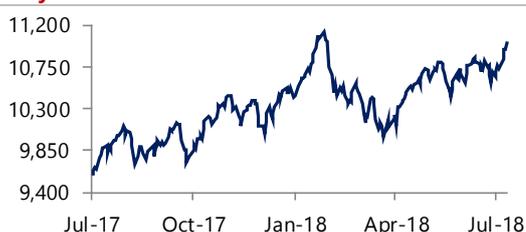


JULY 17, 2018

| Equity | % Chg | | | | |
|-----------------------------------|---------------|---------------|------------------|---------------|----------------|
| | 16-Jul | 1 Day | 1 Mth | 3 Mths | |
| Indian Indices | | | | | |
| SENSEX Index | 36,324 | (0.6) | 2.0 | 5.9 | |
| NIFTY Index | 10,937 | (0.7) | 1.1 | 3.9 | |
| NSEBANK Index | 26,680 | (1.0) | 1.0 | 5.4 | |
| NIFTY 500 Index | 9,231 | (1.3) | (1.2) | (0.9) | |
| CNXMcap Index | 17,794 | (2.6) | (5.4) | (10.3) | |
| BSESMCAP Index | 15,790 | (2.5) | (6.9) | (12.7) | |
| World Indices | | | | | |
| Dow Jones | 25,064 | 0.2 | (0.1) | 1.1 | |
| Nasdaq | 7,806 | (0.3) | 0.8 | 7.2 | |
| FTSE | 7,600 | (0.8) | (0.4) | 5.2 | |
| NIKKEI | 22,597 | 1.8 | (0.7) | 4.0 | |
| Hangseng | 22,597 | 1.8 | (0.7) | 4.0 | |
| Shanghai | 28,540 | 0.0 | (6.7) | (6.0) | |
| Value traded (Rs cr) | | 16-Jul | % Chg Day | | |
| Cash BSE | 2,476 | (18.8) | | | |
| Cash NSE | 27,766 | (6.2) | | | |
| Derivatives | 579,799 | 3.9 | | | |
| Net inflows (Rs cr) | | 12-Jul | MTD | YTD | |
| FII | (41) | (1,227) | (6,067) | | |
| Mutual Fund | 14 | 1,395 | 69,998 | | |
| Nifty Gainers & Losers | | Price | Chg | Vol | |
| 16-Jul | (Rs) | (%) | (mn) | | |
| Gainers | | | | | |
| Tech Mahindra | 657 | 2.5 | 2.9 | | |
| NTPC | 156 | 1.7 | 3.4 | | |
| Infosys Ltd | 1,333 | 1.2 | 17.7 | | |
| Losers | | | | | |
| Dr Reddy's | 2,094 | (9.7) | 3.7 | | |
| Tata Steel | 519 | (7.0) | 11.2 | | |
| Lupin | 818 | (5.5) | 2.9 | | |
| Advances / Declines (BSE) | | | | | |
| 16-Jul | A | B | T | Total | % total |
| Advances | 51 | 139 | 39 | 229 | 100 |
| Declines | 337 | 911 | 99 | 1,347 | 588 |
| Unchanged | 1 | 16 | 18 | 35 | 15 |
| Commodity | | % Chg | | | |
| | 16-Jul | 1 Day | 1 Mth | 3 Mths | |
| Crude (US\$/BBL) | 72.3 | 0.7 | (1.5) | 1.0 | |
| Gold (US\$/OZ) | 1,241 | (0.0) | (3.0) | (7.9) | |
| Silver (US\$/OZ) | 15.8 | (0.2) | (4.5) | (5.7) | |
| Debt / forex market | | 16-Jul | 1 Day | 1 Mth | 3 Mths |
| 10 yr G-Sec yield % | 7.8 | 7.8 | 7.9 | 7.5 | |
| Re/US\$ | 68.6 | 68.5 | 68.0 | 65.5 | |

