Institutional Equity Research

HCL Technologies

IT | India

4QFY17 Result Update | May 11,2017

CMP* (Rs)	839
Upside/ (Downside) (%)	15
Bloomberg Ticker	HCLT IN
Market Cap. (Rs bn)	1,197
Free Float (%)	40
Shares O/S (mn)	1,427

BUY

Target Price: Rs963

Solid quarter, outlook positive

HCL Technologies (HCLT) reported strong revenue growth of 3.8% QoQ in CC terms in 4QFY17, while USD revenue growth came in at a healthy 4.1% QoQ to US$1,817mn. EBIT margin was 46bps above our estimate, aided by revenue growth and higher utilisation. The IT major guided for 10.5-12.5% CC revenue growth for FY18E, and expects a similar EBIT margin range for FY18E, at 19.5-20.5%. The guidance is below what we were expecting, though we believe management is being conservative in a challenging business environment, which, in our view is a prudent strategy.

For the quarter, it was Engineering Services that was the key growth driver, with revenue up by as much as 14.7% QoQ (+14.6% in CC terms). The key IMS segment grew 1.2% QoQ in USD terms (+0.9% QoQ in CC terms). A positive was lower attrition in Software Services, at 16.9% (17.9%).

Enthusing Broad-Based Above Industry Growth

HCLT posted a good 4QFY17, with YoY USD rev growth (14.5%) at its highest in 11 quarters since 4QFY14. The company's 10.5-12.5% CC revenue growth guidance for FY18E implies growth well ahead of NASSCOM's guidance for the IT sector. We are enthused with HCLT's consistently better performances compared with peers and believe the company should command a premium in light of better growth visibility, particularly in the context of such a challenging business environment.

On the vertical front, it was Manufacturing (+6.2% QoQ), Public Services (+8.7%) and Financial Services (+3.7%), that led growth, which was the case in 3QFY17 as well. On the other hand, pressure continues to be witnessed in the Telecom & MPE (-1.8%) and Life Sciences (-0.2%) verticals. Geo-wise, Americas grew by a strong 5.3% QoQ 1.3% qoq while Europe de-grew 2.6% QoQ, which was a disappointment. A key positive is that different parts of HCLT's business portfolio have seen growth, ensuring the overall revenue picture remains healthy, driving confidence on growth sustainability going forward.

Outlook and Valuation – Highest growth among top-tier IT, BUY stays

Given HCLT's consistent performances over the past few quarters, guidance well above industry growth rates and broad-based nature of growth, we expect the IT major to out-perform top-tier peers in FY18E. We believe the company's strong positioning in the high-growth IMS and engineering services businesses is likely to drive underlying revenue growth ahead of peers, which we believe should drive a higher earnings multiple. Valuation at 12.9x/11.5x FY18E/FY19E EPS also leaves room on the table for investors. **We retain our BUY rating on HCLT, with an unchanged target price of Rs963, based on 14x average FY18E and FY19E EPS.**

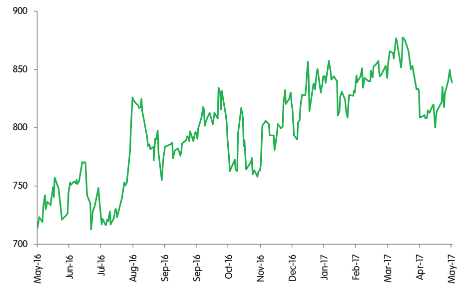
Key Financials (Rs mn)	FY16	FY17	FY18E	FY19E
Net Revenues	311,360	467,230	505,293	570,890
EBIT	62,500	94,740	103,587	116,692
APAT	55,700	84,570	91,776	102,715
Diluted EPS (Rs)	39.4	59.9	65.0	72.7
P/E (x)	16.0	14.0	12.9	11.5
EV / EBITDA (x)	12.0	10.3	9.4	8.1
RoE (%)	27.2	27.5	25.7	25.3
Dividend Yield (%)	2.0	2.9	3.3	3.8

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	1.0	2.1	16.4
Relative to Nifty	(0.9)	(4.9)	(5.3)

