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India Technology

Reuters HCLT.BO
Bloomberg HCLT IB

Priced on 21 June 2013

India Sensex @ 18,774.2

12M hi/lo Rs809.00/453.90

12M price target Rs850.00
±% potential +12%

Shares in issue 684.1m
Free float (est.) 37.8%

Market cap US\$8,924m

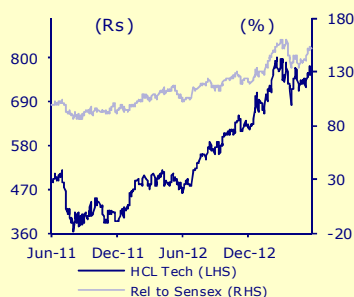
3M average daily volume
Rs1,138.0m (US\$20.5m)

Foreign s'holding 4.3%

Major shareholders
Promoters 62.2%
Foreign Institutions 20.0%

Stock performance (%)

	1M	3M	12M
Absolute	3.1	(1.1)	60.5
Relative	10.1	(1.3)	45.1
Abs (US\$)	(3.1)	(9.3)	54.7



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Business as usual

Solid confidence on margin performance (ex-currency) was the key positive takeaway from our interaction with HCL. Company margin guidance of 18-19% for FY14 at Rs55/\$ could well be beaten in our view. Revenue growth should likely continue the trend seen in recent times – strong infra services and modest growth elsewhere. Overhang from immigration bill & a soft overall market sentiment implies stock re-rating is unlikely but earnings should be good enough to support the stock.

Business as usual on revenue front

HCL suggested that it's business as usual on the demand front and there has been no change in the environment compared to 3 months back. Deal pipeline in infrastructure services segment remains strong and decision-making is progressing normally on such deals. In recent weeks, HCL is seeing some integrated deals in the market – which involve transforming the client's entire IT-BPO infrastructure and then running it. In the past Accenture has been a leader in such deals but Indian vendors are now getting a look-in in some of these. While some clients have been talking about the impending immigration bill, HCL has not seeing any instances of delays due to that. We are estimating 15% growth in \$-revenues in FY14.

Confidence on margin performance ex-currency benefits as well

On advice of external consultants, HCL had embarked on a cost-containment program 18 months back. While a good chunk of that benefit has flown through in margins (through utilisation improvement and facilities consolidation), HCL suggested that there is some more steam left. Record-high utilisations (both onsite and offshore) do not worry HCL and the company believes that those are unlikely to constrain future margin performance. With almost 50% of headcount in US locals, HCL seems better placed than most to tackle the adverse impact of the immigration bill if it goes through. The recent INR depreciation is a positive (1% depreciation c.f. US\$ adds 25bps to margins) but HCL prefers to wait and watch before using the current currency levels as input in its deal modelling.

Stock return could be driven by earnings upgrades/rollover

After a solid 2012 which saw significant earnings upgrade, HCL's stock has taken a breather in 2013 so far. Change in CEO earlier this year and uncertainty around the immigration bill has weighed on stock performance despite solid financials. We expect HCL's good run on financials to continue through 2013 as well which in-turn should allay market fears around leadership change. Given the soft market sentiment, near-term stock return will be led by earnings upgrades and roll-over as re-rating seems unlikely.

Financials

Year to 30 June	11A	12A	13CL	14CL	15CL
Revenue (Rsm)	160,341	210,312	255,072	294,478	337,713
Ebitda (Rsm)	27,487	40,250	56,751	61,495	67,545
Net profit (Rsm)	16,191	24,555	37,335	42,277	46,707
EPS (Rs)	23.7	35.4	53.3	60.1	66.1
CL/consensus (52) (EPS%)	-	-	98	100	100
EPS growth (% YoY)	31.3	49.5	50.6	12.7	9.9
PE (x)	32.1	21.4	14.2	12.6	11.5
PB (x)	6.2	4.9	4.0	3.3	2.8
ROE (%)	20.9	25.6	31.1	28.8	26.6