Nifty



Source: Bloomberg

News Highlights

- ▶ The IMF has trimmed India's growth projection by 0.1 percentage point to 7.3% for 2018-19 owing to high oil prices and a tight monetary policy regime. The effect of the twin headwinds on the IMF's projection for 2019-20 was much sharper 0.3 percentage points to 7.5%. (BS)
- ▶ The government has increased the official maximum load carrying capacity of heavy vehicles, including trucks, by 20%-25% besides scrapping the mandatory annual renewal of fitness certificates for freight carriers. (ET)
- ▶ India raised the import duties on a large number of textile apparels, fibres and related products such as carpets by up to 20%. (BS)
- ▶ Inflation based on wholesale prices accelerated to over 4-year high of 5.77% in June on increasing prices of vegetables and fuel items, raising chances of a rate hike by the RBI in its monetary policy review next month. (Firstpost)
- ▶ LIC came a step closer in acquiring a majority stake in **IDBI Bank** as its board gave an approval to the deal. LIC's shareholding in IDBI Bank will stand at 51% after it takes a series of approvals from the RBI, the SEBI, the government and the bank's board. (BS)
- ▶ The government may infuse about Rs80 bn in five or six state-run banks that are likely to fall short of regulatory capital requirements. These banks may include Nirav Modi scam-hit **Punjab National Bank**. (ET)
- ▶ The committee of creditors (CoC) for Bhushan Power & Steel decided they would vote on **Tata Steel's** resolution proposal. If the plan is approved by the creditors, a letter of intent will be issued to the company and the resolution plan will be filed with the NCLT for approval. (BS)
- ▶ **Tata Steel** is planning to raise as much as \$3.1 bn via overseas loans to repay existing high-cost debt ahead of the merger of its European operations with German steel giant Thyssenkrupp. (ET)
- ▶ **Dr Reddy's Laboratories** said it will appeal the decision of a New Jersey court that ruled against the company over the opioid drug Suboxone, for which a UK drugmaker claims a patent. (ET)
- ▶ **Britannia Industries** has come up with a greenfield manufacturing facility in the country, at an investment of Rs2 bn in Rampur, Assam. The unit has a production capacity of 60,000 tonnes of biscuits annually. (ET)
- ▶ **Larsen & Toubro** has signed a pact with **BEML** to jointly explore emerging opportunities in the domestic and export markets for defence products and systems. (ET)
- ▶ **Lupin** said it had received approval from the U.K. health regulator for its Goa facility. The facility was inspected by the UK MHRA in March 2018 and there were no critical or major observations cited. (BSE)
- ▶ **ICICI Bank** has decided to postpone its AGM amidst independent enquiry conducted by Justice B. N. Srikrishna on alleged cases of impropriety against the bank's CEO Chanda Kochhar. The meeting has been rescheduled to Sept 12 as against the earlier schedule of Aug 10. (ET)

What's Inside

- ▶ **Result Update:** Hindustan Unilever Ltd
- ▶ **Buyback Offer:** HCL Technologies Ltd

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

Result Update

Stock Details

| | | |
|----------------------|---|-------------|
| Market cap (Rs mn) | : | 3790815 |
| 52-wk Hi/Lo (Rs) | : | 1779 / 1130 |
| Face Value (Rs) | : | 1 |
| 3M Avg. daily volume | : | 1,252,986 |
| Shares o/s (m) | : | 2165 |

Source: Bloomberg

Financial Summary

| Y/E Mar (Rs mn) | FY18 | FY19E | FY20E |
|---------------------|---------|---------|---------|
| Revenue | 345,250 | 401,874 | 459,469 |
| Growth (%) | 8.3 | 16.4 | 14.3 |
| EBITDA | 72,760 | 88,327 | 107,607 |
| EBITDA margin (%) | 17.1 | 18.4 | 18.5 |
| PAT | 52,990 | 6,390 | 7,281 |
| EPS | 24.5 | 29.1 | 35.7 |
| EPS Growth (%) | 24.7 | 18.8 | 22.7 |
| BV (Rs/share) | 30.7 | 34.5 | 44.9 |
| Dividend/share (Rs) | 20.0 | 22.0 | 22.0 |
| ROE (%) | 81.9 | 89.3 | 89.8 |
| ROCE (%) | 113.8 | 127.8 | 128.6 |
| P/E (x) | 71.5 | 60.2 | 49.0 |
| EV/EBITDA (x) | 47.6 | 39.3 | 32.3 |
| P/BV (x) | 57.1 | 50.7 | 38.9 |

Source: Company; Kotak Securities – PCG

Shareholding Pattern (%)

| (%) | Jun-18 | Mar-18 | Dec-17 |
|-----------|--------|--------|--------|
| Promoters | 67.2 | 67.2 | 67.2 |
| FII | 12.2 | 12.5 | 12.4 |
| DII | 7.3 | 6.9 | 6.9 |
| Others | 13.4 | 13.4 | 13.5 |