Shareholding Pattern (%)	Dec'16	Mar'17
Promoter	60.3	59.7
Public	39.7	40.3

1 Year Stock Price Performance



*Note: * CMP as on May 11, 2017*

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Key Conference Call Takeaways

- HCLT won 8 large transformational deals in 4QFY17, which were spread across verticals, service lines and geographies.
- The IT major has trained around 13,000 employees on new digital technologies.
- HCLT won 6 new clients over FY17 owing to its focus on "Mode 2"and "Mode 3"services, including cloud, IoT, security, digital and analytics.
- While overall IT budgets are flat, customers are reallocating IT spends towards 'discretionary spend using disruptive technologies', while they are rationalising non-discretionary spend.
- In the BFSI vertical, focus is on cost optimisation in the Capital Markets sub-vertical, while Banking and Insurance are seeing good traction in digital, analytics and mobile.
- Around US$200mn is pending as payment for the IBM IP deal.

Key Risks

- Revenue growth challenges in the core software services segment.
- Deterioration in margin quality, owing to pricing pressure and lower profitability of acquisitions.
- Event-specific risks such as BREXIT, which could impact IT budgets, cutting discretionary spend and delaying new deals.
- With US President Donald Trump having clearly articulated his views on immigration and job creation for US citizens, the likelihood of a more punishing visa regime abounds
- Currency risk.

Exhibit 1: Quarterly Performance (Consolidated)

Particulars (Rs mn)	4QFY17	3QFY17	QoQ (%)	3QFY16	YoY (%)
Net Revenues (US$ mn)	1,817	1,745	4.1	1,587	14.5
Net Revenues	120,530	118,140	2.0	106,980	12.7
Direct Costs	79,870	78,090	2.3	69,610	14.7
Gross Profit	40,660	40,050	1.5	37,370	8.8
SG&A Expenses	14,170	13,770	2.9	13,580	4.3
EBITDA	26,490	26,280	0.8	23,790	11.3
Depreciation	2,330	2,200	5.9	1,570	48.4
EBIT	24,160	24,080	0.3	22,220	8.7
Other Income	2,150	2,300	(6.5)	2,010	7.0
PBT	26,310	26,380	(0.3)	24,230	8.6
Tax	3,060	5,680	(46.1)	4,970	(38.4)
APAT	23,250	20,700	12.3	19,260	20.7
E/o (adj for tax)	0	0	-	0	-
RPAT	23,250	20,700	12.3	19,260	20.7

Source: Company, RSec Research

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Exhibit 2: Margin Break Up

Particulars (%)	4QFY17	3QFY17	QoQ (bps)	3QFY16	YoY (bps)
Direct Costs % Net Revenues	66.3	66.1	17	65.1	120
Gross Profit Margin	33.7	33.9	(17)	34.9	(120)
SG&A Expenses % Net Revenues	11.8	11.7	10	12.7	(94)
EBITDA Margin	22.0	22.2	(27)	22.2	(26)
EBIT Margin	20.0	20.4	(34)	20.8	(73)
Tax Rate	11.6	21.5	(990)	20.5	(888)
APAT Margin	19.3	17.5	177	18.0	129

Source: Company, RSec Research

Exhibit 3: Key Assumptions

Particulars	FY15	FY16*	FY17E	FY18E	FY19E
Software services USD rev. growth (%)	9.0	4.8	6.3	8.0	10.0
IMS USD rev. growth (%)	13.4	10.3	25.1	18.0	17.5
BPO USD rev. growth (%)	21.0	13.0	(15.1)	(5.0)	5.0
Total USD revenue growth (%)	11.1	7.1	11.9	11.4	13.0
USD/INR rate	62.26	66.28	66.98	65.00	65.00
EBIT margin (%)	22.3	20.1	20.3	20.5	20.4

*Source: Company, RSec Research; *Note: FY16 revenue growth has been calculated on a TTM basis.*

