

HCL Technologies

Performance Highlights

(₹ cr) – Consl.	3QFY16	2QFY16	% chg (qoq)	3QFY15	% chg (yoy)
Net revenue	10,698	10,341	3.4	9,267	15.4
EBIT	2,222	2,072	7.2	1,978	12.3
Adj. EBITDA margin (%)	20.8	20.6	73bp	21.3	(57)bp
PAT	1,925	1,920	0.3	1,683	14.4

Source: Company, Angel Research

After this quarter (3QFY2016), the company has migrated to March year-ending.

For 3QFY2016, HCL Technologies (HCL Tech) posted lower than expected numbers on the top-line as well as the bottom-line front. It reported a top-line growth of 1.3% QoQ to US\$1,587mn V/s US\$1,607mn expected. In constant currency (CC) terms, the growth was of 1.7% QoQ. On the operating front, the EBIT margin came in at 20.8%, in line with our expectations. The net profit came in flat on a QoQ basis at ₹1,926cr (V/s ₹1,936cr expected). On the operational front, the utilization level moved up to 85.6% V/s 84.7% in 2QFY2016, while the attrition rate for IT services came in at 17.3% V/s 16.7% in 2QFY2016. **We maintain our Buy recommendation on the stock with a price target of ₹1,000.**

Quarterly highlights: The company posted a 1.3% QoQ growth for the quarter to US\$1,587mn (V/s US\$1,607mn expected). In rupee terms, the company posted a sales growth of 3.4% QoQ to ₹10,698cr (V/s ₹10,850cr expected) while in CC terms the growth was of 1.7% QoQ. In terms of geographies, the company posted 3.7%, (2.4)% and 1.3% QoQ growth in USA, Europe and ROW in CC terms respectively. In terms of verticals, the company posted a QoQ CC growth of -1.3%, 0.9%, 6.4%, 7.1%, -1.2%, 4.2% in Financial Services, Manufacturing, Life sciences & Healthcare, Public Services, Retail & CPG and Telecommunications, Media, Publishing & Entertainment (MPE) respectively. On the operating front, the EBIT margin came in at 20.8%, in line with our expectation. The net profit grew 0.3% QoQ to ₹1,926cr (V/s ₹1,936cr expected).

Outlook and valuation: We expect HCL Tech to post a USD and INR revenue CAGR of 12.5% and 15.5%, respectively, over FY2015–18E. On back of strong order book and given the attractive valuations, we **recommend a Buy on the stock.**

Key financials (Consolidated, US GAAP)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	37,061	30,781	49,242	57,168
% chg	12.6	(16.9)	60.0	16.1
Net profit	7,253	5,643	7,862	9,037
% chg	17.2	(22.2)	39.3	14.9
EBITDA margin (%)	23.5	21.5	20.5	20.5
EPS (₹)	51.4	40.0	55.7	64.1
P/E (x)	14.0	18.0	12.9	11.2
P/BV (x)	4.1	3.6	2.6	2.0
RoE (%)	29.3	20.1	20.3	17.9
RoCE (%)	23.1	15.6	17.2	15.9
EV/Sales (x)	2.4	2.9	1.6	1.2
EV/EBITDA (x)	10.4	13.7	7.7	5.6

Source: Company, Angel Research; Note: CMP as of May 13, 2016

BUY

CMP	₹722
Target Price	₹1,000

Investment Period	12 Months
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Stock Info

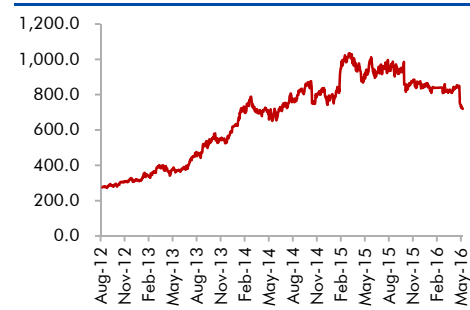
Sector	IT
Market Cap (₹ cr)	101,878
Net Debt (₹ cr)	(101,878)
Beta	0.7
52 Week High / Low	1,048/707
Avg. Daily Volume	144,915
Face Value (₹)	2
BSE Sensex	25,490
Nifty	7,815
Reuters Code	HCLT.BO
Bloomberg Code	HCLT@IN