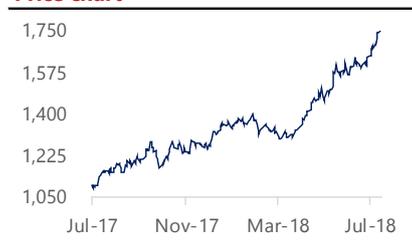
Source: Company

Price Performance (%)

| (%) | 1M | 3M | 6M |
|--------------------|-----|------|------|
| Hindustan Unilever | 8.0 | 23.4 | 26.7 |
| Nifty | 1.1 | 3.9 | 2.2 |

Source: Bloomberg

Price chart



Source: Bloomberg

HINDUSTAN UNILEVER LTD (HUL)

PRICE RS.1753

TARGET RS.1605

SELL

HUL has delivered another strong quarterly performance, with double digit volume growth across all three divisions of home, personal care and food. Overall domestic volume growth was in line with estimates at 12% for Q1FY19 vs. against 11% sequentially and zero % YoY. The company is growing ahead of the industry on the back of WIMI strategy, as also innovations and activations. The company also continues to make margin gains through cost management and favorable product mix. However we believe, sustaining the current level of super normal growth in the longer run would be a huge task for HUL which is trading at super rich valuation of 49x FY20 earnings. We recommend SELL (from Accumulate) valuing at 45x FY20E earnings with an unchanged TP of Rs 1605.

Key Highlights

- Underlying Volume Growth was reported at 12% with sales of Rs 94.87 bn (+11.2% YoY and +4.3% QoQ). Management indicated that the company experienced double digit volume growth across all three divisions of home care, personal care and food.
- Gross margins expanded 190 bps YoY to 54% as crude inflation pressure was more than mitigated by (a) deflation in non-crude commodities, especially palm oil, (b) GST benefits (accounting and underlying) and (c) mix improvement. However, management indicated that crude volatility and currency led inflation are key risks going ahead.

Quarterly Performance

| (Rs mn) | Q1FY18 | Q4FY18 | Q1FY19 | QoQ (%) | YoY (%) |
|-----------------------|---------------|---------------|---------------|-------------|-------------|
| Net Sales | 85,290 | 90,970 | 94,870 | 4.3 | 11.2 |
| Raw Material consumed | 40840 | 43140 | 43640 | 1.2 | 6.9 |
| Gross Profit | 44,450 | 47,830 | 51,230 | 7.1 | 15.3 |
| Gross Profit Margin | 52.1 | 52.6 | 54.0 | 2.7 | 3.6 |
| Employee cost | 4,190 | 4,000 | 4,420 | 10.5 | 5.5 |
| Advertising | 9,050 | 10,700 | 11,530 | 7.8 | 27.4 |
| Other expenses | 12,550 | 12,650 | 12,770 | 0.9 | 1.8 |
| Total operating cost | 66,630 | 70,490 | 72,360 | 2.7 | 8.6 |
| Ebidta | 18,660 | 20,480 | 22,510 | 9.9 | 20.6 |
| Ebidta % | 21.9 | 22.5 | 23.7 | | |
| Depreciation | 1,140 | 1,280 | 1,270 | (0.8) | 11.4 |
| Interest | 60 | 40 | 70 | 75.0 | 16.7 |
| Other income | 1,130 | 1,000 | 1,350 | 35.0 | 19.5 |
| PBT | 18,590 | 20,160 | 22,520 | 11.7 | 21.1 |
| Exceptional | -130 | -640 | -590 | (7.8) | 353.8 |
| Taxes | 5,630 | 6,010 | 6,640 | 10.5 | 17.9 |
| ETR | 30.3 | 29.8 | 29.5 | (1.1) | (2.6) |
| PAT | 12,830 | 13,510 | 15,290 | 13.2 | 19.2 |
| Equity | 2165 | 2165 | 2165 | 0.0 | 0.0 |
| EPS | 5.9 | 6.2 | 7.1 | 13.2 | 19.2 |

Source: Company

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- ❑ Lower cost of goods sold, improvement in product mix, judicious pricing and a strong saving program, but higher advertising and promotional expenditure (to support innovation and face competition) led to EBIDTA of Rs 22.51 bn (+20.6% YoY and +9.9% QoQ) with margin of 23.7% (+180 bps YoY and +120 bps QoQ)
- ❑ Consequently company reported in-line PAT of Rs 15.29 bn (EPS of Rs 7.1 and +19.2 % YoY)

Valuation & outlook

The management has indicated that while the quarter's growth should not be read as a trend, the worst is behind in terms of demand, and that rural growth is picking up. Management is not yet in a position to say rural growth has bounced back to historic levels, but on a low base, rural has started going faster than urban growth. Management expects the competitive intensity to increase going forward. The company is growing ahead of the industry and is consistently delivering higher margins. However we believe, sustaining the current level of super normal growth in the longer run would be a huge task for HUL which is trading at super rich valuation of 49x FY20 earnings. We recommend SELL (from Accumulate) at 45x FY20E earnings with an unchanged TP of Rs 1605.

