HCL Technologies

BUY

INDUSTRY	IT
CMP *(as on 27 Jul 2017)*	Rs 890
Target Price	Rs 980
Nifty	10,021
Sensex	32,383
KEY STOCK DATA	
Bloomberg	HCLT IN
No. of Shares (mn)	1,427
MCap (Rs bn) / ($ mn)	1,270/19,816
6m avg traded value (Rs mn)	1,494

STOCK PERFORMANCE (%)			
52 Week high / low			Rs 928 / 731
	3M	6M	12M
Absolute (%)	9.9	5.5	18.1
Relative (%)	2.1	(10.7)	2.6

SHAREHOLDING PATTERN (%)	
Promoters	59.88
FIs & Local MFs	10.61
FPIs	25.50
Public & Others	4.01

Source : BSE

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Strong operating performance

HCL Tech (HCLT) posted revenue of USD 1,884mn in 1QFY18, 3.7% QoQ, based on 2.7% CC (~1.3% organic), with BFSI and Retail & CPG verticals at 5.3% and 4.9% respectively. Though IMS recovered to 1.7% (0.9% QoQ in 4Q), there are near-term headwinds. Operating performance was strong, with EBIT% at 20.1%, supported by a better mix (higher IP and lower BPM) and productivity gains (utilisation at 86%). HCLT maintained its guidance of 10.5-12.5% CC revenue growth for FY18E, implying CQGR of 2 to 3.2%.

IMS and ER&D have fewer large deals in pipeline, as well as in-sourcing challenges, which may restrict growth in the near term. However, an increase in renewals will support growth. We maintain our positive outlook on HCLT based on (1) Superior growth visibility, supported by Mode-2 and Mode-3 services, (2) Scale dominance in IMS (market expansion strategy) and engineering services, (3) 'DryIce' automation supporting Mode-1 services and (4) Deeper penetration of digital (>60% of top-150 accounts in Mode-2). Expect revenue/EPS growth at 12/10% CAGR respectively over FY17-19E (highest in large-cap IT), factoring in USD revenue growth of 12.1/11.5% for FY18/19E and EBIT% at 19.9/20.3% respectively. Maintain BUY with a TP of Rs 980, 14x FY19E.

Highlights of the quarter

- HCLT won 13 transformational deals in 1Q, as compared to 17 in the previous two quarters. Europe was weak, impacted by large BPM deal (BFSI vertical) and lower IMS. HCLT extended its IPO-partnership with IBM in 1Q to business solutions in marketing automation (digital and analytics), with an investment of USD 140mn. This is core to its Mode-3 strategy of IP-led growth.
- **Near-term outlook:** IMS is expected to remain soft in the near term. However, growth at a premium to HCLT's peers and valuations are at discount.

Financial Summary

YE March (Rs bn)	1QFY18	1QFY17	*YoY (%)*	4QFY17	*QoQ (%)*	FY15	FY16	FY17	FY18E	FY19E
Net Sales	121.49	113.36	*7.2*	120.53	*0.8*	357.09	409.13	467.23	511.26	575.29
EBIT	24.45	23.33	*4.8*	24.16	*1.2*	83.15	82.27	94.74	101.95	116.75
APAT	21.71	20.47	*6.1*	20.22	*7.4*	73.07	73.52	81.54	86.85	97.35
Diluted EPS (Rs)	15.2	14.5	*4.9*	14.2	*7.4*	52.0	52.2	57.6	62.0	69.9
P/E (x)						17.1	17.1	15.6	14.3	12.7
EV / EBITDA (x)						13.2	13.3	12.0	11.2	9.6
RoE (%)						33.4	28.5	27.1	26.1	27.1

Source: Company, HDFC sec Inst Research # Consolidated

Revenue at USD 1,884mn based on 2.6% CC growth and +110 bps QoQ on cross currency

