

Institutional Equity Research

HCL Technologies

IT | India

1QFY18 Result Update | July 27, 2017

CMP* (Rs)	890
Upside/ (Downside) (%)	16
Bloomberg Ticker	HCLT IN
Market Cap. (Rs bn)	1,238
Free Float (%)	40
Shares O/S (mn)	1,392

BUY 

Target Price: Rs1,030

Another Good Quarter, Guidance Maintained

HCL Technologies (HCLT) has delivered a healthy performance in 1QFY18 with USD revenue growing by 3.7% QoQ (2.6% QoQ in CC terms) to US\$1,884mn, marginally ahead of our estimate of US\$1,873mn. Aided by revenue growth and slightly improved utilisation, its EBIT margin beat our estimate by 77bps. Maintaining CC revenue growth guidance at 10.5-12.5%, the IT major expects EBIT margin in 19.5-20.5% range for FY18E. Engineering Services drove quarterly growth with revenue rising by as much as 8.8% QoQ (+7.9% in CC terms), while the key IMS segment grew by 3.2% QoQ (+1.7% QoQ in CC terms). Continued decline in attrition in the Software Services segment at 16.2% (vs. 16.9% in 4QFY17) is a major positive, in our view.

Well-rounded Growth a Key Positive

HCLT has posted a good 1QFY18 with YoY USD revenue growth (11.4%) hitting double digit for the second successive quarter. Even in CC terms, YoY revenue growth hit double digit for the second quarter in succession. Reiteration of 10.5-12.5% CC revenue growth guidance for FY18E is a positive sign, in our view. Maintaining our positive view on HCLT's consistently better performances vis-à-vis its peers, we believe that the company should command a premium in light of better growth visibility, particularly in context of a challenging business environment.

From vertical perspective Financial Services (+6.7% QoQ in USD terms), Manufacturing (+4.6%), Retail & CPG (+7.1%) and Life Sciences & Healthcare (+6.4%) drove growth. Notably, these verticals account for more than 81% of HCLT's total revenue. On the other hand, pressure continues to be witnessed in Telecom & MPE vertical (-2.5% QoQ). From a geographic perspective, Americas grew by a strong 4% QoQ, while RoW grew by 4.8% QoQ. Notably, Europe grew by 2.6% QoQ, below company average. Broad-based growth – not solely dependent on any vertical or service line – is an encouraging factor, which drives confidence on growth sustainability, going forward.

Outlook & Valuation – Highest Growth among Top-tier IT Pack

On the back of consistent performances over past few quarters, well above industry growth guidance and broad-based growth, we expect HCLT to outperform top-tier peers in FY18E, going forward. We believe the company's strong positioning in high-growth IMS and Engineering Services businesses is likely to drive underlying revenue growth ahead of peers, which we believe should enable the stock to command a higher earnings multiple. Valuation at 12.9x/11.5x FY18E/FY19E EPS also seems to be attractive. **We retain our BUY recommendation on the stock with an upwardly revised Target Price of Rs1,030 (Rs963 earlier), as we roll over to FY19E earnings (target at 14x FY19E EPS).**

Key Financials (Rs mn)	FY16*	FY17	FY18E	FY19E
Net Revenues	311,360	467,230	505,444	565,115
EBIT	62,500	94,740	101,193	115,200
APAT	55,700	84,570	89,861	102,424
Diluted EPS (Rs)	40.0	60.8	64.6	73.6
P/E (x)	16.7	14.6	13.8	12.1
EV / EBITDA (x)	12.8	10.9	10.1	8.6
RoE (%)	27.2	27.5	25.2	25.3
Dividend Yield (%)	1.9	2.7	3.1	3.6

Source: Company, RSec Research; * Note: FY16 is a 9-month period ending March 31, 2016.