Segmental Performance

Home care segment continues to be the best performing segment for HUL with the segment delivering 34% YoY EBIT growth for the quarter, 25%+ operating profit growth for the sixth consecutive quarter. Home care EBIT growth continues to be margin-driver for HUL; segmental EBIT margins (not strictly comparable YoY) grew 443 bps YoY to 19.13%, perhaps the highest ever. Home care performance is especially impressive in the backdrop of some return of in-market aggression from P&G

In the **beauty and personal care segment**, management indicated that Skin care registered strong double digit growth on the back of Fair & Lovely and Pond's performance while Hair Care witnessed another double digit growth quarter, led by the premium portfolio and continued robust performance of Indulekha. However, we consider the performance of the personal care segment a tad disappointing with reported sales growth of only 1% YoY and operating profit growth of a modest 8% YoY.

HUL has consolidated **foods and refreshments (F&R) segments** into one from this quarter. On a combined basis, F&R segment revenues (reported, not comparable strictly) and EBIT (comparable) grew 8% and 13%, respectively driven by double-digit growth in tea, ice cream & frozen desserts and foods businesses.

Segmental Performance

| (Rs mn) | Q1FY18 | Q4FY18 | Q1FY19 | QoQ (%) | YoY (%) |
|--------------------------|--------|--------|--------|---------|---------|
| Revenues | | | | | |
| Home | 30,470 | 31,020 | 31,460 | 1.4 | 3.2 |
| Beauty and Personal Care | 43,680 | 40,960 | 44,070 | 7.6 | 0.9 |
| Food and Refreshment | 16,340 | 17,350 | 17,850 | 2.9 | 9.2 |
| EBIT | | | | | |
| Home | 4,480 | 5090 | 6020 | 18.3 | 34.4 |
| Beauty and Personal Care | 10,790 | 10660 | 11620 | 9.0 | 7.7 |
| Food and Refreshment | 2,810 | 2870 | 3340 | 16.4 | 18.9 |

Source: Company

Comments on product portfolio

Management indicated that rural sales grew ahead of urban in Q1FY19. From a portfolio perspective, the company witnessed strong growth in (a) fair and lovely and Pond's in skin care, (b) Indulekha in hair, (c) Lakme in color cosmetics, (d) Dove and Pears in personal wash, (e) Kissan and Knorr in foods, and (f) the Ice-cream portfolio

Valuation & outlook

In terms of numbers, we factor in 17%/14% growth in revenues for FY19/FY20. While gross margins are likely to contract in the coming year, we expect that the company shall be able to save costs in other lines to expand EBITDA margin by ~140 bps over FY18-FY20E. We expect EPS growth of 19%/x23% in FY19/FY20.

The management has indicated that while the quarter's growth should not be read as a trend, the worst is behind in terms of demand, and that rural growth is picking up. Management is not yet in a position to say rural growth has bounced back to historic levels, but on a low base, rural has started going faster than urban growth. Management expects the competitive intensity to increase going forward. The company is growing ahead of the industry and is consistently delivering higher margins. However we believe, sustaining the current level of super normal growth in the longer run would be a huge task for HUL which is trading at super rich valuation of 49x FY20 earnings. We recommend SELL (from Accumulate) at 45x FY20E earnings with an unchanged TP of Rs 1605.

Company Background

Hindustan Unilever Limited (HUL) is India's largest Fast Moving Consumer Goods Company with a heritage of over 80 years in India. HUL is a subsidiary of Unilever, one of the world's leading suppliers of Food, Home Care, Personal Care and Refreshment products with sales in over 190 countries and an annual sales turnover of €53.7 billion in 2017. Unilever has over 67% shareholding in HUL.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