Source: CLSA

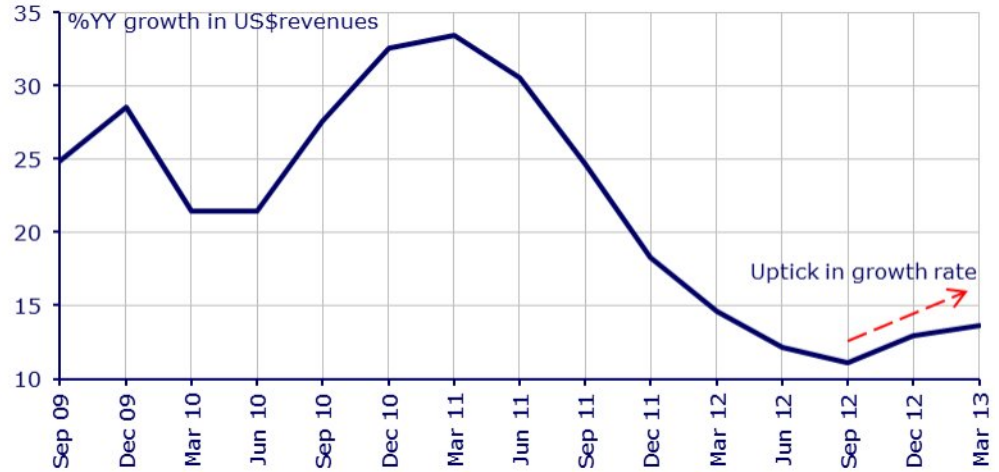
Recent uptick in YY revenue growth is a reassuring signal of the demand environment

However, Infrastructure management continues to be the growth driver, while growth in the software service (66% of revenues) remains sluggish.

Consistent margin improvement has enabled HCLT to close the margin gap with peers like Infosys

Figure 1

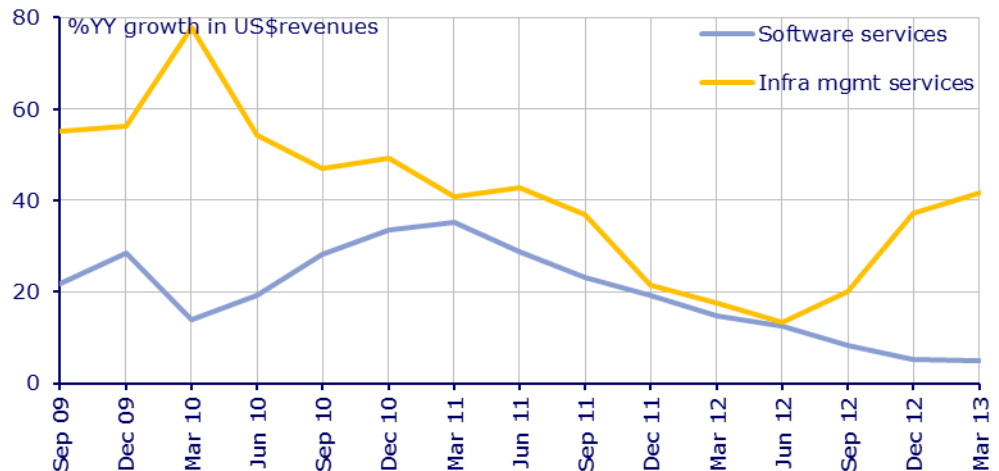
Last two quarters have witnessed an uptick in YY growth rate



Source: CLSA Asia-Pacific Markets

Figure 2

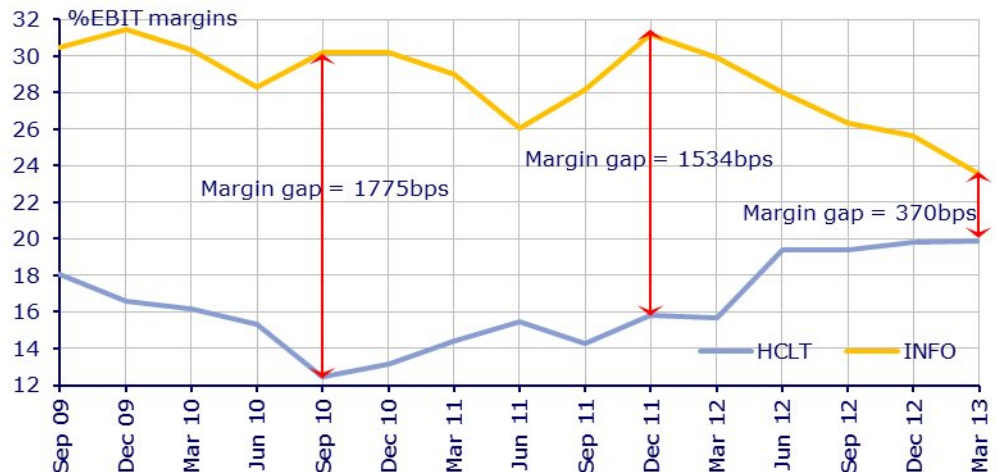
Infrastructure management services is the key growth driver