Quarterly Consolidated Financials Snapshot

Particulars (Rs bn)	1QFY18	1QFY17	*YoY (%)*	4QFY17	*QoQ (%)*
Net Revenues (USD mn)	**1,884**	**1,691**	***11.4***	**1,817**	***3.7***
Net Revenues	**121.49**	**113.36**	***7.2***	**120.53**	***0.8***
Direct Costs	80.57	74.40	*8.3*	79.87	*0.9*
Gross Profit	**40.92**	**38.96**	***5.0***	**40.66**	***0.6***
SG&A Expenses	14.11	13.75	*2.6*	14.17	*(0.4)*
EBITDA	**26.81**	**25.21**	***6.3***	**26.49**	***1.2***
Depreciation	2.36	1.88	*25.5*	2.33	*1.3*
EBIT	**24.45**	**23.33**	***4.8***	**24.16**	***1.2***
Other Income	2.69	2.57	*4.7*	2.12	*26.9*
PBT	**27.14**	**25.90**	***4.8***	**26.28**	***3.3***
Tax	5.43	5.43	*0.0*	3.03	*79.2*
APAT	**21.71**	**20.47**	***6.1***	**20.22**	***7.4***
E/o (adj for tax)	-	-		3.03	
RPAT	21.71	20.47	*6.1*	23.25	*(6.6)*

Source: Company, HDFC sec Inst Research

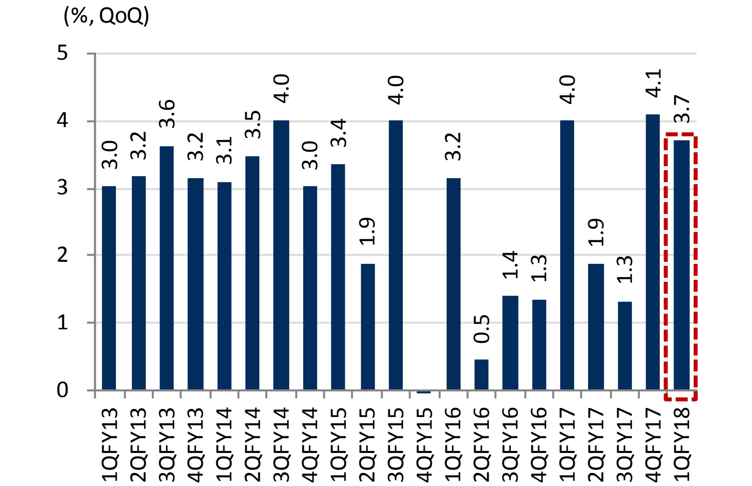
EBIT% came at 20.1% and management maintained its guidance of 19.5-20.5% band

Margin Analysis

	1QFY18	1QFY17	*YoY (bps)*	4QFY17	*QoQ (bps)*
Direct Costs % Net Revenues	66.3	65.6	*69*	66.3	*5*
Gross Profit Margin (%)	33.7	34.4	*(69)*	33.7	*(5)*
SG&A Expenses % Net Revenues	11.6	12.1	*(52)*	11.8	*(14)*
EBITDA Margin (%)	22.1	22.2	*(17)*	22.0	*9*
EBIT Margin (%)	**20.1**	**20.6**	***(46)***	**20.0**	***8***
Tax Rate (%)	20.0	21.0	*(96)*	11.5	*848*
APAT Margin (%)	17.9	18.1	*(19)*	16.8	*109*

