

October 4, 2013

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HCL Technologies Ltd (HCLTECH), the leading global Technology and IT Enterprise, is engaged in providing a range of software services, business process outsourcing and infrastructure services. The company provides solutions across a range of verticals including Retail, Aerospace and defense, Automotive, Telecom, Financial Services, Media and Entertainment, Travel, Transportation and Logistics, Energy and utilities, Life Sciences and Healthcare. With America and Europe being the principal geographical segments, the company has its footprints across 31 countries.

## Investor's Rationale

HCL Tech has booked 12 multi-year deals with TCW in excess of US\$ 1 bn in Q4FY'13. Over the last eight quarters, HCL Tech declared US\$10bn+ of deal wins and implementation of those deals would translate into better revenue visibility for the company in FY'14 and would aid the growth of the company in medium term. Further, the company's strong order book position in IMS space would help HCL Tech to outpace industry average.

The company registered a decent performance in Q4FY'13 as the revenue grew 8% QoQ led by robust growth across its vertical and geography services mix as per the US GAAP. Further, the net profit remained ahead of expectations on the back of higher than expected forex gains and lower tax rate. We remain positive on HCL Tech primarily on account of consistent quarterly performance and better revenue visibility. We expect HCL Tech's revenue to grow at a CAGR of 18% over FY13-15E.

The Foreign Investment Promotion Board (FIPB) has cleared the proposal to hike Foreign Direct Investment (FDI) limit in the company to 74% from 49%. The rise in limit will allow the money to move freely in the company and will benefit the company in enhancing its operations.

The overall client profile has improved for HCL Technologies. The clients under the \$10mn, \$20mn, \$30mn, \$40mn and \$50mn brackets grew from 96, 45, 25, 14 and 10 to 102, 51, 30, 18 and 11, respectively. While the new accounts are scaling up the larger accounts are also sustaining momentum with a 3.7% QoQ growth in Top 20 accounts. HCL Tech has also been penetrating deeper into its clients by offering diverse services. Moreover, contribution from top 5 and top 10 clients increased by 2.8% and 2.4% QoQ, respectively.

Infrastructure service emerges as the primary growth driver as this vertical has grown by 47.5% YoY in FY'13. The company's management remains upbeat over the sector's growth momentum in future backed by its focus on the re-bid market.

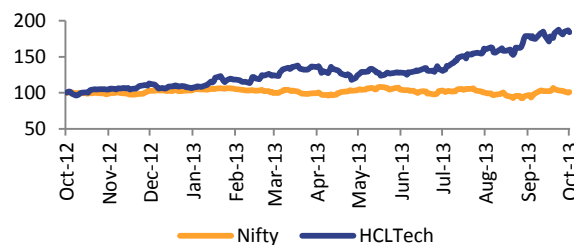
## Market Data

Rating	<b>BUY</b>
CMP (₹)	1,095.7
Target (₹)	<b>1,227</b>
Potential Upside	~12%
Duration	Long Term
Face Value (₹)	2
52 week H/L (₹)	1,119.5/534.3
Adj. all time High (₹)	1,077.5
Decline from 52WH (%)	2.1
Rise from 52WL (%)	105.1
Beta	0.3
Mkt. Cap (₹bn)	763.5
Enterprise Value	415.5

## Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	210.4	258.9	310.7	360.1
EBITDA (₹bn)	39.0	60.1	71.2	82.3
Net Profit (₹bn)	24.2	40.4	48.3	56.8
Adj EPS (₹)	34.9	58.0	69.3	81.4
P/E (x)	31.4	18.9	15.8	13.5
P/BV (x)	7.7	5.8	4.8	4.1
EV/EBITDA (x)	14.9	6.9	3.3	2.4
ROCE (%)	24.5	32.0	32.4	32.3
ROE (%)	24.6	30.7	30.4	30.2

