NSSPL RESEARCH

HCL Technologies Ltd

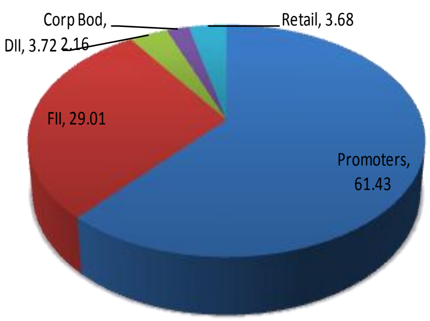
ACCUMULATE

BSE Code	532281
NSE Code	HCLTECH
Bloomberg Code	HCLT:IN
Current Price	1972
Target Price	2044
Mcap Rs bn	1380
Mcap US$ bn	22
52 wk H/L	2007/1257
Face Value	2
2 wk avg vol (000)	1986

Financial Snapshot

₹ Mn	FY14	FY15E	FY16E
Net sales	3,21,437	3,73,713	4,37,578
% ch	25.7	16.3	17.1
EBIDTA	80,353	87,333	1,00,246
%ch	41.9	8.7	14.8
PAT	65,278	71,683	79,678
%ch	61.1	9.8	11.2
EPS	93.0	102.1	113.6
BV	279.3	363.0	453.4
P/E	21.2	19.3	17.4
EV/EBIDTA	14.8	13.0	10.9
ROE	33.3	28.1	25.0
ROCE	40.2	35.7	33.1

Shareholding Pattern



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Revenues shows healthy growth surpassing street estimate

HCL tech posted results beyond street estimates with rupee revenue growth at 6.3% sequentially and 13.4% YoY. The growth has been mainly been backed by a strong dollar with depreciation of the INR by 2.2% over the previous quarter. Revenue in dollar terms has trended by 4% sequentially at $1.49bn. The growth has been driven by larger and midsized deals which have been signed across geographies and services. The deal pipeline look healthy as the TCV is in the range of a billion dollars. These deal booking have been broad based across the infrastructure services, engineering services and digitalization engagements. EBIDTA margins marginally shrunk sequentially by 11bps and 98bps YoY which can be attributed to increase in the employee cost and other expenditures. The net additions of 4718 employees have not impacted the utilization levels that currently stand at 82.9%. The other income in the previous quarter was higher due to the sale of the asset, we are of the opinion that the other income during this quarter which has shown a decline is normalized and may not witness such whipsaws going ahead. The higher depreciation by 4.8% sequentially along with a forex loss compared to the prior quarter has not impacted the profitability which has been at 2.2% QoQ and 28.2% YoY.

Robustness in client addition: HCL tech added a total of 45 clients in the various bands. 1 client was added in $50mn and 2 clients in $40mn. While the $5mn client band witnessed good additions of 12 clients, on the lower end of the client base we see strong additions of 22 clients in $1mn band this quarter. The addition in clients exhibits strong mining trends by its marketing force compared to its previous quarter. We believe with the strong sales force has entailed to add newer clients in different bands, as initiatives have been adopted to increase its employee strength. Increase in employees can be deployed to secure deal wins which would lead to gradual increase in revenues and profitability in the longer run.

Client Contribution	Q2FY15	Q1FY15		Q4FY15	Q3FY14	Q2FY14	Q1FY14
Top 5	14.0%	14.4%		14.7%	15.0%	14.8%	15.1%
Top 10	23.3%	23.1%		23.7%	24.1%	23.8%	23.8%
Top 20	32.4%	33.0%		33.7%	34.2%	33.6%	33.2%
Client Addition	**Q2FY15**	**Q1FY15**	**Addition QoQ**	**Q4FY15**	**Q3FY14**	**Q2FY14**	**Q1FY14**
100 Mn $ +	7	7	-	7	6	6	6
50 Mn $ +	16	15	1	15	14	12	11
40 Mn $ +	22	20	2	20	18	18	19
30 Mn $ +	37	37	-	37	32	30	29
20 Mn $ +	69	67	2	67	64	61	57
10 Mn $ +	121	115	6	114	109	107	105
5 Mn $ +	205	193	12	187	183	183	184
1 Mn $ +	450	428	22	429	432	427	427
Total Adds in Q2FY15			**45**				

Source: NSSPL Research / HCL-Tech

Margin contraction with higher employee cost: HCL Tech has witnessed contraction in the EBIDTA margins by 11bps witnessed on account of an uptick employee cost at 4.8% QoQ. There has been a net addition of 4718 employees this quarter, announced wages hikes to retain much of its workforce and lower the attrition rates. Additionally utilization levels were at 82.9% vs 82.7% sequentially. We believe with the newer deals signed there is headroom for utilization to increase which would bode well for it enabling to improve its margins and operational efficiency.

Attrition under check: The attrition rate has been marginally lower as compared to the last quarter at 16.6%. We believe that the efforts to bring down the attrition to more comfortable levels will ensure better utilization and increase operational efficiency. The company's attrition as compared to its peers has been much lower.