Source: CLSA Asia-Pacific Markets

Figure 3

HCLT has shown 4 quarters of consistent EBIT margin improvement

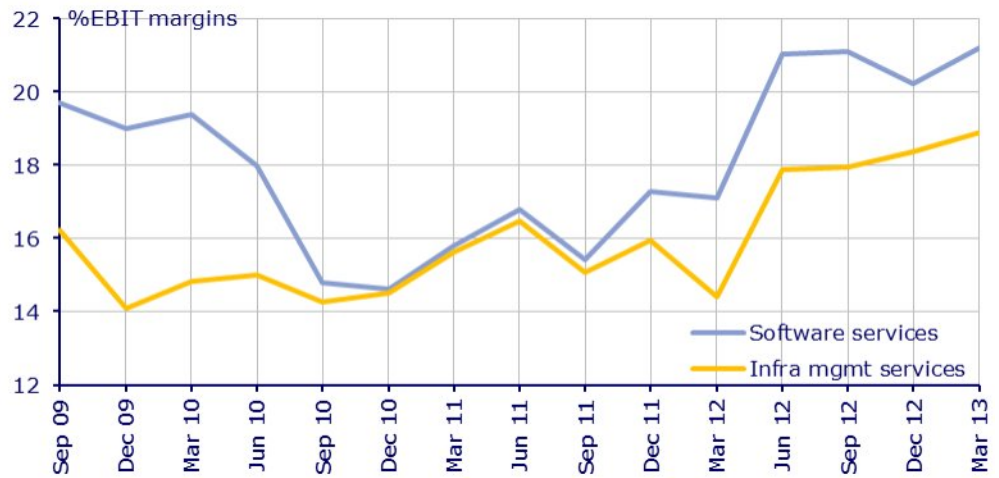


Source: CLSA Asia-Pacific Markets

This margin improvement is reflected evenly between Software services and Infrastructure management

Figure 4

Both the key service lines have delivered margin improvement

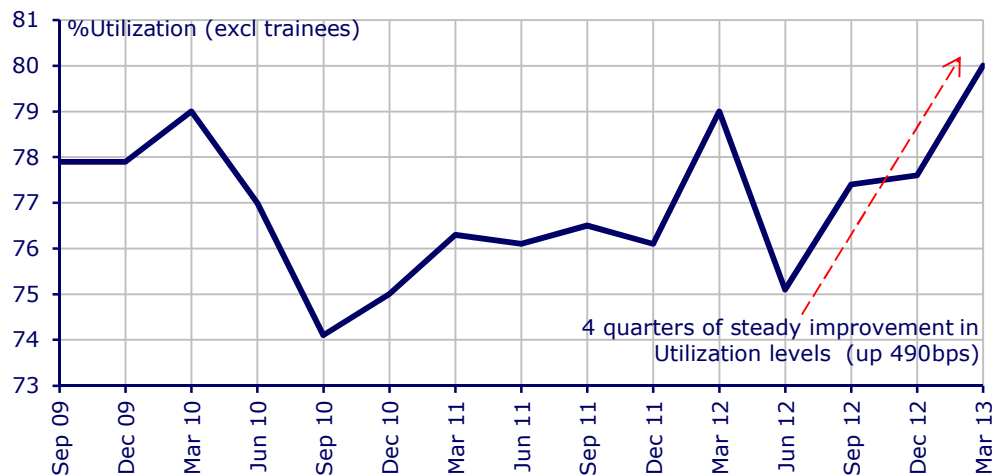


Source: CLSA Asia-Pacific Markets

Utilization levels reach all-time high of 80%, however, management has asserted that they are comfortable operating within the 80-82% range.