## One year Price Chart



## Shareholding Pattern

Shareholding Pattern	Jun'13	Mar'13	Diff.
Promoters	61.9	62.0	(0.1)
FII	24.5	24.3	0.2
DII	6.5	6.6	(0.1)
Others	7.1	7.1	-

*HCL Tech, India's fourth-largest information technology (IT) services provider, had consolidated revenues of US\$ 4.6 bn (₹257.34 bn), as on June 30, 2013 (on LTM basis).*

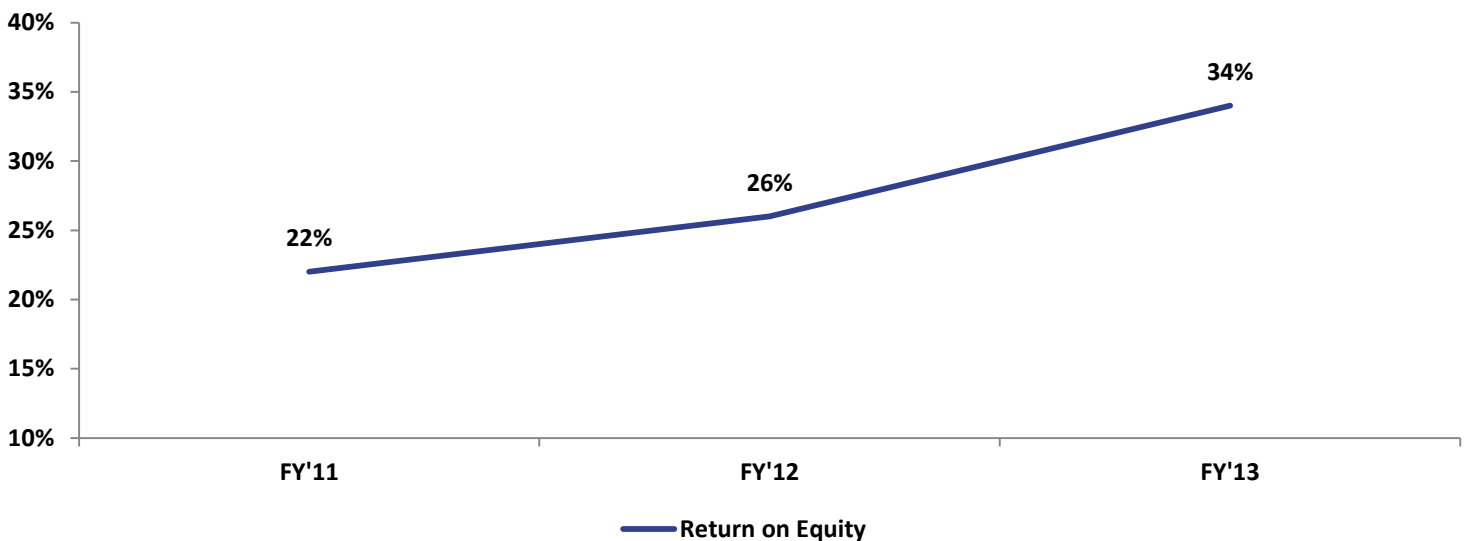
### HCL Technologies Ltd : a leading global Technology and IT Enterprise

HCL Tech, one of the top five-largest offshore IT service providers in India, was established in 1991. It is the leading provider of business transformation, enterprise & custom applications, infrastructure management, BPO, and engineering services. HCL Tech leverages its extensive global offshore infrastructure and network of offices in 31 countries to provide holistic, multi-service delivery in key industry verticals including Financial Services, Manufacturing, Consumer Services, Public Services and Healthcare & Life sciences. On horizontal front, HCL Tech has wide spread services lines with strong presence in niche and high end services areas such as EAS, Engg & R&D and fast growing IMS space. Further, it has dominance and leadership in Remote Infrastructure Management and in Engineering and R&D Services.