Service lines enunciates healthy growth: Growth rates in the IMS service have nearly doubled to around 6% due to several large transformational deals which have been executed. While HCL Tech continues to register deal wins in this segment we could see some delays in the revenues generation as durations for these deals could be elongated. Engineering and R&D posted double digit growth of 13.7%and the management is optimistic on the growth prospects within these services as there have been deal wins.

Services in % growth	Q2 FY15	Q1 FY15	YoY	Q4 FY14	Q3 FY14	Q2 FY14	Q1 FY14
Custom application	3.6%	3.7%	5.2%	0.9%	-2.9%	5.3%	10.9%
Enterprise Application	4.2%	5.7%	4.2%	-9.7%	10.4%	0.3%	5.0%
IMS	6.0%	3.7%	6.0%	1.2%	4.1%	4.7%	19.8%
Business Services	4.1%	3.7%	4.1%	12.1%	-0.2%	10.0%	14.1%
Engineering & R&D services	13.7%	3.7%	13.7%	7.2%	-1.1%	1.0%	11.4%

Source: NSSPL Research / HCL-Tech

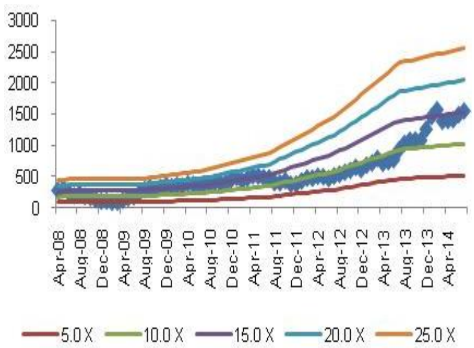
Performance across verticals: The verticals across have posted positive growth for the quarter, Financial services have shown a growth of 0.2% sequentially, management has stated that the growth over the previous quarters have offset the slower growth that has been witnessed in this quarter. We are of the opinion that in the past banking primarily was the maximum revenue contributor, now we are seeing some maturity take place in this segment as the focus is now shifting to other opportunities available in the verticals. HCL tech continues to grow its pipeline in the arena of banking vertical with penetration of newer products along with the focus on digitalization services. Manufacturing services has seen growth of 8.2% and the management has stated that the IT work has moved from core manufacturing to service manufacturing. Life science and health care have shown a spike in growth with 20.4% on the back of large transformational deals that have been executed. Management is confident on the growth to be positive on the back of strong order pipeline going forward. Retail and CPG posted a growth of 8.5% around digital offering. Content management solutions are driving growth for media with growth around 2.6%QoQ. Public services include energy and utilities companies where HCL sees traction, posted growth of 8.6% while companies are looking at cost structure closely we may not expect this vertical to carry on growth at similar levels in the short run.

Revenue in ₹ terms	Q2 FY15	Q1 FY15	QoQ	YoY	Q4 FY14	Q3 FY14	Q2 FY14	Q1 FY14
Financial Services	24693	24633	0.2%	16.5%	23924	22459	21197	20699
Manufacturing	30541	28214	8.2%	11.1%	26620	27802	27498	26510
Lifesciences & Healthcare	10304	8560	20.4%	17.7%	8592	8683	8757	9235
Public Services	8819	8124	8.6%	17.1%	8508	8432	7529	6210
Retail & CPG	9005	8298	8.5%	27.9%	7160	7097	7038	6608
Media, publish & entertainnt (MPE)	7798	7599	2.6%	7.1%	7497	7013	7284	7245
Others	1671	1922	-13.0%	-34.1%	1938	1920	2537	3105
Total	92830	87350	6.3%	13.4%	84240	83407	81840	79610

Source: NSSPL Research / HCL-Tech

Outlook for HCL tech: The management has guided that the investments will be in 3 strategic areas of 1. IT outsourcing 2. Engineering services and 3. The digitization space. IT outsourcing space includes the Infra (IMS) and Application management services (AMS) along with business outsourcing services, has been witnessing good traction and signs of

Forward P/E



success as most components of app management services are being bundled with infra management services and BPO services. IT outsourcing is driven by the Re-bid market with a lot of momentum around this space. Engineering services is an area where most of the work is been taking place especially new product developments. HCL tech has a dominant position capturing larger market share and has witnessed the engineering space moving into full service outsourcing. Lastly is the digitization space trend which is pervasive and exist in all service offering to clients which is gaining traction and trending providing an impetus for growth going ahead.

