDA	5,844	6,138	5,634	6,051	6,807	16.5	12.5	18,493	18,675	(1.0)
Depreciation	1,100	1,131	1,217	1,230	1,182	7.5	(3.9)	3,629	3,879	(6.4)
EBIT	4,744	5,007	4,417	4,821	5,625	18.6	16.7	14,864	14,796	0.5
Other Income	(767)	(1,578)	(634)	(79)	15	(102.0)	(119.0)	-698	(3,724)	(81.3)
PBT	3,977	3,429	3,783	4,742	5,640	41.8	18.9	14,166	11,072	27.9
Total Tax	754	246	778	1,019	1,250	65.8	22.7	3,047	2,106	44.7
Adjusted PAT	3,223	3,183	3,006	3,723	4,390	36.2	17.9	11,119	8,966	24.0
(Profit)/loss from JV's/Ass/MI	12	0	-2	0	0			-2	23	
APAT after MI	3,235	3,183	3,004	3,723	4,390	35.7	17.9	11,117	8,989	23.7
Extra ordinary items	0	0	0	0	0			0	-	
Reported PAT	3,235	3,183	3,004	3,723	4,390	35.7	17.9	11,117	8,989	23.7
Reported EPS	4.7	4.6	4.3	5.3	6.3	33.9	17.3	16	13	22.1

Margins (%)						(bps)	(bps)			
EBIDTA	19.0	17.9	15.6	15.7	16.7	(231)	103	16.0	20.4	(442)
EBIT	15.4	14.6	12.2	12.5	13.8	(163)	131	12.9	16.2	(332)
EBT	12.9	10.0	10.5	12.3	13.8	90	155	12.3	12.1	15
PAT	10.5	9.3	8.3	9.6	10.8	25	113	9.6	9.8	(21)
Effective Tax rate	19.0	7.2	20.6	21.5	22.2	320.3	67.3	21.5	19.0	249

Source: Company, Emkay Research

Stiffer supply side headwinds for HCL Tech V/s peers

The street has been greatly relieved by HCL Tech's margin improvement in the March'11 quarter after a 500 bps decline since Sep'09 quarter. We note that the company management remains committed to improving margins by ~100 bps in June'11 quarter (we build in ~130 bps sequential improvement in June'11 quarter) as BPO losses reduce further along with improvement in utilization going forward.

While peers Infosys and TCS hire 70%+ from campuses, HCL T's has depended largely on laterals

In our view HCL Tech faces higher supply side headwinds as compared to it's peers Infosys and TCS as it's hiring is more lateral driven as compared to more fresher loaded hiring policy and more so when demand for experienced talent is running high (refer table below which shows that for Infosys and TCS lateral hiring constitutes only ~20-25% of overall gross hiring, while for HCL Tech, lateral hiring accounts for 70%+ of overall hiring). Further while both TCS and Infosys are able to gain benefit of the broadening of the employee pyramid on account of this factor, HCL Tech is unable to gain from this factor

Lateral Addition as % of Gross Addition

Co Name	FY09	FY10	FY11
Infosys	20.5	17.8	18.4
TCS*	19.1	26.1	30
HCL Tech*	76.7	81.5	73.5

*Refers to 9mFY11 for HCL Tech and TCS

Source: Companies, Emkay Research

Given HCL Tech's bent at new clients/businesses; is SG&A a lever?