HCL Tech's Infrastructure Services Division (ISD) is the fastest growing service offering business line and contributes 24.2% to company's total revenues. HCL Tech, along with its subsidiaries, had consolidated revenues of US\$ 4.6 bn (₹257.34 bn), as on June 30, 2013 (on LTM basis). During the quarter ended June 30, 2013, HCL Tech has booked in excess of US\$ 1 bn, including 12 multi- year deals from F500/G2000 clients. These were primarily from Manufacturing, Financial Services and Lifesciences & Healthcare verticals.

Internationally, the company has its presence in more than 31 countries, but earns more than half of its revenues from customers in the US. One of the largest global engineering services providers in the world, HCL Tech's Engineering and R&D Services (ERS) business unit constitutes 18.7% of the company's overall revenues. The total active clients of the firm stood at 549 as of June 30, 2013. Its total headcount stood at 85,505 at the end of the quarter ended June 2013.

**ROE at 34% in FY'13 (US GAAP); the highest in the last 5 years and is amongst the best in the industry**



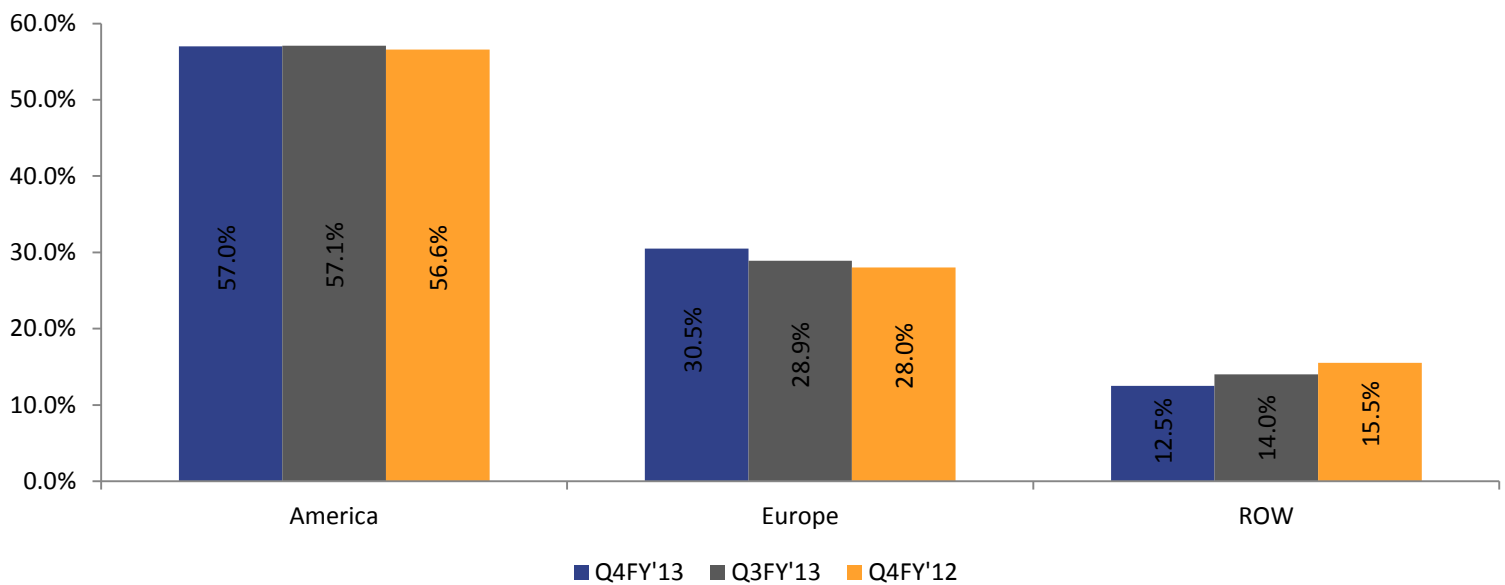
*Strong growth across verticals and geographies resulted in 8% QoQ increase in consolidated sales.*