| (Year-end March) | FY17 | FY18 | FY19E | FY20E |
|--------------------------|----------------|----------------|----------------|----------------|
| Revenues | 318,900 | 345,250 | 401,874 | 459,469 |
| % change YoY | 2.7 | 8.3 | 16.4 | 14.3 |
| Raw material cost | 156,850 | 162,320 | 192,836 | 220,759 |
| Employee cost | 16,200 | 17,450 | 18,323 | 19,239 |
| Other expenses | 85,380 | 92,720 | 102,388 | 111,865 |
| Total Operating expd | 258,430 | 272,490 | 313,547 | 351,862 |
| EBITDA | 60,470 | 72,760 | 88,327 | 107,607 |
| Depreciation | 3,960 | 4,780 | 5,019 | 5,270 |
| EBIT | 56,510 | 67,980 | 83,308 | 102,337 |
| Other income | 5,260 | 5,690 | 6,828 | 8,194 |
| Financial expenses | 220 | 200 | 200 | 200 |
| Profit before tax | 61,550 | 73,470 | 89,936 | 110,330 |
| Tax | 19,060 | 20,480 | 26,981 | 33,099 |
| ETR (%) | 31.0 | 27.9 | 30.0 | 30.0 |
| Profit after tax | 42,490 | 52,990 | 62,955 | 77,231 |
| Minorities& Associates | 0 | 0 | 0 | 0 |
| Net income | 42,490 | 52,990 | 62,955 | 77,231 |
| % change YoY | 2.0 | 24.7 | 18.8 | 22.7 |
| Shares outstanding (m) | 2,164 | 2,165 | 2,165 | 2,165 |
| EPS | 19.6 | 24.5 | 29.1 | 35.7 |

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement

| (Year-end March) | FY17 | FY18 | FY19E | FY20E |
|----------------------------|-----------------|-----------------|-----------------|-----------------|
| PAT | 42,490 | 52,990 | 62,955 | 77,231 |
| Depreciation +DTL | 3,960 | 4,780 | 5,019 | 5,270 |
| Change in working capital | 6,050 | 9,410 | 656 | 3,139 |
| CF from operations | 52,500 | 67,180 | 68,630 | 85,640 |
| Capex | (13,230) | (8,209) | (4,978) | (4,977) |
| Investments | (10,580) | 6,160 | - | - |
| CF from investments | (23,810) | (2,049) | (4,978) | (4,977) |
| Equity issuance | - | 1 | - | - |
| Debt raised | - | - | - | - |
| Dividend Paid | (42,228) | (49,680) | (54,648) | (54,648) |
| Miscellaneous items | - | - | - | - |
| CF from financing | (42,228) | (49,679) | (54,648) | (54,648) |
| Net cash flow | (13,538) | 15,452 | 9,004 | 26,015 |
| Opening cash | 30,004 | 16,466 | 31,918 | 40,922 |
| Closing cash | 16,466 | 31,918 | 40,922 | 66,937 |

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

| (Year-end March) | FY17 | FY18 | FY19E | FY20E |
|----------------------------------|----------------|----------------|----------------|----------------|
| Cash | 16,466 | 31,918 | 40,922 | 66,937 |
| Debtors | 9,280 | 11,470 | 10,838 | 12,407 |
| Inventory | 23,620 | 23,590 | 27,095 | 31,018 |
| Other current assets | 12,660 | 19,220 | 16,008 | 17,577 |
| <i>Total current assets</i> | <i>45,560</i> | <i>54,280</i> | <i>53,941</i> | <i>61,003</i> |
| LT investments | 41,370 | 35,210 | 35,210 | 35,210 |
| Net fixed assets | 42,270 | 45,699 | 45,658 | 45,365 |
| Total assets | 145,666 | 167,107 | 175,732 | 208,516 |
| Creditors | 60,060 | 70,130 | 70,447 | 80,647 |
| Provisions | 1,810 | 2,030 | 2,030 | 2,030 |
| Other current liabilities | 20,740 | 28,580 | 28,580 | 28,580 |
| <i>Total current liabilities</i> | <i>82,610</i> | <i>100,740</i> | <i>101,057</i> | <i>111,257</i> |
| LT debt | 0 | 0 | 0 | 0 |
| Minority Interest | 0 | 0 | 0 | 0 |
| Equity Capital | 2,164 | 2,165 | 2,165 | 2,165 |
| Reserves | 60,892 | 64,202 | 72,510 | 95,093 |
| <i>Networth</i> | <i>63,056</i> | <i>66,367</i> | <i>74,674</i> | <i>97,257</i> |
| Total liabilities | 145,666 | 167,107 | 175,732 | 208,516 |
| BVPS (Rs) | 29.1 | 30.7 | 34.5 | 44.9 |

Source: Company, Kotak Securities – Private Client Research;