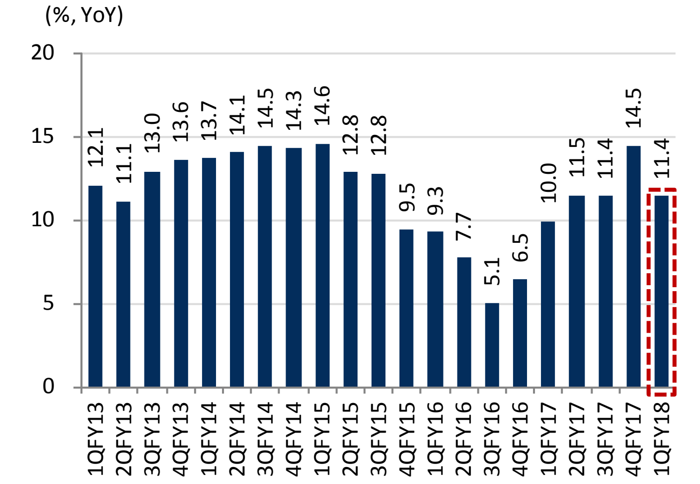
Source: Company, HDFC sec Inst Research

QoQ USD Revenue Growth Trajectory



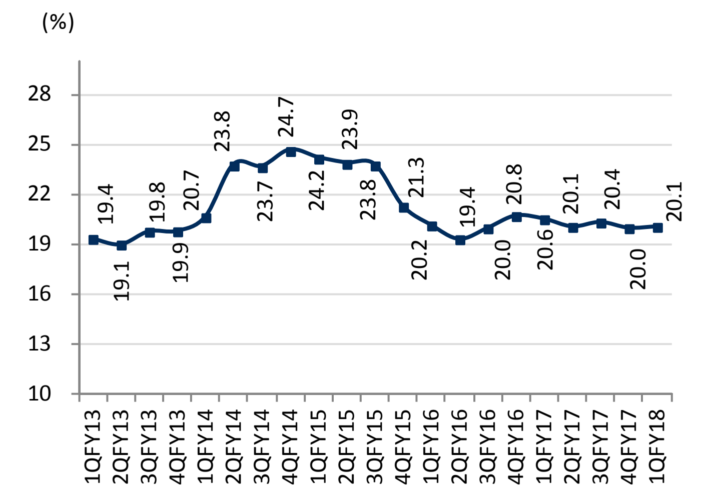
Source: Company, HDFC sec Inst Research, *1QFY17 organic

YoY USD Revenue Growth Trajectory



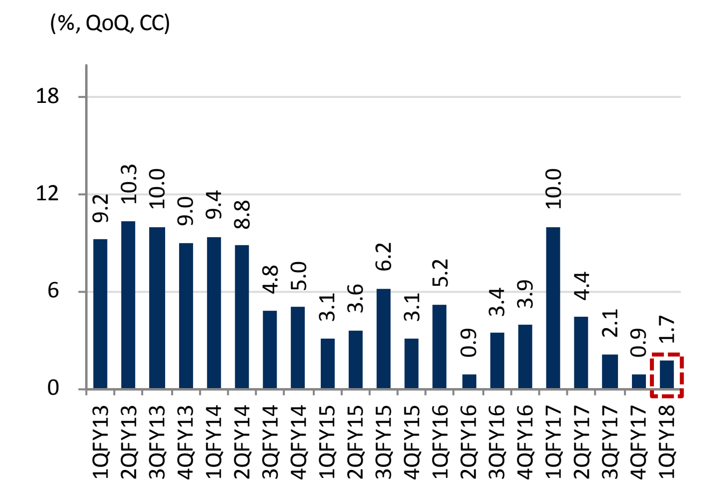
Source: Company, HDFC sec Inst Research

EBIT Margin Trajectory



Source: Company, HDFC sec Inst Research

QoQ Infra Services USD Revenue Trajectory



Source: Company, HDFC sec Inst Research, *1QFY17 organic

BFSI grew 5.3% CC and Retail & CPG grew 4.9% CC, which is a significant outperformance over larger peers

Vertical Revenue Break-up

(% of rev)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Manufacturing	31.5	31.4	33.2	32.2	33.9	34.6	34.9
Financial Services	25.9	25.0	23.6	24.1	24.3	24.2	24.9
Life Sciences and Health Care	12.2	12.8	11.9	12.6	12.0	11.5	11.8
Public Services	10.6	11.1	11.7	10.9	11.2	11.7	11.1
Telecom, Media, Publishing & Entertainment	9.7	9.9	9.1	9.4	8.9	8.4	7.9
Retail & CPG	9.5	9.2	10.0	10.4	9.4	9.2	9.5
Others	0.6	0.6	0.5	0.4	0.3	0.4	0.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, HDFC Sec Inst Research