Exhibit 4: Actuals vs RSec estimates

(4QFY17)	Actuals	RSec estimates	% variation from RSec estimates
Revenue (US$ mn)	1,817	1,791	1.5
Revenue (Rs mn)	120,530	119,811	0.6
EBIT (Rs mn)	24,160	23,870	1.2
EBIT margin (%)	20.0	19.9	46 bps
Net profit (Rs mn)	23,250	20,419	13.9

Source: Company, RSec Research

Exhibit 5: Earlier, revised estimates

Particulars	Earlier estimates	Revised estimates	% change	Earlier estimates	Revised estimates	% change
		FY18E			FY19E	
Revenue (US$ mn)	7,828	7,774	(0.7)	8,845	8,783	(0.7)
Revenue (Rs mn)	528,415	505,293	(4.4)	601,485	570,890	(5.1)
EBIT (Rs mn)	106,064	103,587	(2.3)	118,270	116,692	(1.3)
EBIT margin (%)	20.1	20.5	43 bps	19.7	20.4	78 bps
EPS (Rs)	64.1	65.0	1.4	71.9	72.7	1.2

Source: RSec Research

Exhibit 6: Vertical split

(% of rev)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Financial Services	25.9	25.0	23.6	24.1	24.3	24.2
Manufacturing	31.5	31.4	33.2	32.2	33.9	34.6
Telecom, Media, Publishing & Entert.	9.7	9.9	9.1	9.4	8.9	8.4
Retail & CPG	9.5	9.2	10.0	10.4	9.4	9.2
Life Sciences and Healthcare	12.2	12.8	11.9	12.6	12.0	11.5
Public Services	10.6	11.1	11.7	10.9	11.2	11.7
Others	0.6	0.6	0.5	0.4	0.3	0.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, RSec Research

Exhibit 7: Vertical growth

(QoQ, %)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Financial Services	0.6	(2.2)	0.6	4.0	2.2	3.7
Manufacturing	(1.7)	1.0	12.6	(1.2)	6.7	6.2
Telecom, Media, Publishing & Entert.	2.5	3.4	(2.1)	5.2	(4.1)	(1.8)
Retail & CPG	9.5	(1.9)	15.8	5.9	(8.4)	1.9
Life Sciences and Healthcare	(0.2)	6.3	(1.0)	7.9	(3.5)	(0.2)
Public Services	7.5	6.1	12.3	(5.1)	4.1	8.7
Others	1.4	1.3	(11.2)	(18.5)	(24.0)	38.8
Total	**1.4**	**1.3**	**6.5**	**1.9**	**1.3**	**4.1**

Source: Company, RSec Research

Exhibit 8: Service line split

(% of rev)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Software Services (Apps + Engg)	59.0	58.6	56.0	55.6	56.1	57.3
Infrastructure Services	35.5	36.2	39.9	40.3	39.9	38.8
Business Services	5.5	5.2	4.1	4.1	4.0	3.9
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, RSec Research

Exhibit 9: Service line growth

(QoQ, %)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Software Services (Apps + Engg)	0.4	0.7	1.8	1.1	2.2	6.3
Infrastructure Services	2.6	3.3	17.4	2.9	0.3	1.2
Business Services	5.2	(4.2)	(16.0)	1.9	(1.1)	1.5
Total	**1.4**	**1.3**	**6.5**	**1.9**	**1.3**	**4.1**

Source: Company, RSec Research

Exhibit 10: Geographical split

(% of rev)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Americas	61.0	62.5	59.9	61.9	61.9	62.6
Europe	29.9	28.4	31.4	29.3	29.6	27.7
Rest of the World	9.1	9.1	8.7	8.8	8.5	9.7
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, RSec Research

Exhibit 11: Geographic growth

(QoQ, %)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Americas	5.4	3.8	2.1	5.3	1.3	5.3
Europe	(4.4)	(3.7)	17.8	(4.9)	2.4	(2.6)
Rest of the World	(3.9)	1.3	1.8	3.0	(2.1)	18.8
Total	**1.4**	**1.3**	**6.5**	**1.9**	**1.3**	**4.1**