Ratio Analysis

| (Year-end March) | FY17 | FY18 | FY19E | FY20E |
|---------------------------------|--------|-------|-------|-------|
| EBITDA margin (%) | 19.0 | 17.1 | 18.4 | 18.5 |
| EBIT margin (%) | 17.7 | 19.7 | 20.7 | 22.3 |
| Net profit margin (%) | 13.3 | 15.3 | 15.7 | 16.8 |
| ROE (%) | 67.5 | 81.9 | 89.3 | 89.8 |
| ROCE (%) | 98.2 | 113.8 | 127.8 | 128.6 |
| DPS | 17.0 | 20.0 | 22.0 | 22.0 |
| Dividend payout (%) | 99.4 | 93.8 | 86.8 | 70.8 |
| Working capital turnover (days) | (38.9) | 65.2 | 63.7 | 65.9 |
| Debt Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 |
| PER (x) | 89.1 | 71.5 | 60.2 | 49.0 |
| P/C (x) | 81.5 | 65.6 | 55.7 | 45.9 |
| Dividend yield (%) | 1.0 | 1.1 | 1.3 | 1.3 |
| P/B (x) | 60.1 | 57.1 | 50.7 | 38.9 |
| EV/Sales (x) | 11.7 | 10.8 | 9.3 | 8.1 |
| EV/ EBITDA (x) | 56.8 | 47.6 | 39.3 | 32.3 |

Source: Company, Kotak Securities – Private Client Research

Buyback Offer

Stock Details

| | | |
|--------------------|---|------------|
| Market cap (Rs mn) | : | 1357997 |
| 52-wk Hi/Lo (Rs) | : | 1108 / 825 |
| Face Value (Rs) | : | 2 |
| 3M Avg. daily vol | : | 2,601,168 |
| Shares o/s (m) | : | 1,392 |

Source: Bloomberg

Price Performance (%)

| Companies | 3M | 6M | 1 Yr |
|--------------------|-----|------|------|
| MINDTREE LTD | 25 | 76 | 114 |
| FIRSTSOURCE SOLU | 29 | 73 | 120 |
| L&T IT | 32 | 68 | 140 |
| MPHASIS LTD | 35 | 63 | 110 |
| KPIT TECHNOLOGIE | 29 | 46 | 121 |
| TATA CONSULTANCY | 26 | 41 | 69 |
| HEXAWARE TECHNOL | 20 | 41 | 109 |
| L&T TECHNOLOGY SER | 12 | 30 | 75 |
| CYIENT LTD | 10 | 23 | 42 |
| INFOSYS LTD | 21 | 22 | 43 |
| NSE IT | 12 | 19 | 44 |
| TECH MAHINDRA LT | (2) | 18 | 73 |
| PERSISTENT SYS | 18 | 8 | 25 |
| SONATA SOFTWARE | (4) | 6 | 110 |
| SENSEX Index | 6 | 4 | 13 |
| HCL TECH LTD | (2) | 3 | 16 |
| NIFTY Index | 4 | 2 | 12 |
| WIPRO LTD | (2) | (14) | 9 |
| ECLERX SERVICES | (3) | (19) | (9) |

Source: Bloomberg

Shareholding Pattern (%)

| (%) | Jun-18 | Mar-18 | Dec-17 |
|-----------|--------|--------|--------|
| Promoters | 60.2 | 60.2 | 60.1 |
| FII | 26.5 | 25.6 | 25.3 |
| DII | 9.8 | 5.7 | 5.8 |
| Others | 3.5 | 8.5 | 8.8 |

Source: Company

Price chart



Source: Bloomberg

HCL TECHNOLOGIES LTD (HCL TECH)

PRICE Rs.972

BUYBACK PRICE Rs.1100

NOT RATED

We expect HCL TECH's buyback can have an entitlement ratio of more than 16% for retail investors. At CMP the **upside looks limited** but investors can accumulate the stock at lower levels to participate in the buyback. Based on the assumption of 16% entitlement ratio, retail investors can buy ~182 shares, assuming stock price remains on or below Rs. 1100 on the record date.