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	7.4	10.7	22.8
Relative to Nifty	2.0	3.4	5.5

Shareholding Pattern (%)	Jun'17	Jul'17
Promoter	59.7	59.9
Public	40.3	40.1

1 Year Stock Price Performance



Note: * CMP as on July 26, 2017

Research Analyst: Harit Shah

Contact: 022 33201276

Email: harit.shah@relianceada.com

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Key Conference Call Takeaways

- ▶ HCLT won 14 large transformational deals in 1QFY18, which were spread across verticals, service lines and geographies.
- ▶ EBIT margin was impacted by around 40bps owing to INR appreciation.
- ▶ HCLT is seeing some effect of in-sourcing of IT work, although the impact is not as much as was the case 1 year ago.
- ▶ Europe revenue was weak owing to some financial services work getting in-sourced owing to regulatory issues.
- ▶ HCLT paid around US\$140mn as part of its 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, cut discretionary spend and delay new deals.
- ▶ With the 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)	1QFY18	4QFY17	QoQ (%)	1QFY17	YoY (%)
Net Revenues (US\$ mn)	1,884	1,817	3.7	1,691	11.4
Net Revenues	121,490	120,530	0.8	113,360	7.2
Direct Costs	80,570	79,870	0.9	74,400	8.3
Gross Profit	40,920	40,660	0.6	38,960	5.0
SG&A Expenses	14,110	14,170	(0.4)	13,750	2.6
EBITDA	26,810	26,490	1.2	25,210	6.3
Depreciation	2,360	2,330	1.3	1,880	25.5
EBIT	24,450	24,160	1.2	23,330	4.8
Other Income	2,690	2,150	25.1	2,530	6.3
PBT	27,140	26,310	3.2	25,860	4.9
Tax	5,430	3,060	77.5	5,390	0.7
APAT	21,710	23,250	(6.6)	20,470	6.1
E/o (adj for tax)	0	0	-	0	-
RPAT	21,710	23,250	(6.6)	20,470	6.1

Source: Company, RSec Research

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Exhibit 2: Margin Break Up

Particulars (%)	1QFY18	4QFY17	QoQ (bps)	1QFY17	YoY (bps)
Direct Costs % Net Revenues	66.3	66.3	5	65.6	69
Gross Profit Margin	33.7	33.7	(5)	34.4	(69)
SG&A Expenses % Net Revenues	11.6	11.8	(14)	12.1	(52)
EBITDA Margin	22.1	22.0	9	22.2	(17)
EBIT Margin	20.1	20.0	8	20.6	(46)
Tax Rate	20.0	11.6	838	20.8	(84)
APAT Margin	17.9	19.3	(142)	18.1	(19)

Source: Company, RSec Research

Exhibit 3: Key Assumptions

Particulars	FY16*	FY17	FY18E	FY19E
Software services USD rev. growth (%)	4.8	6.3	13.0	10.0
IMS USD rev. growth (%)	10.3	25.1	11.0	15.0
BPO USD rev. growth (%)	13.0	(15.1)	(5.0)	5.0
Total USD revenue growth (%)	7.1	11.9	11.5	11.8
USD/INR rate	66.28	66.98	65.00	65.00
EBIT margin (%)	20.1	20.3	20.0	20.4

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

Exhibit 4: Actuals vs RSec estimates

(1QFY18)	Actuals	RSec estimates	% variation from RSec estimates
Revenue (US\$ mn)	1,884	1,873	0.6
Revenue (Rs mn)	121,490	120,729	0.6
EBIT (Rs mn)	24,450	23,372	4.6
EBIT margin (%)	20.1	19.4	77 bps
Net profit (Rs mn)	21,710	20,462	6.1

Source: Company, RSec Research

Exhibit 5: Earlier, revised estimates

Particulars	Earlier estimates	Revised estimates	% change			
				Earlier estimates	Revised estimates	% change
				FY18E		
Revenue (US\$ mn)	7,774	7,776	0.0	8,783	8,694	(1.0)
Revenue (Rs mn)	505,293	505,444	0.0	570,890	565,115	(1.0)
EBIT (Rs mn)	103,587	101,193	(2.3)	116,692	115,200	(1.3)
EBIT margin (%)	20.5	20.0	(48) bps	20.4	20.4	(6) bps
EPS (Rs)	65.0	64.6	(0.6)	72.7	73.6	1.2