While HCL Tech has led the Tier I IT services pack on revenue growth through CY09 and CY10, a closer analysis of the growth reveals that HCL Tech's growth has been driven primarily by non top 10 client accounts as compared to stronger client mining for Infosys and TCS. **We note that while for Infosys and TCS, revenues from top 5/top 10 clients have grown in line/ higher than co average, in case of HCL Tech revenues from top 5/top 10 clients have grown at lower than co average.**

Overall revenues	CY08	CY09	CY10
Infosys	4684	4629	5735
% growth		-1.2	23.9
TCS	6099	6086.5	7628
% growth		-0.2	25.3
HCL Tech	1993	2453	3091
% growth		23.1	26.0
Revenues from Top 5 clients			
Infosys	1372	1231	1496
% growth		-10.3	21.5
TCS	1016	1120	1520
% growth		10.3	35.7
HCL Tech	526	490	541
% growth		-6.8	10.3
Revenues from Top 10 client			
Infosys	1372	1231	1507
% growth		-10.3	22.5
TCS	1549	1591	2092
% growth		2.7	31.5
HCL Tech	733	698	798
% growth		-4.8	14.4
Revenues from Non Top 10 clients			
Infosys	3312	3398	4228
% growth		2.6	24.4
TCS	4550	4496	5536
% growth		-1.2	23.1
HCL Tech	1260	1756	2293
% growth		39.3	30.6

HCL Tech's higher than peer revenue growth has been led by strong growth outside of non top 10 client accounts...

Source: Companies, Emkay Research

In our view HCL Tech has been aggressive at winning new clients (note that HCL Tech has done better at bagging new clients both in CY09 and CY10 as compared to peers Infosys and TCS) which entailed higher sales investments. However the company has not repeated similar success at client mining as is evident from the table below which essentially compares the client metrics between Infosys and HCL Tech.

New client additions	CY08	CY09	CY10
Infosys	159	131	152
TCS	180	124	140
HCL Tech	117	169	184

Source: Companies, Emkay Research

We note that Infosys's quarterly revenues were similar to HCL Tech's current quarterly revenues of ~US\$ 900 mn in June'07 quarter. **The table below while HCL Tech lead Infosys on number of US\$ 1 mn+ and US\$ 5 mn+ clients at similar size, it has lagged in growing revenues from clients beyond that.**

While HCL Tech has led peers in terms of new client additions, it has not been as successful in mining them as well...

	Infosys(June'07 qtr)	HCL Tech(March'11 qtr)
No of US\$ 1 mn + clients	285	324
No of US\$ 5 mn + clients	113	119
No of US\$ 10mn + clients	75	70
No of US\$ 20 mn + clients	40	31
No of US\$ 30 mn + clients	26	19
No of US\$ 40 mn + clients	18	10
No of US\$ 50 mn + clients	13	8
No of US\$ 100 mn + clients	3	1
Total Number of Active clients	509	453

Source: Companies, Emkay Research

In our view HCL Tech does a relatively better job at gaining entry into new client accounts but finds it difficult to mine them further by selling multiple service lines to them. **This in our view could be on account of HCLT's narrow breadth of services portfolio/lack of multiple services portfolio making it difficult to gain from the S& M leverage.**

Our FY12/13E earnings remain unchanged despite marginal increase in US\$ revenue assumptions

(All fig in Rs mn except EPS)	FY11E			FY12E			FY13E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenues(US\$ mn)	3,530	3,538	0.2	4,366	4,388	0.5	5,242	5,267	0.5
Revenues	158,796	158,516	-0.2	196,481	197,450	0.5	235,885	237,003	0.5
EBITDA	26,519	26,225	-1.1	34,750	34,801	0.1	40,871	41,019	0.4
Net profits	16,174	15,934	-1.5	22,262	22,289	0.1	26,767	26,886	0.4
EPS	23.4	23.0	-1.5	31.9	32.0	0.1	38.2	38.4	0.4