HCL TECH Buyback Details

- Recently, HCL TECH has announced its second buy-back plan of Rs. 40 bn (max.) which is 11.59%, of the fully paid-up equity share capital and free reserves (consolidated) of the Company as on March 31, 2018. Earlier, in May'17 it announced its first buyback at Rs 1,000/share with a buyback size of Rs 35 bn, representing 13.62% of the aggregate of the fully paid-up equity share capital and free reserves. Last time, the acceptance ratio was 67%.
- The company will buy back upto 36.36 mn shares i.e. upto 2.60% of the paid-up equity capital. We are hopeful that the proposed buyback will be completed by Q3FY19 end.
- Buyback is in-line with HCL's policy of returning 50% of net income to shareholders.
- **Tender offer route:** The buyback is proposed to be made under the tender offer route.
- The company has fixed a price of Rs 1,100/share, ~13% higher than CMP. The premium offered is lower than what its peers have offered and to that extent it has disappointed.
- We expect the entitlement ratio for small retail investors is likely to be higher than others because of SEBI's mandate that companies reserve 15% of the buyback for small shareholders with holdings worth less than Rs. 2 lacs.
- This implies a lesser entitlement ratio for institutional holders, depending on how much the promoter is tendering in this process.
- We expect breakeven price for retail investors to be ~Rs.952/share as against CMP of Rs.972/-
- **Conclusion:** In the IT space, lot of large companies have gone ahead with equity Buyback scheme in order to reward shareholders and to return excess cash over the past two years.
- HCL TECH too has done the same but the premium offered this time is lower than what its peers have offered and hence to that extent it is not very exciting.
- Yes, we do agree that with the limited information available it is difficult to calculate exact entitlement ratio. Hence, instead of calculating the maximum gain a retail investor can make by participating in the buy-back, we worked other-way-round and calculated minimum/floor gain a retail investor can make. Due to limited upside and lower entitlement Ratio, the buy-back doesn't look very attractive at this juncture. Any meaningful correction in the stock price due to weak market conditions can be utilized to accumulate the stock to participate in the buy-back offer.
- As and when we get more information we will update you with the updated entitlement ratio.

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Key details for BUYBACK

Buyback Details

| | |
|------------------------------|-------|
| C.M.P. (Rs./share) | 972 |
| M. Cap. (Rs. bn) | 1,353 |
| Total No. of Shares (mn) | 1,392 |
| Open offer (In Shares – mn) | 36 |
| Open Offer Price (Rs./share) | 1,100 |
| Outlay in buyback (Rs. bn.) | 40 |
| Open Offer (%) | 2.61 |

Source: Company

Overview of Funds Invested

Consolidated balance sheet as on 31st march 2018.

| | | (₹ in crores) | |
|-------------|-----------------------------------|-------------------------------------|-------------------------------------|
| Particulars | | As at 31 March 2018 (Audited) | As at 31 March 2017 (Audited) |
| I. | ASSETS | | |
| | (1) Non-current assets | | |
| | (a) Property, plant and equipment | 4,560 | 3,998 |
| | (b) Capital work in progress | 320 | 448 |
| | (c) Goodwill | 6,799 | 6,504 |
| | (d) Other intangible assets | 7,394 | 4,733 |
| | (e) Investment in associate | - | 126 |
| | (f) Financial assets | | |
| | (i) Investments | 303 | 34 |
| | (ii) Loans | 235 | - |
| | (iii) Others | 857 | 710 |
| | (g) Deferred tax assets (net) | 1,837 | 1,652 |
| | (h) Other non-current assets | 1,160 | 1,094 |
| | (2) Current assets | | |
| | (a) Inventories | 172 | 276 |
| | (b) Financial assets | | |
| | (i) Investments | 2,357 | 1,146 |
| | (ii) Trade receivables | 9,639 | 8,301 |
| | (iii) Cash and cash equivalents | 1,699 | 1,321 |
| | (iv) Other bank balances | 2,319 | 7,723 |
| | (v) Loans | 3,410 | 2,521 |
| | (vi) Others | 3,456 | 3,407 |
| | (c) Other current assets | 1,506 | 1,768 |
| | TOTAL ASSETS | 48,023 | 45,762 |

Source: Company

Shareholding pattern

Pre-Buyback Shareholding Pattern of the Company as on June 8, 2018

| Shareholders | No. of shareholders | % of shares |
|--|----------------------|----------------|
| Promoters and Promoter Group | 837,880,610 | 60.17% |
| Foreign Investors | 373,866,523 | 26.85% |
| Indian Financial Institutions/ Banks /Insurance Companies/Alternate Investment Funds | 56,764,157 | 4.08% |
| Mutual Funds | 76,790,019 | 5.51% |
| Bodies Corporate/Trusts/Clearing Members/NBFC | 13,020,348 | 0.94% |
| Resident Individuals and others | 34,085,047 | 2.45% |
| Total | 1,392,406,704 | 100.00% |

Source: company

We are optimistic that entitlement ratio will be much higher than 16%.