Valuations:

At the current price the stock is trading at a P/E multiple of 19.3x and 17.4x, a P/BV of 5.4x and 4.3x and an EV/EBITDA of 13.0x and 10.9x for FY15E & FY16E respectively. Based on the deal bookings and the outlook given by the management we believe that growth for HCLT will continue although at a slower pace at the profit levels as this was on account of the dollar strengthening and we do not expect as much volatility in the currency going ahead. The higher utilization aided with addition in employees and various initiatives taken by the management including salary hikes and promotions to bring attrition to comfortable levels will keep margins in check. Taking this into consideration we believe HCLT should trade at a P/E multiple of 18x FY16E which is a discount to TCS and Infosys but a slight premium to Wipro where the growth rate is lower. Taking this into effect we revise upward our target price to ₹2044, even though we have increased target price we retain our recommendation of "**ACCUMULATE**" as the stock has moved up quite a lot post its results .We believe on corrections towards ₹1800 the stock would be a good investment opportunity.

Financials

Profit & Loss

In ₹ million	FY13	FY14	FY15E	FY16E
Net sales	2,55,811	3,21,437	3,73,713	4,37,578
YoY (%)	*22.8*	*25.7*	*16.3*	*17.1*
Total expenses	1,99,199	2,41,084	2,86,380	3,37,332
EBIDTA	56,612	80,353	87,333	1,00,246
YoY (%)	*53.2*	*41.9*	*8.7*	*14.8*
Other income	3,511	6,774	9,454	11,094
PBIDT	60,123	87,127	96,787	1,11,340
Depre/ Amor	6,368	6,809	4,656	4,882
PBIT	53,755	80,318	92,131	1,06,458
Interest	1,056	1,145	488	488
PBT	52,699	79,173	91,644	1,05,970
(-) Tax	12,253	14,096	20,162	26,493
Tax/ PBT	23.3	17.8	22.0	25.0
Share of loss of associ	2	-201	-201	-201
PAT	40,444	65,278	71,683	79,678
Minority interest	-43	-183	-183	-183
Exceptional Item	0			
Net Profit	40,401	65,095	71,500	79,495
YoY (%)	66.7	61.1	9.8	11.2

Balance Sheet

In ₹ million	FY13	FY14	FY15E	FY16E
Equity capital	1,394	1,400	1,400	1,400
Reserves	1,30,246	1,94,098	2,52,677	3,15,975
Net worth	1,31,640	1,95,498	2,54,077	3,17,375
Total borrowings	9,253	4,065	4,065	4,065
Non current Liabilities	9,200	9,301	9,863	10,463
Current Liabilities	73,454	90,360	93,760	95,325
Minority interest	447	573	390	207
Total liabilities	**2,23,993**	**2,99,797**	**3,62,155**	**4,27,435**
Net block	67,525	74,439	75,093	76,211
CWIP	4,938	5,310	6,000	6,000
Investments	7,130	6,617	1,21,270	1,67,270
Deferred tax	7,419	8,150	8,150	8,150
Current assets	**1,20,064**	**1,87,233**	**1,29,984**	**1,43,815**
Non current assets	16,917	18,048	21,658	25,989
Total assets	**2,23,993**	**2,99,797**	**3,62,155**	**4,27,435**

Cash Flow

In ₹ million	FY13	FY14	FY15E	FY16E
Net profit	40,401	65,095	71,500	79,495
Depn and w/o	6,368	6,809	4,656	4,882
Deferred tax	192	1,623	0	0
Change in wrkg cap	-5,039	2,038	-17,370	-14,490
Other income	-3,511	-6,774	-9,454	-11,094
Operating cash flow	**38,410**	**68,791**	**49,331**	**58,793**
Other income	3,511	6,774	9,454	11,094
Capex	-5,288	-12,157	-6,000	-6,000
Investments	-3,404	-517	-1,17,700	-49,731
Investing cash flow	**-5,180**	**-5,900**	**-1,14,246**	**-44,638**
Dividend	-9,752	-8,134	-13,104	-16,380
Equity	0	0	0	0
Debt	-6,009	-5,188	0	0
Financing cash flow	**-15,761**	**-13,322**	**-13,104**	**-16,380**
Others	-1,174	2,769	0	0
Net change in cash	**16,294**	**52,337**	**-78,019**	**-2,225**

Key Ratios

	FY13	FY14	FY15E	FY16E
EPS (Rs)	58.0	93.0	102.1	113.6
CEPS (Rs)	67.1	102.7	108.8	120.5
Book value (Rs)	188.9	279.3	363.0	453.4
DPS (Rs)	12.0	10.0	16.0	20.0
Debt-equity (x)	6.6	2.9	2.9	2.9
ROCE	38.2%	40.2%	35.7%	33.1%
ROE	30.7%	33.3%	28.1%	25.0%
Valuations				
PE (x)	34.0	21.2	19.3	17.4
Cash PE (x)	29.4	19.2	18.1	16.4
Price/book value (x)	10.4	7.1	5.4	4.3
Dividend yield	0.61%	0.51%	0.81%	1.01%
Market cap/sales	5.4	4.3	3.7	3.2
EV/sales (x)	5.4	4.3	3.7	3.2
EV/EBDITA (x)	22.3	14.8	13.0	10.9

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