	Q3 FY11 (% contri to revenue)	Growth	
		% QoQ	% YoY
Service Offerings			
Core Software	71.2%	5.4%	35.2%
BPO	5.4%	0.6%	-4.2%
IMS	23.4%	8.5%	40.8%
Revenue Breakup by Geography (in %)			
US	54.3	0.6%	21.8%
Europe	27	7.4%	34.9%
Asia Pacific	18.7	21.4%	80.8%
Revenue by Service Offering (in %)			
Enterprise App Services	21.4	6.3%	33.5%
Engg & R&D services	17.7	1.2%	24.3%
Industry Solutions	32	6.5%	42.8%
Infrastructure services	23.4	8.6%	40.7%
BPO services	5.4	0.3%	-5.2%
Revenues by Contract Type (in %)			
Time & material	58	58.5	59.5
Fixed Price	42	41.5	40.5
Revenues by industry (in %)			
BFSI	26.2	12.7%	37.1%
Hi Tech Manufacturing	27.3	6.6%	36.4%
Telecom	10.3	0.9%	18.5%
Retail	8.7	1.2%	54.8%
Media, Publishing & Entertainment	6.6	2.7%	11.5%
Life Sciences	8	0.8%	42.3%
Others	7.3	33.2%	54.6%
Energy Utilities -Public Sector	5.6	-17.7%	6.8%
Client Contribution to revenues (in %)			
Top 5, %	16.2	2.0%	21.5%
Top 10, %	25.2	4.2%	30.3%
Top 20, %	36.2	4.7%	32.0%
Utilisation (Core Software)			
Offshore	71.9	70.1	76.2
Offshore(excluding Trainees)	76.3	75.0	79.0
Onsite	96.5	95.9	95.6
Total Employees			
Gross Addition	7,534	8,379	5,730
Net Addition	1,153	2,049	2,441

Asia Pac leading the growth rate
by growing at 21% sequentially

BFSI/Mfg grew at a higher rate
at ~13%/~7% sequentially

Financials

Income Statement

Y/E, June (Rs. m)	FY09	FY10	FY11E	FY12E
Net Sales	106,084	125,650	158,516	197,450
Growth (%)	39	18	26	25
Total Expenditure	(83,643)	(100,837)	(132,287)	(162,631)
Growth (%)		21	31	23
EBIDTA	22,441	24,813	26,229	34,819
Growth (%)		11	6	33
EBIDTA %	21.2	19.7	16.5	17.6
Other Income	-	-	-	-
Depreciation	(4,494)	(5,010)	(4,960)	(5,861)
EBIT	17,947	19,803	21,269	28,958
Interest				
EBT	14,490	14,501	20,567	29,345
Tax	(2,514)	(2,352)	(4,634)	(7,043)
EAT	11,976	12,149	15,934	22,303
Growth (%)		1	31	40
EAT (%)	11.3	9.7	10.1	11.3

Cash Flow

Y/E, June (Rs. m)	FY09	FY10	FY11E	FY12E
Net Profit after Tax	11,969	12,172	15,932	22,303
Add : Depreciation	4,494	5,010	4,960	5,861
Add : Misc exp w/off	-	-	-	-
Net changes in WC	(1,739)	(4,668)	(3,191)	(14,439)
Operational Cash Flows	15,276	12,974	17,892	29,343
Capital expenditure	(38,547)	(6,139)	(11,713)	(7,200)
Investments	-	-	-	-
Investing Cash Flows	(38,547)	(6,139)	(11,713)	(7,200)
Borrowings	29,496	(3,139)	(2,061)	-
dividend paid	(5,639)	(3,239)	(6,095)	(6,524)
Issue of shares	8	19	4	-
Share Premium	-	-	-	-
Financing Cash Flows	23,816	(6,352)	(8,152)	(6,524)
changes in cash	545	483	(1,973)	15,619
Opening balance	3,658	4,203	4,686	4,875
Closing balance	4,203	4,686	4,875	20,494

