

More Reds than Greens for HCL Infosystems

We meet up with the management of HCL INFOSYSTEM at recently held analyst meet, following are the key takeaways of the meeting.

System integration business continues to impact HCL Infosystems

System integration business contributes 7% of the total revenues that HCL Infosystems generates. This business continued to see delays in projects. Delay in release of payments by customers of HCL Infosystems has resulted in increased costs and provisions on account of receivables. We anticipate that there could be some additional cost impact on the projects business of the company and to overcome this problem it will take some time.

Drop in sales in Telecom distribution business

HCL is the single largest distributor of Nokia Mobile Phones in India. The sales of Nokia has not picked much in last financial year due to stiff competition, this has impacted the revenues of HCL Infosystems. Sales for FY2011 were impacted to the tune of Rs928cr.

Hurdle for MTNL and HCL Infosystems

Mahanagar Telephone Nigam Limited (MTNL) is a one of the biggest customer for HCL Infosystems. The Central Bureau of Investigation (CBI) has sprung into action yet again and this time it could spell serious worry for MTNL and IT giant HCL. The bureau has registered a case against MTNL and HCL Infosystems officers for alleged irregularities in awarding work of broadcast networks. The officials have been alleged of discrepancies undertaken for pricing an exorbitant price of about Rs570crore for broadcast networks by manipulating the specification for the Commonwealth Games held in New Delhi last October. The investigation is still going on, clearly any negative outcome would impact HCL Infosystems.

Some Positives that can trigger HCL INFOSYSTEMS upwards

- If Management is able to revive Business integration business (though it looks difficult as things are progressing).
- DIGISCHOOL Business performs better than expected. (The contribution will still be small)
- HCL Infosystem recently extended its agreement with Nokia till December'2014. Off lately Nokia has been aggressive in cell phone market by way of launching dual sim and other better models against competition.
- Better than expected performance from new business areas such as remote services and emerging markets in Middle East and Africa.

Financials

Profitability has reduced since there is a slowdown in sales affecting EBITDA. Revenues from system integration have reduced sharply due to delay in customer acceptances leading to cost overruns and delay in payments. There has also been drop in telecom distribution business.

Annual Highlights (consolidated)

Particulars (Rs crs)	FY2011	FY2010
Sales	11,460	12,080
EBITDA	287	376
EBITDA (%)	2.5	3.1
PAT	168	242

Valuations

Methods	Current	Historic Average	Lowest	Highest
PE RATIO	7.9	11.5	3.3	19.8
P/BV	0.7	3.0	0.6	6.0
EV/EBIDTA	5.4	7.8	2.8	14.5

- Historic PE, P/BV and EV/EBIDTA is calculated from June'00-June'10 on a yearly basis

Though the current PE, P/BV and EV/EBITDA are trading way below the historical valuations and hence stock appears cheap. However company's System Integration business continued to be severely impacted and fully recovery will take a good amount of time. So for at least 12-15 months this stock would be in consolidation phase having more of sideways movements. We recommended investors to stay away from this counter right now and play a wait and watch game and wait for positive triggers to come along.

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