*HCL Tech enjoys the status of being a debt free company.*

### A decent performance in Q4FY'13

HCL Tech posted a modest performance in Q4FY'13 with 8% QoQ increase in its consolidated sales at ₹69.44 bn primarily on account of robust growth across its vertical and geography services mix as per US GAAP. The IT services and BPO services segments revenues grew by 8.1% and 8.2% QoQ, respectively. The growth in IT services was mainly driven by sharp increase in revenue from the Infrastructure Services and Software services. Further, other services such as Engineering and R&D Services (+4.1% QoQ) and Custom Application Services (+1.3% QoQ) witnessed good growth. However, sales from Enterprise Application Services fell by 3.7% QoQ. On the EBITDA front, the company reported a 14.5% QoQ growth at ₹11.48 bn, with the EBITDA and EBIT margin rose by 105 bps and 118 bps to 23.5% and 21.0% respectively led by currency depreciation and increase in utilization levels. The fall in direct cost and SG&A cost by 80bps and 30bps (as % of sales) respectively also boosted the margins.

### Geographical revenue distribution



*Net profit surged 16.3% QoQ backed by a forex gain of ₹0.31 bn, during the quarter, against ₹0.23 bn in Q4FY'12.*

HCL Tech reported a healthy net profit growth of 16.3% QoQ at ₹12.1 bn assisted by higher forex gain (₹0.31 bn against ₹0.23 bn) and better EBITDA performance. Sharp fall in effective tax rate by 240bps QoQ to 21.4% also aid to the net profit growth. As a result, the net margin of the company rose to 17.4%, marking a seventh straight quarter of margin expansion. Besides, the company expects its EBIT margin to stay in the range of 18.5% to 19% at ₹55 to a dollar which was the average exchange rate last year. Besides, the company's capex in FY'13 has been close to 3.7% of revenue and it further plans to increase it upto 4% in FY'14. We expect HCL tech's revenue to grow at a CAGR of 18% over FY13-15E.

Broad based growth across verticals with the Public Services led the segment with a whopping 6.4% QoQ growth.

### Broad based growth across vertical and geographies: Revenue from US and Europe to grow further

**Verticals - Broad growth except Retail & CPG:** Sales from the Financial Services grew (4.2% QoQ), Manufacturing (4.3% QoQ), Public Services (6.4% QoQ), Media Publishing & Entertainment (3% QoQ) and Life Sciences (2.8% QoQ) witnessed good growth for Q4FY'13. However, Retail & Consumer Packaged Goods (CPG) witnessed flat growth during the same period.

**Geography - Sharp growth from Europe:** Growth in HCL Technology's top line was also driven by strong incremental revenues across Americas and Europe regions, and depreciating domestic currency versus the US dollar. The company witnessed a sharp rise in revenue from the world's largest economy, the US, up by 57.0% YoY during the quarter, on the back of recovery in the US economy. Europe, being a difficult market for other peers, saw a significant growth as the clients were looking at vendors who can undertake complex projects and HCL has gained their confidence in those terms. Revenue from Europe and RoW rose 30.5% and 12.5% YoY, respectively.

### Revenue growth trend across verticals in constant currency (%)

Verticals	Q4FY'12	Q1FY'13	Q2FY'13	Q3FY'13	Q4FY'13
Financial Services	5.2	3.6	10.1	1.0	5.8
Manufacturing	1.6	-	2.0	7.8	4.7
Telecom	(2.8)	(3.2)	(2.2)	4.7	5.9
Retail & CPG	4.2	10.2	0.7	2.9	0.8
Media, Publishing & Entertainment	4.4	7.3	4.2	(1.4)	3.2
Lifesciences & Healthcare	22.9	14.6	2.6	(1.6)	3.2
Public Services	13.1	(1.7)	4.7	14.8	7.3

HCLTech has added 1,102 employees during Q4FY'13 taking its total employee base to 85,505 and the company remains optimistic of further employee addition in future.