Vertical-wise Revenue Growth

(QoQ, %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Manufacturing	(1.7)	1.0	12.6	(1.2)	6.7	6.2	4.5
Financial Services	0.6	(2.2)	0.6	4.0	2.2	3.7	6.5
Life Sciences and Health Care	(0.2)	6.3	(1.0)	7.9	(3.5)	(0.2)	6.4
Public Services	7.5	6.1	12.3	(5.1)	4.1	8.7	(1.6)
Telecom, Media, Publishing & Entertainment	2.5	3.4	(2.1)	5.2	(4.1)	(1.8)	(2.5)
Retail & CPG	9.5	(1.9)	15.8	6.0	(8.4)	1.9	7.1
Others	1.4	1.3	(11.2)	(18.5)	(24.0)	38.8	(100.0)
Total	**1.4**	**1.3**	**6.5**	**1.9**	**1.3**	**4.1**	**3.7**

Source: Company, HDFC Sec Inst Research

IMS grew 1.7% CC and ER&D (21.5% of revenue) grew 7.9% CC (supplemented by Geometric consolidation)

Europe was flat (-0.4% CC) as compared to -3% CC in 4Q

Service Line Break-up

(% of rev)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Software Services (Apps + Engg)	59.0	58.6	56.1	55.6	56.1	57.3	57.8
Infrastructure Services	35.5	36.2	39.8	40.3	39.8	38.8	38.6
Business Services	5.5	5.2	4.1	4.1	4.0	3.9	3.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, HDFC Sec Inst Research

Service Line Growth

(QoQ, %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Software Services (Apps + Engg)	0.3	0.7	1.9	1.1	2.3	6.2	4.7
Infrastructure Services	2.4	3.5	17.1	3.2	0.0	1.5	3.2
Business Services	6.9	(4.9)	(15.6)	0.3	0.9	0.5	(5.7)
Total	**1.4**	**1.3**	**6.5**	**1.9**	**1.3**	**4.1**	**3.7**

Source: Company, HDFC Sec Inst Research

Geographic Revenue Break-up

(% of rev)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Americas	**61.0**	**62.5**	**59.9**	**61.9**	**61.9**	**62.6**	**62.8**
Europe	29.9	28.4	31.4	29.3	29.6	27.7	27.4
Rest of the World	9.1	9.1	8.7	8.8	8.5	9.7	9.8
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, HDFC Sec Inst Research

Geographic Revenue Growth

(QoQ, % CC)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Americas	5.5	3.7	2.0	5.5	1.7	5.3	3.8
Europe	**(2.4)**	**(2.4)**	**16.9**	**(2.1)**	**6.8**	**(3.0)**	**(0.4)**
Rest of the World	(3.4)	1.3	0.0	2.0	(0.5)	15.8	3.1
Total	**2.1**	**1.7**	**6.0**	**2.8**	**3.0**	**3.8**	**2.6**

Source: Company, HDFC Sec Inst Research

Headcount, Attrition And Utilisation Data

(Nos.)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Total headcount	**103,696**	**104,896**	**107,968**	**109,795**	**111,092**	**115,973**	**117,781**
Technical	*94,652*	*95,649*	*98,225*	*99,897*	*101,154*	*105,547*	*107,029*
Support	*9,044*	*9,247*	*9,743*	*9,898*	*9,938*	*10,426*	*10,752*
Gross Additions	6,234	9,280	10,515	9,083	8,467	10,605	9,462
Net Additions	(1,875)	1,200	3,072	1,827	1,297	4,881	1,808
Voluntary LTM Attrition (%)	16.7	17.3	17.8	18.6	17.9	16.9	16.2
Utilisation Excluding Trainees (%)	84.7	85.6	85.8	85.3	84.6	85.7	86.0