Shareholding Pattern (%)

Promoters	60.4
MF / Banks / Indian Fls	8.8
FII / NRIs / OCBs	27.5
Indian Public / Others	3.3

Abs.(%)	3m	1yr	3yr
Sensex	10.9	(5.2)	29.4
HCL Tech	(9.5)	(21.1)	90.7

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2016 performance (Consolidated, US GAAP)

Y/E March (₹ cr)	3QFY16	2QFY16	% chg (qoq)	3QFY15	% chg (yoy)	FY16	FY15	% chg(yoy)
Net revenue	10,698	10,341	3.4	9,267	15.4	40,913	35,708	14.6
Cost of revenue	6,961	6,768	2.9	5,997	16.1	26,901	22,583	19.1
Gross profit	3,737	3,573	4.6	3,270	14.3	14,012	13,125	6.8
SG&A expense	1,358	1,348	0.7	1,179	15.2	5,217	4,308	21.1
EBITDA	2,378	2,225	6.9	2,091	13.7	8,795	8,817	(0.2)
Dep. and amortization	157	153	2.6	113	38.9	569	504	12.9
EBIT	2,222	2,072	7.2	1,978	12.3	8,226	8,313	(1.0)
Other income	200	355	(43.7)	179	11.7	1,009	856	
PBT	2,422	2,427	(0.2)	2,157	12.3	9,235	9,169	0.7
Income tax	497	508	(2.2)	473	5.1	1,883	1,864	1.0
PAT	1,925	1,920	0.3	1,683	14.4	7,352	7,305	0.6
Forex gain/(loss)	-	0	-	-	-	-	-	-
Adjusted PAT	1,925	1,920	0.3	1,683	14.4	7,352	7,305	0.6
EPS	13.6	13.6	0.3	11.9	14.4	52.3	52.0	0.6
Gross margin (%)	34.9	34.6	38bp	35.3	(35)bp	34.2	36.8	(251)bp
EBITDA margin (%)	22.2	21.5	71bp	22.6	(34)bp	21.5	24.7	(320)bp
EBIT margin (%)	20.8	20.0	73bp	21.3	(57)bp	20.1	23.3	(317)bp
PAT margin (%)	18.0	18.6	(57)bp	18.2	(17)bp	18.0	20.5	(249)bp

Source: Company, Angel Research, Note-FY2016 is a 12month results for meaningful comparison, From FY2017, the company has become a March ending company

Exhibit 2: 3QFY2016 – Actual Vs Angel estimates

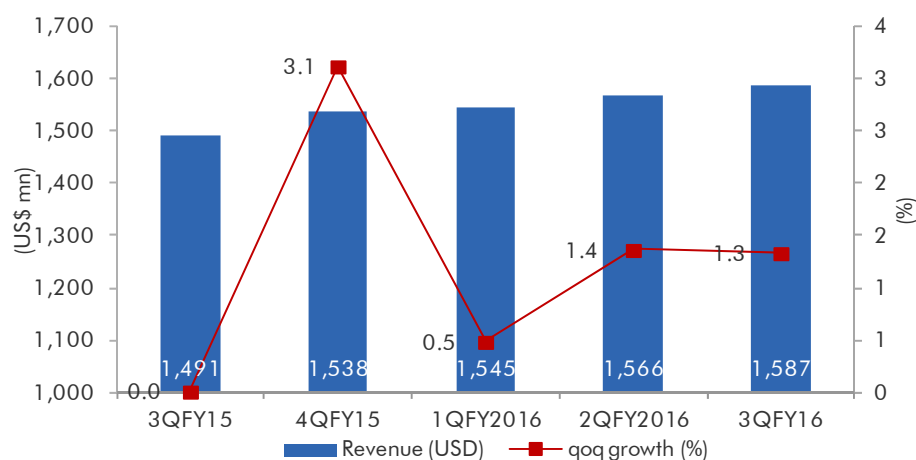
(₹ cr)	Actual	Estimate	Variation (%)
Net revenue	10,698	10,850	(1.4)
EBITDA margin (%)	20.8	20.7	10bp
PAT	1,925	1,936	(0.6)