### Hiring to continue in the upcoming quarter

The company has witnessed an addition of 1,102 employees during Q4FY'13, taking its total employee strength to 85,505. The blended utilization (excluding trainees) in the Software services remained almost flat at 84% in Q4'FY13 from 83.8% in Q3'FY13. Further, the employee addition in IT services during the quarter stood at 686 while the attrition of the IT services rose to 14.9% in Q4'FY13 from 14.2% in Q3'FY'13. The net employee addition in infrastructure services segment was 1,091 employees in Q4FY'13, with the employee count in the segment rose to 23,012. Further, the BPO services have witnessed a net addition of 416 employees during the quarter, taking the segment's total employee base to 10,593. While, the Offshore Attrition – Quarterly (excludes involuntary attrition) declined to 6.9% in Q4'FY13 from 7.9% in Q3'FY'13. The employee rationalization program in the BPO business segment has led to a sharp decline in employee strength during

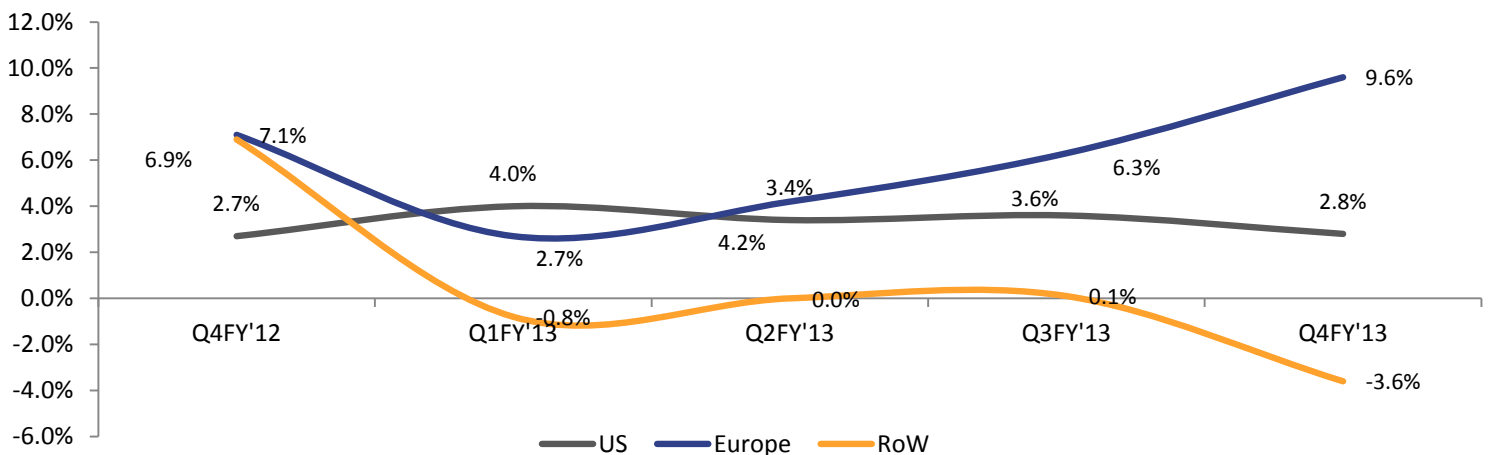
HCL Tech has bagged 12 large deal wins during the quarter with total contract value of more than US\$1bn.

Q2FY'13 and Q3FY'13. However, the company, which is quite optimistic of enhancing the order book position in the coming quarters, expects more employee addition in future.