Source: Company, HDFC Sec Inst Research

Key Assumptions

Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E
Software Services USD Rev. Growth (%)	4.5	9.1	4.8	6.4	16.1	11.5
IMS USD Rev. Growth (%)	37.9	16.6	10.3	25.0	7.9	11.9
BPO USD Rev. Growth (%)	14.7	27.5	13.0	(14.8)	(2.3)	6.4
Total USD Revenue Growth (%)	**14.1**	**12.4**	**7.1**	**11.9**	**12.1**	**11.5**
USD/INR Rate	59.58	61.48	65.61	67.0	65.4	66.0
EBIT Margin (%)	**23.3**	**23.3**	**20.1**	**20.3**	**19.9**	**20.3**

Source: Company, HDFC Sec Inst Research

Change In Estimates

Particulars	Earlier estimates	Revised estimates	*% change*
		FY18E	
Revenue (USD mn)	7,887	7,819	*(0.9)*
Revenue (Rs bn)	515.78	511.26	*(0.9)*
EBIT (Rs bn)	102.30	101.95	*(0.3)*
EBIT margin (%)	*19.8*	*19.9*	*11bps*
EPS (Rs)	60.4	62.0	*2.8*
		FY19E	
Revenue (USD mn)	8,589	8,716	*1.5*
Revenue (Rs bn)	566.89	575.29	*1.5*
EBIT (Rs bn)	114.16	116.75	*2.3*
EBIT margin (%)	*20.1*	*20.3*	*16bps*
EPS (Rs)	67.4	69.9	*3.7*

Peer Valuation

Company	Mcap (Rs bn)	CMP (Rs)	Reco.	TP (Rs)	EPS (Rs)			P/E (x)			RoE (%)		
					FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
TCS	4,751	2,482	NEU	2,500	133.4	134.8	147.1	18.6	18.4	16.9	33.4	30.4	31.2
Infosys	2,224	972	BUY	1,120	62.8	63.2	70.4	15.5	15.4	13.8	22.0	20.9	22.3
Wipro	1,405	290	NEU	280	16.7	18.8	21.7	17.4	15.4	13.3	16.4	15.5	16.1
HCL Tech.	**1,270**	**890**	**BUY**	**980**	**57.6**	**62.0**	**69.9**	**15.6**	**14.3**	**12.7**	**27.1**	**26.1**	**27.1**
Tech Mahindra	335	377	NEU	406	31.6	30.4	33.9	11.9	12.4	11.1	18.1	15.8	15.9

Source: HDFC sec Inst Research

Consolidated Income Statement

YE March (Rs bn)	FY15	FY16	FY17	FY18E	FY19E
Net Revenues (US$mn)	**5,822**	**6,235**	**6,975**	**7,819**	**8,716**
Growth (%)	***12.4***	***7.1***	***11.9***	***12.1***	***11.5***
Net Sales	**357.09**	**409.13**	**467.23**	**511.26**	**575.29**
Growth (%)	***13.5***	***14.6***	***14.2***	***9.4***	***12.5***
Cost of Revenue	225.83	269.00	308.90	338.82	379.23
SG&A Expenses	43.07	52.17	55.24	60.83	67.85
EBITDA	**88.19**	**87.96**	**103.09**	**111.61**	**128.22**
EBITDA (%)	***24.7***	***21.5***	***22.1***	***21.8***	***22.3***
EBITDA Growth (%)	***9.3***	***(0.3)***	***17.2***	***8.3***	***14.9***
Depreciation	5.04	5.69	8.35	9.66	11.47
EBIT	**83.15**	**82.27**	**94.74**	**101.95**	**116.75**
Other Income	9.53	11.03	10.24	10.54	10.61
Interest	0.97	0.95	0.89	0.74	0.92
PBT	**91.71**	**92.35**	**104.09**	**111.75**	**126.43**
Tax (incl deferred)	18.64	18.83	19.52	24.90	29.08
Minority Interest and associate profit	-	-	-	-	-
RPAT	**73.07**	**73.52**	**84.57**	**86.85**	**97.35**
APAT	**73.07**	**73.52**	**81.54**	**86.85**	**97.35**
APAT Growth (%)	***27.6***	***0.6***	***10.9***	***6.5***	***12.1***
EPS	**52.0**	**52.2**	**57.6**	**62.0**	**69.9**
EPS Growth (%)	***27.0***	***0.5***	***10.4***	***7.7***	***12.7***