Source: Company, Angel Research

Sales lower than expected

The company posted a 1.3% QoQ growth for the quarter to US\$1,587mn (V/s US\$1,607mn expected). In rupee terms, the company posted a sales growth of 3.5% QoQ to ₹10,698cr (V/s ₹10,850cr expected) while in CC terms the growth was of 1.7% QoQ. In terms of geographies, the company posted 3.7 %, (2.4)% and 1.3% QoQ growth in USA, Europe and ROW in CC terms respectively. In terms of verticals, the company posted a QoQ CC growth of (1.3%), 0.9%, 6.4%, 7.1%, (1.2%), 4.2% in Financial Services, Manufacturing, Life sciences & Healthcare, Public Services, Retail & CPG and Telecommunications, Media, Publishing & Entertainment (MPE) respectively.

The company signed 7 transformational deals during the quarter with TCV of more than US\$2bn, taking the number of transformational engagements during the nine month financial year to 25 with TCV of more than US\$4bn. These wins were broad-based across service lines and industry verticals, led by the company's next-generation offerings – BEYONDigital, IoT WORKS and Next-Gen ITO.

Exhibit 3: Revenue growth trend


Source: Company, Angel Research

In terms of services, the Engineering & R&D services (which constitute 18.6% of sales) posted a growth 1.9% QoQ (CC), while Application services (which constitute 40.4% of sales) grew by 0.5% QoQ in CC terms. Infrastructure services, another important segment of the company, which contributes by around 18.6% to overall sales, posted a growth of 3.9% QoQ. Business services, which constitute 5.5% of sales, de-grew by 4.1% QoQ on CC basis.

Exhibit 4: Revenue growth trend (Service wise)

	% of revenue	% growth CC (qoq)	% growth (yoy)
Application services	40.4	0.5	4.0
Infrastructure services	18.6	3.9	14.0
Business services	5.5	(4.1)	10.1
Engineering and R&D services	18.6	1.9	5.9

Source: Company, Angel Research

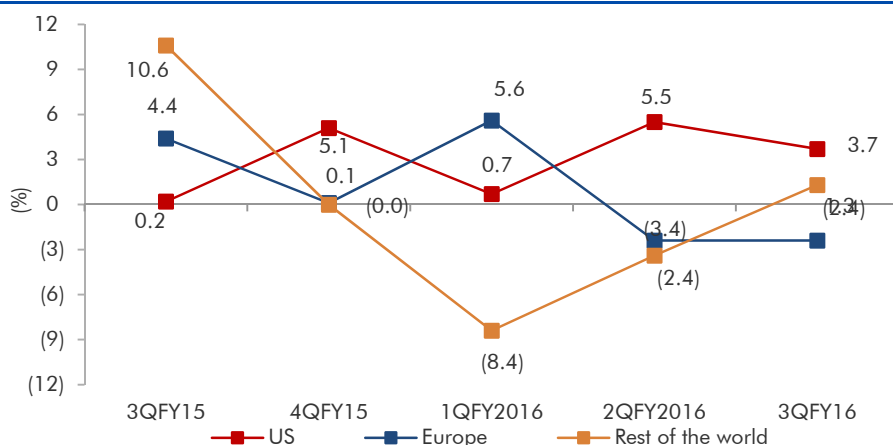
Industry segment wise, the company's Financial Services vertical (contributed 25.9% to revenue) posted a 1.3% QoQ de-growth in CC terms. The Manufacturing vertical (contributed 31.5% to revenue) posted a 0.9% QoQ growth in CC terms. Public services; Life sciences & Healthcare; and Telecommunication, Media, Publishing & Entertainment reported a QoQ growth of 7.1%, 6.4%, and 4.2%, all in CC terms, respectively. Retail & CPG (contributed 9.5% of the revenue) on the other hand reported de-growth of 1.2% QoQ in revenue in CC terms, during the quarter.