### Large deals coming in from the renewal market

The company, which generates most of its revenue from 're-bids' or contract renewals by clients, is eyeing large deals from the renewal market. The company already has bagged 12 multi-year deals from F500/G2000 clients having a total contract value of more than USD 1 bn in Q4FY'13, and it now sees large momentum market on the re-bid side. It was seen that HCLTech added 36 clients and had 549 active clients by the end of Q4FY'13, displaying considerable strength among its peers. These significant large deal wins boosted the outlook of the company this fiscal. Over the last eight quarters, HCL declared US\$10bn+ of deal wins and implementation of those deals would translate into better revenue visibility for the company this fiscal and would aid the growth of the company in medium term. The company has been focusing a lot on the US and Europe markets to chase the rebid opportunity. The management believes US will continue to perform well while that of Europe the company is seeing increased demand from first time outsourcers in Europe and planned to consolidate on the strong traction achieved in Europe in the recent past. Further, the company's management highlighted that the company expects good traction in Manufacturing and BFSI space.

### Geographical revenue growth trend



HCLTech has added one client each in US\$50mn-100mn and US\$40-50mn revenue brackets, thus increasing the active client base to 549 in Q4FY'13 from 547 in Q3FY'13.

### Acquisition of big clients to enhance the profitability

HCL Tech has seen an improvement in its client pyramid in Q4FY'13 with addition of 36 new clients. The company added one client each in US\$50mn-100mn and US\$40-50mn revenue brackets, thus increasing the active client base to 549 in Q4FY'13 from 547 in Q3FY'13. The company's top clients registered a lower-than-company's average growth, with revenue from the top 5 and top 10 clients increased by 2.8% and 2.4% QoQ, respectively. The clients under the \$10mn, \$20mn, \$30mn, \$40mn and \$50mn revenue brackets grew from 96, 45, 25, 14 and 10 to 102, 51, 30, 18 and 11, respectively. While the new accounts are scaling up, the larger accounts are also gaining momentum with a 3.7% QoQ growth in Top 20

accounts. These clients' additions boosted the outlook of the company in the coming quarters. We expect the company to post a 19% CAGR growth in PAT over FY13-15E.

### Client metrics

No. of clients	Q4FY'12	Q1FY'13	Q2FY'13	Q3FY'13	Q4FY'13
100 mn dollar +	5	5	5	5	5
50-100 mn dollar	5	5	5	5	6
40-50 mn dollar	4	4	5	5	7
30-40 mn dollar	11	15	14	14	12
20-30 mn dollar	20	20	21	22	21
10-20 mn dollar	51	49	48	47	51
5-10 mn dollar	68	75	80	89	84
1-5 mn dollar	233	228	240	235	242
<b>Active Client Relationship</b>	536	536	544	547	549
<b>New Client Relationship</b>	50	38	39	37	36

### Infrastructure management services division remains the key growth driver

HCL Tech's Infrastructure Services Division is the fastest growing business line contributed 29.2% to revenue and continues to post stellar growth. The IMS vertical witnessed a revenue growth of 13.8% QoQ and 48.9% YoY in Q4FY'13 to `21,876 mn. We believe that HCL Tech is well positioned to benefit from the indication of revival in the discretionary spending in USA along with increased demand from first time outsourcers in Europe backed by its robust Infrastructure management business. Further, the company's dominant position in the IMS vertical coupled with strong order book position in IMS space would help HCL Tech to outpace industry average.

### Long term outlook remains positive for IT business

The information technology (IT) and Information Technology Enabled Services (ITES) industry has been one of the key driving forces fuelling India's economic growth with Indian IT Industry accounts for 55% of the global market in offshore IT. According to a survey by Gartner, India is one of the fastest-growing IT services markets in the world, with three-quarters of large Indian enterprises planning to increase IT spending in FY'13, with an average IT budget of US\$ 12.2 mn. Moreover, demand from emerging countries is expected to show strong growth going forward. Besides, the devaluation in rupee aids margin and improves the competitiveness of Indian IT service companies. However, visa issues are becoming structural for the IT companies and this has impacted their sub-contracting cost and consequently the margins. Recent protectionist measures have led to significant increase in Visa cancellation rates. And on-going congressional debate in US over comprehensive immigration reform is matter of concern and would add to the companies and IT sector worries as a whole.