Source: RSec Research

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Exhibit 6: Vertical split

(% of rev)	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Financial Services	25.0	23.6	24.1	24.3	24.2	24.9
Manufacturing	31.4	33.2	32.2	33.9	34.6	34.9
Telecom, Media, Publishing & Ent.	9.9	9.1	9.4	8.9	8.4	7.9
Retail & CPG	9.2	10.0	10.4	9.4	9.2	9.5
Life Sciences and Healthcare	12.8	11.9	12.6	12.0	11.5	11.8
Public Services	11.1	11.7	10.9	11.2	11.7	11.0
Others	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

Source: Company, RSec Research

Exhibit 7: Vertical growth

(QoQ, %)	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Financial Services	(2.2)	0.6	4.0	2.2	3.7	6.7
Manufacturing	1.0	12.6	(1.2)	6.7	6.2	4.6
Telecom, Media, Publishing & Ent.	3.4	(2.1)	5.2	(4.1)	(1.8)	(2.5)
Retail & CPG	(1.9)	15.8	5.9	(8.4)	1.9	7.1
Life Sciences and Healthcare	6.3	(1.0)	7.9	(3.5)	(0.2)	6.4
Public Services	6.1	12.3	(5.1)	4.1	8.7	(2.5)
Others	1.3	(11.2)	(18.5)	(24.0)	38.8	(100.0)
Total	1.3	6.5	1.9	1.3	4.1	3.7

Source: Company, RSec Research

Exhibit 8: Service line split

(% of rev)	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Software Services (Apps + Engg)	58.6	56.0	55.6	56.1	57.3	57.8
Infrastructure Services	36.2	39.9	40.3	39.9	38.8	38.6
Business Services	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

Source: Company, RSec Research

Exhibit 9: Service line growth

(QoQ, %)	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Software Services (Apps + Engg)	0.7	1.8	1.1	2.2	6.3	4.6
Infrastructure Services	3.3	17.4	2.9	0.3	1.2	3.2
Business Services	(4.2)	(16.0)	1.9	(1.1)	1.5	(4.3)
Total	1.3	6.5	1.9	1.3	4.1	3.7

Source: Company, RSec Research

Exhibit 10: Geographical split

(% of rev)	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Americas	62.5	59.9	61.9	61.9	62.6	62.8
Europe	28.4	31.4	29.3	29.6	27.7	27.4
Rest of the World	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

Source: Company, RSec Research

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Exhibit 11: Geographic growth

(QoQ, %)	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Americas	3.8	2.1	5.3	1.3	5.3	4.0
Europe	(3.7)	17.8	(4.9)	2.4	(2.6)	2.6
Rest of the World	1.3	1.8	3.0	(2.1)	18.8	4.8
Total	1.3	6.5	1.9	1.3	4.1	3.7

Source: Company, RSec Research

Exhibit 12: Headcount, attrition, utilisation data

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

Source: Company, RSec Research

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Profit and Loss Statement

Y/E March (Rs mn)	FY16*	FY17	FY18E	FY19E
Net Revenues (US\$ mn)	4,698	6,975	7,776	8,694
Growth (%)	N.A.	N.A.	11.5	11.8
Net Sales	311,360	467,230	505,444	565,115
Growth (%)	N.A.	N.A.	8.2	11.8
Cost of Revenue	204,720	308,900	334,374	375,207
SG&A Expenses	39,690	55,240	60,653	64,988
EBITDA	66,950	103,090	110,417	124,920
EBITDA (%)	21.5	22.1	21.8	22.1
EBITDA Growth (%)	(23.0)	54.0	7.1	13.1
Depreciation	4,450	8,350	9,223	9,720
EBIT	62,500	94,740	101,193	115,200
EBIT (%)	20.1	20.3	20.0	20.4
EBIT Growth (%)	(24.2)	51.6	6.8	13.8
Other Income	8,710	10,201	11,737	13,413
Interest	740	861	604	583
PBT	70,470	104,080	112,326	128,031
Tax (incl deferred)	14,770	19,510	22,465	25,606
APAT	55,700	84,570	89,861	102,424
APAT Growth (%)	N.A.	N.A.	6.3	14.0
EPS	40.0	60.8	64.6	73.6
EPS Growth (%)	N.A.	N.A.	6.3	14.0