Exhibit 5: Revenue growth trend (Industry wise)

	% of revenue	% growth (CC qoq)	% growth (yoy)
Financial services	25.9	(1.3)	4.6
Manufacturing	31.5	0.9	1.1
Life sciences & Healthcare	12.2	6.4	22.6
Public Services	10.6	7.1	16.5
Retail & CPG	9.5	(1.2)	18.5
Telecom, MPE	9.7	4.2	19.2

Source: Company, Angel Research

Among geographies, in CC terms, Americas grew by 3.7%, Europe de-grew by 2.4%, while RoW grew by 1.3% on a sequential basis.

Exhibit 6: Revenue growth trend (Geography wise in CC terms)


Source: Company, Angel Research

Hiring and utilization

During the quarter, the overall headcount of HCL Tech increased by 9,280 to 1,04,896 employees. The attrition rate in IT Services inched up to 17.3% V/s 16.7% in 2QFY2016. The blended utilization level of the company inched up to 85.6% V/s 84.7% in 2QFY2016.

Exhibit 7: Hiring trend

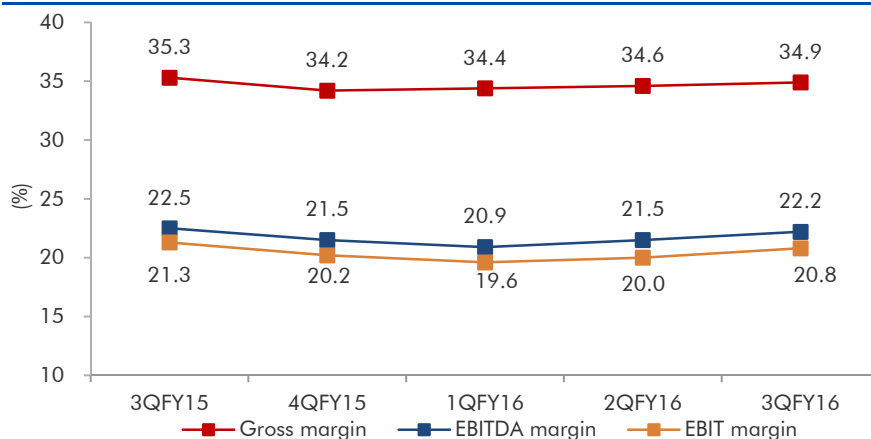
Particulars	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16
Technical	95,190	97,135	96,541	94,652	95,649
Support	8,994	8,972	9,030	9,044	9,247
Total employee base	1,04,184	1,06,107	105,571	103,696	104,896
Gross addition	11,041	9,448	7,889	6,234	9,280
Net addition	3,944	1,923	(1559)	(1875)	1200
Attrition - IT services (LTM) - %	16.2	16.5	16.3	16.7	17.3

Source: Company, Angel Research

Operating margin in line of expectation

On the operating front, the EBITDA margin came in at 22.2%, an uptick of 71bp QoQ. The Adj. EBIT margin came in at 20.8% V/s 20.0% in 2QFY2016, an expansion of 73bp QoQ. Business continuity costs in Chennai were headwinds in addition to partial wage hikes; these were however offset by depreciation of the INR and sequential decline in the headcount.

Exhibit 8: Margin profile



Source: Company, Angel Research

Client pyramid

HCL Tech signed 7 transformational deals during the quarter with TCV of more than US\$2bn, taking the number of transformational engagements during the nine month financial year to 25 with TCV of more than US\$4bn. These wins were broad-based across service lines and industry verticals, led by the company's next-generation offerings – BEYONDigital, IoT WoRKs and Next-Gen ITO.