Source: Company, HDFC sec Inst Research

Consolidated Balance Sheet

YE March (Rs bn)	FY15	FY16	FY17	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	2.81	2.82	2.85	2.78	2.78
Reserves	239.43	270.12	326.64	333.46	380.71
Total Shareholders' Funds	**242.24**	**272.94**	**329.50**	**336.25**	**383.49**
Total Debt	**5.23**	**9.52**	**4.45**	**7.12**	**8.01**
Long-term Provisions & Others	1.18	3.27	(5.57)	(4.66)	(3.44)
TOTAL SOURCES OF FUNDS	**248.65**	**285.73**	**328.38**	**338.71**	**388.06**
APPLICATION OF FUNDS					
Net Block	34.04	38.17	47.38	45.58	50.46
CWIP	5.52	6.11	4.48	4.81	5.38
Goodwill & Other Intangible Assets	48.72	61.39	98.94	111.47	125.27
Investments	1.07	3.21	1.60	3.09	3.46
LT Loans & Advances, Others	24.75	27.76	18.04	19.74	22.21
Total Non Current Assets	**114.08**	**136.63**	**170.43**	**184.68**	**206.78**
Debtors	65.39	76.82	83.01	90.83	102.21
Cash & Equivalents	105.49	98.15	107.94	101.02	121.55
Other Current Assets	59.59	73.58	79.79	87.32	98.23
Total Current Assets	**230.47**	**248.55**	**270.74**	**279.17**	**321.99**
Creditors	6.25	7.00	8.01	8.79	9.83
Other Current Liabilities & Provns	89.64	92.46	104.79	116.36	130.87
Total Current Liabilities	**95.90**	**99.45**	**112.80**	**125.15**	**140.70**
Net Current Assets	**134.57**	**149.10**	**157.95**	**154.02**	**181.29**
TOTAL APPLICATION OF FUNDS	**248.65**	**285.73**	**328.38**	**338.71**	**388.06**

Source: Company, HDFC sec Inst Research

Consolidated Cash Flow

YE March (Rs bn)	FY15	FY16	FY17	FY18E	FY19E
Reported PBT	91.71	92.35	104.09	111.75	126.43
Non-operating & EO items	0.66	(2.54)	(6.67)	0.69	0.91
Interest expenses	0.97	0.95	0.89	0.74	0.92
Depreciation	5.04	5.69	8.35	9.66	11.47
Working Capital Change	(20.28)	(21.70)	0.94	(3.00)	(6.73)
Tax paid	(18.64)	(18.83)	(19.52)	(24.90)	(29.08)
OPERATING CASH FLOW (a)	**59.46**	**55.93**	**88.08**	**94.93**	**103.92**
Capex	(9.70)	(18.06)	(18.02)	(14.24)	(15.68)
Free cash flow (FCF)	*49.77*	*37.87*	*70.06*	*80.69*	*88.25*
Investments	(11.08)	(10.18)	(24.13)	(9.67)	(17.88)
INVESTING CASH FLOW (b)	**(20.77)**	**(28.23)**	**(42.16)**	**(23.91)**	**(33.56)**
Debt Issuance	1.17	4.28	(5.07)	2.67	0.89
Interest expenses	(0.97)	(0.95)	(0.89)	(0.74)	(0.92)
FCFE	*49.96*	*41.20*	*64.10*	*82.63*	*88.21*
Share capital Issuance	0.01	0.00	0.02	(0.04)	-
Dividend	(31.26)	(34.66)	(41.10)	(45.10)	(50.11)
FINANCING CASH FLOW (c)	**(31.05)**	**(31.33)**	**(47.04)**	**(78.20)**	**(50.14)**
NET CASH FLOW (a+b+c)	**7.64**	**(3.63)**	**(1.12)**	**(7.17)**	**20.22**
Closing Cash & Equivalents	105.49	98.15	107.94	101.02	121.55