The entitlement ratio is the number of shares offered under a buyback to the total outstanding shares of the company. For retail investors, it's the ratio of shares tendered by such investors to the total number of shares held by this category of shareholders.

Expected retail acceptance ratio

| Particulars | Units | Calculation |
|---------------------------------|-----------------|-------------|
| Total equity shares | Mn shares | 1,392 |
| The company will buy-back | Mn shares | 36.4 |
| Max. Buy back price | Rs./share | 1,100 |
| Max. buy-back amount | Rs. Mn | 40,000 |
| Buy-back to total equity | % | 2.61 |
| SEBI guidelines (Reserved) | 15% (Mn shares) | 5.45 |
| Small shareholders means* | Rs.2 lacs (max) | 182 |
| Resident Individuals and others | Mn shares | 34.1 |
| Entitlement ratio | % | 16.0 |
| CMP | Rs/share | 972 |
| Upside Pre-tax | % | 2.1 |
| Short-term tax | % | 15.0 |
| Upside post tax | % | 1.8 |

Source: Kotak Securities - Private Client Research and company data. Note: Brokerage will be separate; * Assuming price on record date to be Rs1100/-.

Breakeven price for retail investors

| Break-even | Rs./share |
|-------------------------------------|------------|
| CMP | 985 |
| BUYBACK price | 1,100 |
| Gain | 115 |
| Entitlement ratio | 16% |
| Breakeven price (Before tax) | 967 |

Source: Kotak Securities - Private Client Research. Note: Brokerage will be separate.

Conservatively, we have assumed the lowest entitlement ratio.

What if analysis?

We have worked out couple of scenarios regarding acceptance ratio and post buyback sale price.

Scenario analysis

| Post Offer price | Acceptance | | | | | | | | | | | | |
|------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | 16% | 20% | 24% | 28% | 32% | 36% | 40% | 44% | 48% | 52% | 56% | 60% | 64% |
| 825 | -11% | -9% | -8% | -7% | -6% | -5% | -4% | -3% | -2% | 0% | 1% | 2% | 3% |
| 850 | -8% | -7% | -6% | -5% | -4% | -3% | -2% | -1% | 0% | 1% | 2% | 3% | 4% |
| 875 | -6% | -5% | -4% | -3% | -3% | -2% | -1% | 0% | 1% | 2% | 3% | 4% | 5% |
| 900 | -4% | -3% | -2% | -2% | -1% | 0% | 1% | 2% | 2% | 3% | 4% | 5% | 6% |
| 925 | -2% | -1% | -1% | 0% | 1% | 2% | 2% | 3% | 4% | 5% | 5% | 6% | 7% |
| 950 | 0% | 1% | 1% | 2% | 3% | 3% | 4% | 5% | 5% | 6% | 6% | 7% | 8% |
| 975 | 2% | 3% | 3% | 4% | 4% | 5% | 5% | 6% | 6% | 7% | 8% | 8% | 9% |
| 1,000 | 5% | 5% | 5% | 6% | 6% | 7% | 7% | 7% | 8% | 8% | 9% | 9% | 9% |
| 1,025 | 7% | 7% | 7% | 8% | 8% | 8% | 9% | 9% | 9% | 9% | 10% | 10% | 10% |
| 1,050 | 9% | 9% | 9% | 9% | 10% | 10% | 10% | 10% | 10% | 11% | 11% | 11% | 11% |
| 1,075 | 11% | 11% | 11% | 11% | 11% | 12% | 12% | 12% | 12% | 12% | 12% | 12% | 12% |
| 1,100 | 13% |
| 1,125 | 15% | 15% | 15% | 15% | 15% | 15% | 15% | 15% | 15% | 14% | 14% | 14% | 14% |
| 1,150 | 17% | 17% | 17% | 17% | 17% | 16% | 16% | 16% | 16% | 16% | 15% | 15% | 15% |

Source: Kotak Securities - Private Client Research. Note: Brokerage will be separate.

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Definitions of ratings

- BUY** – We expect the stock to deliver more than 12% returns over the next 12 months
- ACCUMULATE** – We expect the stock to deliver 5% - 12% returns over the next 12 months
- REDUCE** – We expect the stock to deliver 0% - 5% returns over the next 12 months
- SELL** – We expect the stock to deliver negative returns over the next 12 months
- NR** – **Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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