Balance Sheet

Y/E, June (Rs. m)	FY09	FY10	FY11E	FY12E
Equity share capital	1,335	1,354	1,358	1,358
Reserves & surplus	55,508	69,015	75,780	91,559
Minority Interest	15	(2)	-	-
Networth	56,858	70,368	77,139	92,917
Secured Loans	0	0	0	0
Unsecured Loans	29771	26632	24571	24571
Loan Funds	29771	26632	24571	24571
Total Liabilities	86,629	97,000	101,710	117,488
Goodwill	42315	43122	42515	42515
Gross Block	36,422	42,049	49,239	56,439
Less: Depreciation	18,553	23,563	28,523	34,384
Net block	60,184	61,608	63,231	64,570
Capital WIP	1,000	-	1,000	1,000
Investment	-	-	-	-
Current Assets	65,755	74,107	81,886	111,176
Sundry debtors	27,083	30,496	33,875	41,113
Cash & bank balance	4,203	4,686	4,875	20,494
Loans & advances	8,608	9,640	11,096	15,401
Current Liab & Prov	40,309	38,715	44,384	59,235
Current liabilities	32,675	31,329	34,874	47,388
Provisions	7,634	7,386	9,511	11,847
Net current assets	25,446	35,392	37,502	51,941
Total Assets	86,630	97,000	101,710	117,488

Key Ratios

Y/E, June (Rs. m)	FY09	FY10	FY11E	FY12E
EPS (Rs)	17.4	17.6	22.9	32.0
CEPS (Rs)	23.9	24.8	30.1	40.4
Book Value Per Share (Rs)	82.5	101.7	111.1	133.3
Dividend Per Share (Rs)	7.0	4.0	7.5	8.0
Valuations Ratios (x)				
PER	30.1	29.7	22.8	16.3
P/CEPS	21.9	21.1	17.4	12.9
P/BV	6.3	5.1	4.7	3.9
EV/EBIDTA	16.5	14.6	13.9	10.0
EV/Sales	3.5	2.9	2.3	1.8
M-Cap/sales	3.4	2.9	2.3	1.8
Profitability Ratios (%)				
RoCE	25.8	21.6	21.4	26.4
RoNW	22.0	19.1	21.6	26.2
EBITDA Margin	21.2	19.7	16.5	17.6
EBIT Margins	16.9	15.8	13.4	14.7
Net Profit Margin	11.3	9.7	10.1	11.3

Recommendation History: HCL Technologies – HCLT IN

Date	Reports	Reco	CMP	Target
20/01/2011	HCL Technologies Q2FY11 Result Update	Hold	508	540
20/10/2010	HCL Technologies Q1FY11 Result Update	Hold	426	430
29/07/2010	HCL Technologies Q4FY10 Result Update	Accumulate	382	430
22/04/2010	HCL Technologies Q 3FY10 Result Update	Accumulate	374	430

Recent Research Reports

Date	Reports	Reco	CMP	Target
15/04/2011	Infosys Q4FY11 Result Update	Accumulate	2,989	3,250
06/04/2011	eClerx Company Update	Accumulate	685	740
11/03/2011	Hexaware Technologies Initiating Coverage	Accumulate	55	66
25/02/2011	Mphasis Company Update	Reduce	455	450

Emkay Global Financial Services Ltd.

Paragon Center, H -13 -16, 1st Floor, Pandurang Budhkar Marg, Worli, Mumbai – 400 013. Tel No. 6612 1212. Fax: 6624 2410

DISCLAIMER: This document is not for public distribution and has been furnished to you solely for your information and may not be reproduced or redistributed to any other person. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions. This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. No person associated with Emkay Global Financial Services Ltd. is obligated to call or initiate contact with you for the purposes of elaborating or following up on the information contained in this document. The material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon. Neither Emkay Global Financial Services Ltd., nor any person connected with it, accepts any liability arising from the use of this document. The recipient of this material should rely on their own investigations and take their own professional advice. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. We and our affiliates, officers, directors, and employees world wide, including persons involved in the preparation or issuance of this material may; (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or may perform or seek to perform investment banking services for such company(ies) or act as advisor or lender / borrower to such company(ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The same persons may have acted upon the information contained here. No part of this material may be duplicated in any form and/or redistributed without Emkay Global Financial Services Ltd.'s prior written consent. No part of this document may be distributed in Canada or used by private customers in the United Kingdom. In so far as this report includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.