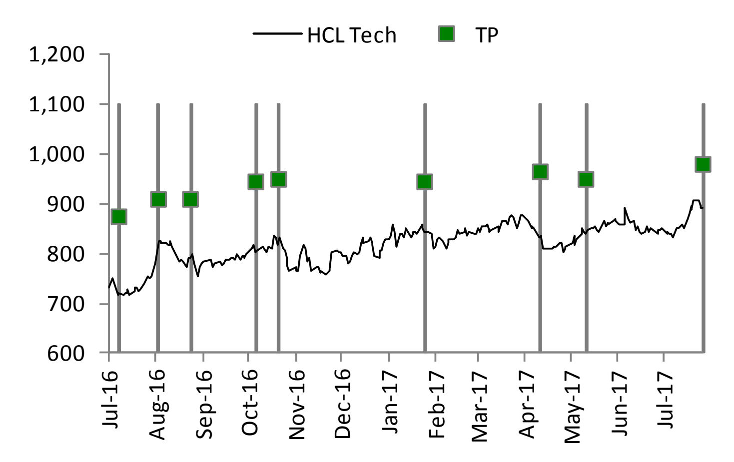
Source: Company, HDFC sec Inst Research

Key Ratios

	FY15	FY16	FY17	FY18E	FY19E
PROFITABILITY (%)					
EBITDA Margin	24.7	21.5	22.1	21.8	22.3
APAT Margin	20.5	18.0	17.5	17.0	16.9
RoE	33.4	28.5	27.1	26.1	27.1
RoIC or Core RoCE	52.9	39.6	37.7	34.6	35.7
RoCE	32.6	27.6	26.6	26.1	26.8
EFFICIENCY					
Tax Rate (%)	20.3	20.4	18.8	22.3	23.0
Fixed Asset Turnover (x)	5.4	5.7	4.5	4.4	4.4
Debtors (days)	67	69	65	65	65
Payables (days)	6	6	6	6	6
Cash Conversion Cycle (days)	62	65	61	61	61
Net Debt/EBITDA (x)	(1.1)	(1.0)	(1.0)	(0.8)	(0.9)
Net Debt/Equity (x)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)
Interest Coverage (x)	85.4	86.2	106.3	138.4	126.4
PER SHARE DATA					
EPS (Rs/sh)	52.0	52.2	57.6	62.0	69.9
CEPS (Rs/sh)	55.6	56.1	63.0	69.3	78.2
DPS (Rs/sh)	19.0	21.0	24.0	27.0	30.0
BV (Rs/sh)	172.9	195.7	232.1	242.8	276.7
VALUATION					
P/E	17.1	17.1	15.6	14.3	12.7
P/BV	5.1	4.5	3.8	3.7	3.2
EV/EBITDA	13.2	13.3	12.0	11.2	9.6
OCF/EV (%)	5.1	4.8	7.1	7.6	8.4
FCF/EV (%)	4.3	3.2	5.6	6.5	7.2
FCFE/mkt cap (%)	4.0	3.3	5.1	6.6	7.0
Dividend Yield (%)	2.1	2.4	2.7	3.0	3.4

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
8-Jul-16	717	BUY	875
4-Aug-16	826	BUY	910
25-Aug-16	790	BUY	910
6-Oct-16	816	BUY	945
22-Oct-16	832	BUY	950
25-Jan-17	849	BUY	945
11-Apr-17	833	BUY	965
12-May-17	839	BUY	950
27-Jul-17	890	BUY	980

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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Any holding in stock –No

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