Exhibit 9: Client pyramid

Particulars	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16
US\$1mn–5mn	262	265	262	267	262
US\$5mn–10mn	84	87	91	87	84
US\$10mn–20mn	50	51	58	66	49
US\$20mn–30mn	35	33	32	32	35
US\$30mn–40mn	16	17	19	16	16
US\$40mn–50mn	5	6	6	4	5
US\$50mn–100mn	10	10	11	12	10
US\$100mn plus	7	7	7	7	7

Source: Company, Angel Research

Investment arguments

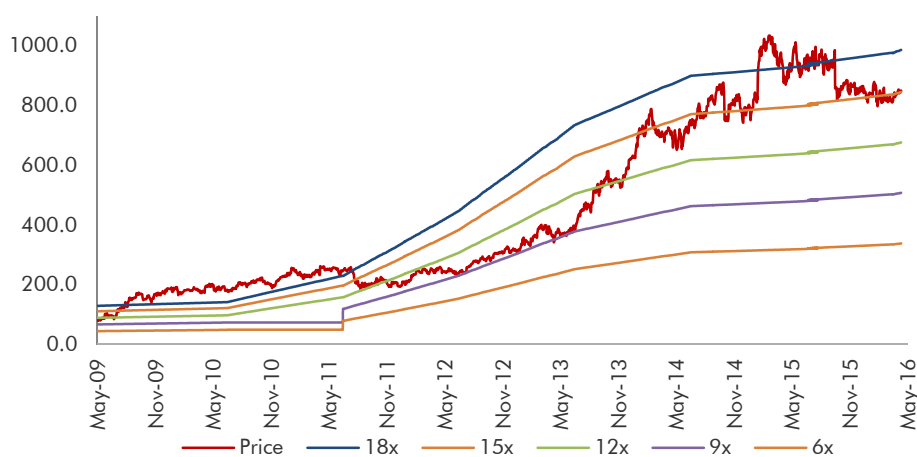
Robust outlook: The company's engineering services has been seeing lumpy growth over the last few quarters. This is however largely a function of the timing of large transformational deals. 6-8 of the large deals signed a few quarters ago will aid the company to continue to post industry leading growth, although the same is unlikely to be consistent on a sequential basis. Other service areas like application support & maintenance have been seeing slow growth. Although the area is well-penetrated, there is potential for churn, and there could likely be entry of new customers. We expect HCL Tech to post a USD and INR revenue CAGR of 12.5% and 15.5%, respectively, over FY2015–18E (inclusive of the acquisition of Geometric Software and Volvo deals).

Healthy pipeline: HCL Tech signed 7 transformational deals during the quarter with TCV of more than US\$2bn, taking the number of transformational engagements during the nine month financial year to 25 with TCV of more than US\$4bn. These wins were broad-based across service lines and industry verticals, led by our Next-generation offerings – BEYONDigital, IoT WoRKS and Next-Gen ITO.

Outlook and valuation

On the operating front, HCL Tech's EBIT margin has been around 20.1% in FY2016, a dip of 317bp over the previous financial year. With the acquisition of geometric software and Volvo, we expect the EBIT margin to be under pressure. We expect the EBIT and PAT to post a 10.0% and 7.6% CAGR, respectively, over FY2015-18E. At the current market price, the stock is trading at 12.9x FY2017E and 11.2x FY2018E EPS. **We recommend a Buy on the stock with a price target of ₹1,038.**

Exhibit 10: One-year forward PE (x) chart



Source: Company, Angel Research

Exhibit 11: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2017E EBITDA (%)	FY2017E P/E (x)	FY2015-17E EPS CAGR (%)	FY2017E EV/Sales (x)	FY2017E RoE (%)
HCL Tech	Buy	722	1,000	38.5	20.5	12.9	4.2	1.6	20.3
Infosys	Accumulate	1,207	1,374	13.9	27.5	18.5	10.6	3.4	22.4
TCS	Buy	2,523	3,004	19.0	28.3	17.9	11.8	3.6	34.6
Tech Mahindra	Accumulate	478	530	10.8	17.0	14.2	8.0	1.3	19.1
Wipro	Buy	540	680	26.0	23.8	13.3	9.7	1.7	20.0