Source: Company, RSec Research

Exhibit 12: Headcount, attrition, utilisation data

(Nos.)	2QFY16	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Total headcount	**103,696**	**104,896**	**107,968**	**109,795**	**111,092**	**115,973**
Technical	94,652	95,649	98,225	99,897	101,154	105,547
Support	9,044	9,247	9,743	9,898	9,938	10,426
Gross additions	**6,234**	**9,280**	**10,515**	**9,083**	**8,467**	**10,605**
Net additions	**(1,875)**	**1,200**	**3,072**	**1,827**	**1,297**	**4,881**
Voluntary LTM attrition (%)	16.7	17.3	17.8	18.6	17.9	16.9
Utilisation excluding trainees (%)	84.7	85.6	85.8	85.3	84.6	85.7

Source: Company, RSec Research

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Profit and Loss Statement

Y/E March (Rs mn)	FY15	FY16*	FY17	FY18E	FY19E
Net Revenues (US$ mn)	**5,952**	**4,698**	**6,975**	**7,774**	**8,783**
Growth (%)	11.1	N.A.	N.A.	11.4	13.0
Net Sales	370,610	311,360	467,230	505,293	570,890
Growth (%)	12.6	N.A.	N.A.	8.1	13.0
Cost of Revenue	237,980	204,720	308,900	334,374	378,815
SG&A Expenses	45,630	39,690	55,240	58,109	65,652
EBITDA	**87,000**	**66,950**	**103,090**	**112,810**	**126,423**
EBITDA (%)	**23.5**	**21.5**	**22.1**	**22.3**	**22.1**
EBITDA Growth (%)	**0.4**	**(23.0)**	**54.0**	**9.4**	**12.1**
Depreciation	4,510	4,450	8,350	9,223	9,731
EBIT	**82,490**	**62,500**	**94,740**	**103,587**	**116,692**
EBIT (%)	**22.3**	**20.1**	**20.3**	**20.5**	**20.4**
EBIT Growth (%)	**4.0**	**(24.2)**	**51.6**	**9.3**	**12.7**
Other Income	10,010	8,710	10,201	11,737	12,284
Interest	880	740	861	604	583
PBT	**91,620**	**70,470**	**104,080**	**114,720**	**128,393**
Tax (incl deferred)	19,080	14,770	19,510	22,944	25,679
APAT	**72,540**	**55,700**	**84,570**	**91,776**	**102,715**
APAT Growth (%)	**13.9**	**N.A.**	**N.A.**	**8.5**	**11.9**
EPS	**51.4**	**39.4**	**59.9**	**65.0**	**72.7**
EPS Growth (%)	**13.9**	**N.A.**	**N.A.**	**8.5**	**11.9**

**Note: FY16 is a 9 month period ending March 31, 2016. Thus, direct growth is not comparable in FY17.*

Balance Sheet

Y/E March (Rs mn)	FY15	FY16*	FY17	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	2,810	2,815	2,823	2,823	2,823
Reserves	244,696	277,406	332,081	377,618	427,488
Total Shareholders' Funds	**247,506**	**280,221**	**334,904**	**380,441**	**430,311**
Total Debt	**8,411**	**12,271**	**7,345**	**7,767**	**7,767**
Long Term Provisions & Others	12,590	12,635	12,525	12,525	12,525
Creditors	9,115	9,081	27,007	10,753	12,177
Other Current Liabilities & Provns	79,484	83,465	82,542	89,840	101,571
Total Current Liabilities	**88,599**	**92,546**	**109,549**	**100,593**	**113,749**
TOTAL SOURCES	**357,106**	**397,673**	**464,323**	**501,326**	**564,352**
APPLICATION OF FUNDS					
Net Block	32,888	37,922	41,497	47,432	54,828
CWIP	5,310	5,310	5,310	5,310	5,310
Goodwill & Other Intangible Assets	52,039	64,194	73,583	73,583	73,583
Licenced IPRs	-	-	40,673	40,673	40,673
Investments	80	1,601	1,467	1,467	1,467
LT Loans & Advances, Others	30,663	38,787	37,118	37,118	37,118
Total Non Current Assets	**120,979**	**147,813**	**199,647**	**205,583**	**212,979**
Debtors	65,632	77,213	83,014	96,906	111,050
Cash & Bank	110,212	113,164	115,361	116,018	148,984
Liquid Investments	7,675	5,365	11,457	11,457	11,457
Other Current Assets	52,608	54,118	54,844	71,363	79,883
Total Current Assets	**236,127**	**249,860**	**264,676**	**295,743**	**351,373**
TOTAL APPLICATION	**357,106**	**397,673**	**464,323**	**501,326**	**564,352**