*IT services' exports has been the major contributor to India's total exports with over 58% of the total IT-BPO exports during FY'11.*

**Balance Sheet (Consolidated)**

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
<b>Share Capital</b>	<b>1,387</b>	<b>1,394</b>	<b>1,394</b>	<b>1,394</b>
Share application money pending allotment	28	50	-	-
Reserve and Surplus	96,964	130,196	157,304	186,482
<b>Net Worth</b>	<b>98,377</b>	<b>131,640</b>	<b>158,698</b>	<b>187,876</b>
Minority Interest	11	447	-	-
Loans	15,262	9,253	7,286	5,738
Provisions	16,734	19,231	22,115	25,433
Current liabilities	46,376	56,221	70,276	87,846
Other long term liabilities	6,616	7,202	7,922	8,715
<b>Total Liabilities</b>	<b>183,378</b>	<b>223,993</b>	<b>266,298</b>	<b>315,607</b>
Goodwill	43,914	44,333	44,333	44,333
Fixed Assets	26,402	28,131	33,444	38,460
Investments	6,732	7,130	8,477	10,047
Loans & Advance	16,709	28,458	35,572	44,465
Deferred tax assets	6,616	7,419	7,419	7,419
Current Assets	78,744	104,345	132,458	165,829
Non-current assets	4,261	4,177	4,595	5,054
<b>Total assets</b>	<b>183,378</b>	<b>223,993</b>	<b>266,298</b>	<b>315,607</b>

**Key Ratios (Consolidated)**

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	18.5	23.2	22.9	22.9
EBIT Margin (%)	15.9	20.8	20.5	20.4
NPM (%)	11.5	15.6	15.5	15.8
ROCE (%)	24.5	32.0	32.4	32.3
ROE (%)	24.6	30.7	30.4	30.2
EPS (₹)	34.9	58.0	69.3	81.4
P/E (x)	31.4	18.9	15.8	13.5
BVPS(₹)	141.9	188.9	227.7	269.6
P/BVPS (x)	7.7	5.8	4.8	4.1
EV/Operating Income (x)	2.8	1.6	0.8	0.6
EV/EBITDA (x)	14.9	6.9	3.3	2.4

**Profit & Loss Account (Consolidated)**

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
<b>Net Sales</b>	<b>210,371</b>	<b>258,877</b>	<b>310,652</b>	<b>360,082</b>
Expenses	171,354	198,754	239,439	277,749
EBITDA	39,017	60,123	71,213	82,333
<i>EBITDA margin (%)</i>	<i>18.5</i>	<i>23.2</i>	<i>22.9</i>	<i>22.9</i>
Depreciation	5,492	6,368	7,641	8,864
EBIT	33,524	53,755	63,572	73,470
EBIT Margin%	16	20.8	20.5	20.7
Interest	1,426	1,056	898	763
PBT	32,098	52,699	62,674	73,707
Tax	7,827	12,253	14,415	16,952
Minority Interest	1	43	-	-
Share in earnings of associate	(43)	(2)	-	-
<b>Net Profit</b>	<b>24,227</b>	<b>40,401</b>	<b>48,259</b>	<b>56,754</b>
<i>NPM%</i>	<i>11.5</i>	<i>15.6</i>	<i>15.5</i>	<i>15.8</i>

**Valuation and view**

HCL Tech continued to report better numbers over the last couple of years notwithstanding the economic turbulence. With the robust client addition coupled with its dominant position in the IMS vertical and strong order book position in IMS space would help HCL Tech to outpace industry average. Further, we believe that the company will be able to sustain the momentum of bagging large deals in the quarters ahead that stands in testimony of better revenue visibility for the company. Thus, we believe that the company to achieve a revenue CAGR growth ~18% over FY13-15E.

At a current CMP of ₹1,095.7, HCL Tech is attractively placed at P/E and P/BVPS of ~13.5x and 4.1x for FY15E. Considering the above aspects, we rate the stock as 'BUY' with a potential upside of 12% for the coming 12 months.



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