Source: Company, Angel Research

Company Background

HCL Tech is India's fifth largest IT services company, with over 1,00,000 employees catering to more than 450 clients. The company's service offerings include Enterprise Application Services (EAS), Custom Applications, Engineering and Research and Development (ERD) and Infrastructure Management Services (IMS). In December 2008, HCL Tech acquired UK-based SAP consulting company - Axon, which now contributes ~10% to its consolidated revenue. Recently, during 3QFY2016, the company acquired Geometric Software.

Profit and loss statement (Consolidated, US GAAP)

Y/E Mar (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	32,908	37,061	30,781	49,242	57,168
Cost of revenues	20,209	23,798	20,235	32,549	37,788
Gross profit	12,699	13,263	10,546	16,693	19,380
% of net sales	38.6	35.8	34.3	33.9	33.9
SG&A expenses	4,070	4,563	3,940	6,598	7,661
% of net sales	12.4	12.3	12.8	13.4	13.4
EBITDA	8,629	8,700	6,606	10,095	11,719
% of net sales	26.2	23.5	21.5	20.5	20.5
Depreciation and amort.	753	451	393	640	740
% of net sales	2.3	1.2	1.3	1.3	1.3
EBIT	7,876	8,249	6,213	9,454	10,979
% of net sales	23.9	22.3	20.2	19.2	19.2
Other income, net	492	912	756	756	756
Profit before tax	8,369	9,161	6,969	10,211	11,736
Provision for tax	1,629	1,908	1,364	2,349	2,699
% of PBT	19.5	20.8	19.6	23.0	23.0
PAT	6,739	7,253	5,605	7,862	9,037
Share from equity invest.	-	-	-	-	-
Forex loss	(549)	-	-	-	-
ESOP charges	25	103	38	38	38
Reported net profit	6,190	7,253	5,643	7,862	9,037
Fully diluted EPS (₹)	43.9	51.4	40.0	55.7	64.1

Note: FY2016 Numbers are 9 month figures

Balance sheet (Consolidated, US GAAP)

Y/E Mar (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Cash and cash equivalent	1,021	1,352	729	6,950	13,473
Account receivables, net	5,684	6,563	7,721	8,504	9,873
Unbilled receivables	2,024	2,923	3,002	2,955	3,430
Deposit with banks	8,370	9,670	10,587	15,587	20,587
Deposit (one year with HDFC Ltd)	-	-	-	-	-
Invest. securities, available for sale	609	767	537	2,250	2,250
Other current assets	2,125	2,338	2,410	2,710	3,010
Total current assets	19,833	23,613	24,986	38,956	52,624
Property and equipment, net	3,147	3,820	4,323	4,623	4,923
Intangible assets, net	5,149	5,204	6,419	6,419	6,419
Deposits with HDFC Ltd.	-	-	-	-	-
Fixed deposits with banks	-	-	-	-	-
Investment securities HTM	-	8	160	160	160
Investment in equity investee	16	-	-	-	-
Other assets	2,346	3,066	3,879	4,780	4,780
Total assets	30,490	35,711	39,768	54,939	68,906
Current liabilities	8,197	9,232	9,509	13,199	15,323
Borrowings	751	469	973	973	973
Other liabilities	1,462	1,259	1,264	2,077	2,078
Total liabilities	10,409	10,960	11,745	16,249	18,374
Minority interest	-	-	-	-	-
Total stockholder equity	20,081	24,751	28,022	38,690	50,532
Total liab. and stock holder equity	30,490	35,711	39,768	54,939	68,906