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Cash Flow Statement

Y/E March (Rs mn)	FY15	FY16*	FY17	FY18E	FY19E
PAT	72,540	55,700	84,570	91,776	102,715
Non-operating & EO items	0	0	0	(15)	(15)
Depreciation	4,510	4,450	8,350	9,223	9,731
Working Capital Change	(13,255)	(8,020)	3,773	(39,364)	(9,506)
OPERATING CASH FLOW (a)	**63,795**	**52,130**	**96,693**	**61,620**	**102,925**
Capex	(11,242)	(9,484)	(11,925)	(15,159)	(17,127)
Investments	(5,005)	(9,645)	1,803	0	0
INVESTING CASH FLOW (b)	**(16,247)**	**(19,129)**	**(10,122)**	**(15,159)**	**(17,127)**
Debt Issuance	(8,500)	3,905	(5,036)	422	0
Share capital Issuance	1,412	5	8	0	0
Dividend	(26,298)	(27,992)	(39,633)	(46,239)	(52,844)
FINANCING CASH FLOW (c)	**(33,386)**	**(24,082)**	**(44,661)**	**(45,817)**	**(52,844)**
NET CASH FLOW (a+b+c)	14,162	8,919	41,910	644	32,953
Non-operating and EO items	2,143	(5,967)	(39,713)	13	13
Closing Cash & Bank	**110,212**	**113,164**	**115,361**	**116,018**	**148,984**
Free Cash Flow	**52,553**	**42,646**	**84,768**	**46,461**	**85,798**

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Key Ratios

Y/E March (Rs mn)	FY15	FY16*	FY17	FY18E	FY19E
Profitability (%)					
EBITDA Margin	23.5	21.5	22.1	22.3	22.1
APAT Margin	19.6	17.9	18.1	18.2	18.0
RoE	32.4	27.2	27.5	25.7	25.3
RoIC or Core RoCE	31.3	20.6	25.6	24.6	25.5
RoCE	27.7	23.2	23.6	22.7	22.6
Efficiency					
Tax Rate (%)	20.8	21.0	18.7	20.0	20.0
Fixed Asset Turnover (x)	4.4	3.3	4.4	4.2	4.1
Debtors (days)	65	68	65	70	71
Payables (days)	12	14	27	10	10
Cash Conversion Cycle (days)	53	54	38	60	61
Net Debt/EBITDA (x)	(1.3)	(1.6)	(1.2)	(1.1)	(1.2)
Net Debt/Equity (x)	(0.4)	(0.4)	(0.4)	(0.3)	(0.4)
Interest Coverage (x)	93.7	84.5	110.0	171.4	200.3
Per Share Data (Rs)					
EPS	51.4	39.4	59.9	65.0	72.7
CEPS	54.0	42.0	65.2	71.0	79.1
DPS	16.0	17.0	24.0	28.0	32.0
BV	175.2	198.4	237.1	269.3	304.6
Valuation					
P/E (x)	16.3	16.0	14.0	12.9	11.5
P/BV (x)	4.8	4.2	3.5	3.1	2.8
EV/EBITDA (x)	12.2	12.0	10.3	9.4	8.1
OCF/EV (%)	6.0	4.9	9.2	5.8	10.1
FCF/EV (%)	4.9	4.0	8.0	4.4	8.4
FCFE/mkt cap (%)	4.5	3.6	7.2	3.9	7.3
Dividend Yield (%)	1.9	2.0	2.9	3.3	3.8

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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