Figure 5

Utilization is at historical highs

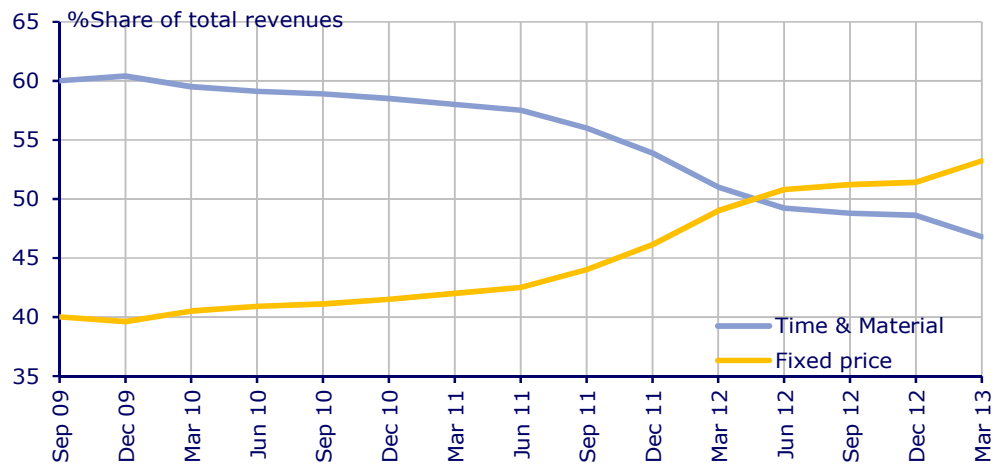


Source: CLSA Asia-Pacific Markets

Greater fixed price projects have introduced non-linearity in revenues and allow HCLT to operate at higher utilization levels

