

# HCL Technologies

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Reuters: HCLT.BO; Bloomberg: HCLT IN

## Reader's Digest Bankruptcy – Impact Not To Be Significant

Reader's Digest Association (RDA), the owner of the popular magazine, *Reader's Digest* has filed for Chapter 11 bankruptcy in the US, the second time since August 2009. The company is reeling under high debt and will attempt to reduce it by US\$465mn when it exits Chapter 11. It should be noted that RDA's international operations are not part of the filing. RDA is an important client of HCL Technologies (HCLT), having signed a seven-year, US\$350mn deal with it in March 2009, spanning application development and infrastructure services across 45 countries in North America, Latin America and Asia. While there may not be an impact on HCLT at this point of time, an important event to watch is RDA's emergence from bankruptcy. The company expects to come out of restructuring over six months. In our view, a worst-case scenario would be RDA shutting down, in which case HCLT would lose the contract and write down receivables of US\$4.3mn for services rendered. There could also be uncertainty as regards RDA's IT strategy after emerging from bankruptcy, in which case HCLT's revenue from RDA could also decline. In a worst case scenario, if RDA is unable to come out of bankruptcy and HCLT loses the contract, we expect revenue impact of 0.9%, EBITDA margin impact of 50bps and EPS impact of 2.5% in FY14E. Currently, in the wake of stronger-than-peer revenue growth, healthy EPS CAGR of 28.8% over FY12-FY14E and a reasonable valuation at 12.2x FY14E EPS, we have retained our Buy rating on HCLT with a target price of Rs840.

**RDA files for bankruptcy, the second time since 2009:** RDA, a key client of HCLT has filed for Chapter 11 bankruptcy with the US Bankruptcy Court in the southern district of New York. RDA, owner of the popular magazine, *Reader's Digest*, is reeling under a high debt burden and will restructure it to finally emerge with a debt of around US\$100mn, around US\$465mn lower. It should be noted that this is the second time since August 2009 that RDA has filed for bankruptcy. RDA's international operations are not part of the filing.

**Signed a seven-year, US\$350mn deal with HCLT in March 2009:** RDA had signed a seven-year, US\$350mn deal with HCLT in March 2009, encompassing application development and infrastructure management services spanning 45 countries across North America, Latin America and Asia. Thus, annualised deal revenue amounts to US\$50mn.

**Critical factor to watch out for – RDA's emergence from bankruptcy:** In our view, an important event to watch out for is RDA's emergence from bankruptcy. In our view, a worst-case scenario would be RDA shutting down, in which case HCLT would lose the contract and write down receivables to the tune of US\$4.3mn. There could also be uncertainty regarding RDA's IT strategy after emerging out of bankruptcy, in which case HCLT's revenue from RDA could also decline.

**EPS impact of 2.5% seen in FY14E in a worst-case scenario:** In a worst case scenario of HCLT losing the RDA contract, we expect revenue impact of 0.9%, EBITDA margin impact of 50bps and EPS impact of 2.5% in FY14E.

**Valuation:** Currently, in the wake of stronger-than-peer revenue growth, healthy EPS CAGR of 28.8% over FY12-FY14E and reasonable valuation at 12.2 FY14E EPS, we have retained our Buy rating on HCLT with a target price of Rs840.

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	125,882	160,342	210,312	254,518	278,447
YoY (%)	18.9	27.4	31.2	21.0	9.4
EBITDA	25,785	27,488	40,251	56,169	59,632
EBITDA (%)	20.5	17.1	19.1	22.1	21.4
Adj. PAT	13,058	17,095	25,260	36,421	41,935
YoY (%)	2.3	30.9	47.8	44.2	15.1
FDEPS (Rs)	18.6	24.4	36.1	52.0	59.9
RoE (%)	20.5	22.1	26.4	29.8	27.1
RoCE (%)	18.7	17.0	22.5	26.8	23.4
P/E (x)	39.2	29.9	20.2	14.0	12.2
EV/EBITDA (x)	19.7	18.3	12.3	8.5	7.5

Source: Company, Nirmal Bang Institutional Equities Research

**BUY**

Sector: Information Technology

CMP: Rs730

Target Price: Rs840

Upside: 15%

Harit Shah

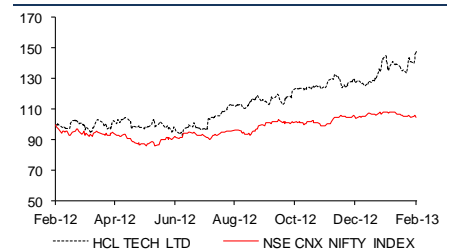
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### Key Data

Current Shares O/S (mn)	694.7
Mkt Cap (Rsbn/US\$bn)	506.7/9.3
52 Wk H / L (Rs)	732/441
Daily Vol. (3M NSE Avg.)	1,574,830

### One Year Indexed Stock Performance



### Price Performance (%)

	1 M	6 M	1 Yr
HCL Tech.	2.0	30.8	47.7
Nifty Index	(3.2)	8.6	5.0

Source: Bloomberg

## Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
2 June 2011	Buy	514	620
1 July 2011	Buy	493	620
28 July 2011	Buy	504	603
12 August 2011	Sell	408	381
23 September 2011	Hold	382	394
30 September 2011	Sell	410	394
23 November 2011	Hold	386	437
2 January 2012	Buy	388	504
17 January 2012	Buy	425	504
30 March 2012	Hold	478	504
18 April 2012	Hold	496	515
29 June 2012	Hold	461	515
25 July 2012	Buy	514	600
4 October 2012	Hold	590	600
17 October 2012	Hold	580	647
7 January 2013	Hold	634	647
18 January 2013	Buy	703	840

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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