Note: FY2016 Numbers are 9 month figures

Cash flow statement (Consolidated, US GAAP)

Y/E Mar (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Pre tax profit from operations	7,797	7,253	5,643	7,862	9,037
Depreciation	733	451	393	640	740
Expenses (deferred)/written off/others	(584)	(168)	(48)	(48)	(48)
Pre tax cash from operations	7,946	7,536	5,988	8,455	9,729
Other income/prior period ad	572	912	756	756	756
Net cash from operations	8,518	8,448	6,744	9,211	10,485
Tax	(1,547)	(1,908)	(1,364)	(2,349)	(2,699)
Cash profits	6,971	6,540	5,381	6,863	7,786
(Inc)/dec in current assets	(1,749)	(1,991)	(1,309)	(1,036)	(2,144)
Inc/(dec) in current liabilities	1,654	1,035	277	3,690	2,124
Net trade working capital	(95)	(956)	(1,033)	2,654	(20)
Cashflow from operating activities	6,875	5,584	4,348	9,517	7,766
(Inc)/dec in fixed assets	(1,094)	(674)	(503)	(300)	(300)
(Inc)/dec in intangibles	(248)	(55)	(1,215)	-	-
(Inc)/dec in investments	(4,688)	(1,458)	(687)	(6,714)	(5,000)
(Inc)/dec in minority interest	-	-	-	-	-
Inc/(dec) in non current liabilities	(54)	(203)	5	814	-
(Inc)/dec in non current assets	(107)	(214)	(72)	(300)	(300)
Cashflow from investing activities	(6,191)	(2,602)	(2,473)	(6,500)	(5,600)
Inc/(dec) in debt	55	-	-	-	-
Inc/(dec) in equity/premium	-	-	-	-	-
ESOP charges	(25)	(103)	(103)	(103)	(103)
Dividends	(296)	(1,651)	(2,805)	(2,805)	(2,805)
Others	(129)	(208)	2,385	621	7,692
Cashflow from financing activities	(396)	(1,962)	(523)	(2,287)	4,784
Cash generated/(utilised)	289	331	(623)	6,221	6,523
Cash at start of the year	732	1,021	1,352	729	6,950
Cash at end of the year	1,021	1,352	729	6,950	13,473

Note: FY2016 Numbers are 9 month figures

Key ratios

Y/E Mar	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio (x)					
P/E (on FDEPS)	16.4	14.0	18.0	12.9	11.2
P/CEPS	14.6	13.2	16.8	11.9	10.4
P/BVPS	5.1	4.1	3.6	2.6	2.0
Dividend yield (%)	1.9	1.9	2.4	2.4	2.4
EV/Sales	2.8	2.4	2.9	1.6	1.2
EV/EBITDA	10.7	10.4	13.7	7.7	5.6
EV/Total assets	3.0	2.5	2.3	1.4	1.0
Per share data (₹)					
EPS (Fully diluted)	43.9	51.4	40.0	55.7	64.1
Cash EPS	49.2	54.6	42.8	60.3	69.3
Dividend	14.0	14.0	17.0	17.0	17.0
Book value	142	175	199	274	358
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.8	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.1	1.1	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.2	0.2	0.2	0.2	0.2
Asset turnover ratio (Sales/Assets)	1.1	1.0	0.8	0.9	0.8
Leverage ratio (Assets/Equity)	1.5	1.4	1.4	1.4	1.4
Operating ROE	33.6	29.3	20.0	20.3	17.9
Return ratios (%)					
RoCE (pre-tax)	25.8	23.1	15.6	17.2	15.9
Angel RoIC	38.4	34.5	22.4	31.5	33.8
RoE	30.8	29.3	20.1	20.3	17.9
Turnover ratios (x)					
Asset turnover (fixed assets)	11.2	10.6	7.6	11.0	12.0
Receivables days	71	68	83	78	68

Note: FY2016 Numbers are 9 month figures

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Disclosure of Interest Statement	HCL Technologies
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15)
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