Figure 6

Fixed price projects generate more than half the revenues



Source: CLSA Asia-Pacific Markets

Summary financials

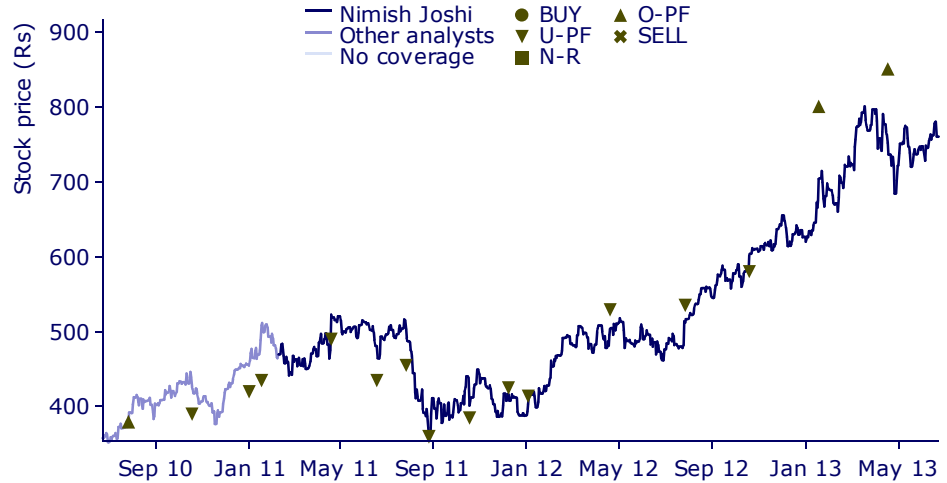
Year to 30 June	2011A	2012A	2013CL	2014CL	2015CL
Summary P&L forecast (Rsm)					
Revenue	160,341	210,312	255,072	294,478	337,713
Op Ebitda	27,487	40,250	56,751	61,495	67,545
Op Ebit	22,511	34,609	49,895	53,929	58,819
Interest income	-	-	-	-	-
Interest expense	(1,064)	(688)	(405)	(363)	(281)
Other items	(402)	(1,186)	(433)	848	1,554
Profit before tax	21,045	32,735	49,056	54,413	60,092
Taxation	(4,854)	(8,180)	(11,721)	(12,136)	(13,385)
Minorities/Pref divs	0	0	0	0	0
Net profit	16,191	24,555	37,335	42,277	46,707
Summary cashflow forecast (Rsm)					
Operating profit	22,511	34,609	49,895	53,929	58,819
Operating adjustments	745	8,739	3,676	3,332	3,154
Depreciation/amortisation	4,976	5,641	6,857	7,567	8,727
Working capital changes	(1,383)	(9,994)	(13,493)	(7,098)	(7,788)
Net interest/taxes/other	(6,067)	(6,565)	(12,154)	(11,288)	(11,831)
Net operating cashflow	20,782	32,430	34,780	46,441	51,080
Capital expenditure	(8,654)	(8,250)	(10,000)	(10,000)	(10,000)
Free cashflow	12,128	24,181	24,780	36,441	41,080
Acq/inv/disposals	972	(12,974)	(12,974)	(12,974)	(12,974)
Int, invt & associate div	(2,277)	927	(839)	485	1,274
Net investing cashflow	(9,959)	(20,297)	(23,813)	(22,489)	(21,700)
Increase in loans	(8,575)	(7,506)	(1,500)	(1,500)	(1,500)
Dividends	(8,483)	(13,409)	(16,103)	(18,796)	(21,490)
Net equity raised/other	6,263	11,818	4,357	4,357	4,357
Net financing cashflow	(10,795)	(9,097)	(13,246)	(15,939)	(18,633)
Incr/(decr) in net cash	28	3,037	(2,278)	8,013	10,747
Exch rate movements	0	0	0	0	0
Opening cash	24,933	24,961	27,998	25,720	33,732
Closing cash	24,961	27,998	25,720	33,732	44,479
Summary balance sheet forecast (Rsm)					
Cash & equivalents	24,961	27,998	25,720	33,732	44,479
Debtors	25,910	38,360	53,111	61,316	70,318
Inventories	1,664	2,261	2,261	2,261	2,261
Other current assets	17,303	25,010	39,226	44,215	49,572
Fixed assets	22,168	24,777	27,920	30,354	31,627
Intangible assets	(107)	(2,908)	(2,908)	(2,908)	(2,908)
Other term assets	47,465	60,439	73,413	86,387	99,361
Total assets	139,364	175,937	218,743	255,357	294,711
Short-term debt	-	-	-	-	-
Creditors	2,855	5,909	7,166	8,274	9,488
Other current liabs	35,794	53,856	71,315	80,484	90,549
Long-term debt/CBs	16,360	8,853	7,353	5,853	4,353
Provisions/other LT liabs	-	-	0	0	0
Minorities/other equity	22	3	3	3	3
Shareholder funds	84,332	107,316	132,906	160,744	190,318
Total liabs & equity	139,364	175,937	218,743	255,357	294,711
Ratio analysis					
Revenue growth (% YoY)	27.6	31.2	21.3	15.4	14.7
Ebitda growth (% YoY)	6.8	46.4	41.0	8.4	9.8
Ebitda margin (%)	17.1	19.1	22.2	20.9	20.0
Net profit margin (%)	10.1	11.7	14.6	14.4	13.8
Dividend payout (%)	25.3	16.9	11.2	10.0	9.1
Effective tax rate (%)	23.1	25.0	23.9	22.3	22.3
Ebitda/net int exp (x)	25.8	58.5	140.1	169.3	240.6
Net debt/equity (%)	(10.2)	(17.8)	(13.8)	(17.3)	(21.1)
ROE (%)	20.9	25.6	31.1	28.8	26.6
ROIC (%)	69.0	92.7	110.3	95.7	94.0
EVA@/IC (%)	51.8	75.6	93.2	78.5	76.8

Source: CLSA

Companies mentioned

HCL Tech (HCLT IB - RS759.40 - OUTPERFORM)

Recommendation history of HCL Technologies Ltd HCLT IB



Date	Rec	Target	Date	Rec	Target
17 April 2013	O-PF	850.00	26 August 2011	U-PF	360.00
17 January 2013	O-PF	800.00	27 July 2011	U-PF	455.00
18 October 2012	U-PF	580.00	19 June 2011	U-PF	435.00
26 July 2012	U-PF	535.00	20 April 2011	U-PF	490.00
19 April 2012	U-PF	529.00	19 January 2011	U-PF	435.00
03 January 2012	U-PF	414.00	03 January 2011	U-PF	420.00
08 December 2011	U-PF	425.00	20 October 2010	U-PF	390.00
18 October 2011	U-PF	385.00	29 July 2010	O-PF	380.00

Source: CLSA



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Note: In the interests of timeliness, this document has not been edited.

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