*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)	FY16*	FY17	FY18E	FY19E
SOURCES OF FUNDS				
Share Capital - Equity	2,815	2,823	2,784	2,784
Reserves	277,406	332,081	376,343	426,655
Total Shareholders' Funds	280,221	334,904	379,127	429,439
Total Debt	12,271	7,345	7,767	7,767
Long Term Provisions & Others	12,635	12,525	12,525	12,525
Creditors	9,081	27,007	27,057	28,944
Other Current Liabilities & Provns	83,465	82,542	89,955	100,661
Total Current Liabilities	92,546	109,549	117,012	129,605
TOTAL SOURCES	397,673	464,323	516,431	579,336
APPLICATION OF FUNDS				
Net Block	37,922	41,497	47,436	54,670
CWIP	5,310	5,310	5,310	5,310
Goodwill & Other Intangible Assets	64,194	73,583	73,583	73,583
Licenced IPRs	-	40,673	40,673	40,673
Investments	1,601	1,467	1,467	1,467
LT Loans & Advances, Others	38,787	37,118	37,118	37,118
Total Non Current Assets	147,813	199,647	205,587	212,821
Debtors	77,213	83,014	96,935	109,927
Cash & Bank	113,164	115,361	131,077	165,756
Liquid Investments	5,365	11,457	11,457	11,457
Other Current Assets	54,118	54,844	71,375	79,376
Total Current Assets	249,860	264,676	310,844	366,516
TOTAL APPLICATION	397,673	464,323	516,431	579,336

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Cash Flow Statement

Y/E March (Rs mn)	FY16*	FY17	FY18E	FY19E
PAT	55,700	84,570	89,861	102,424
Non-operating & EO items	0	0	(15)	(15)
Depreciation	4,450	8,350	9,223	9,720
Working Capital Change	(8,020)	3,773	(22,986)	(8,397)
OPERATING CASH FLOW (a)	52,130	96,693	76,083	103,732
Capex	(9,484)	(11,925)	(15,163)	(16,953)
Investments	(9,645)	1,803	0	0
INVESTING CASH FLOW (b)	(19,129)	(10,122)	(15,163)	(16,953)
Debt Issuance	3,905	(5,036)	422	0
Share capital Issuance	5	8	(39)	0
Dividend	(27,992)	(39,633)	(45,599)	(52,113)
FINANCING CASH FLOW (c)	(24,082)	(44,661)	(45,216)	(52,113)
NET CASH FLOW (a+b+c)	8,919	41,910	15,704	34,666
Non-operating and EO items	(5,967)	(39,713)	13	13
Closing Cash & Bank	113,164	115,361	131,077	165,756
Free Cash Flow	42,646	84,768	60,919	86,779

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

Key Ratios

Y/E March	FY16*	FY17	FY18E	FY19E
Profitability (%)				
EBITDA Margin	21.5	22.1	21.8	22.1
APAT Margin	17.9	18.1	17.8	18.1
RoE	27.2	27.5	25.2	25.3
RoIC or Core RoCE	20.6	25.6	24.0	25.2
RoCE	23.2	23.6	22.2	22.4
Efficiency				
Tax Rate (%)	21.0	18.7	20.0	20.0
Fixed Asset Turnover (x)	3.3	4.4	4.2	4.1
Debtors (days)	68	65	70	71
Payables (days)	14	27	25	24
Cash Conversion Cycle (days)	54	38	45	47
Net Debt/EBITDA (x)	(1.6)	(1.2)	(1.2)	(1.4)
Net Debt/Equity (x)	(0.4)	(0.4)	(0.4)	(0.4)
Interest Coverage (x)	84.5	110.0	167.4	197.8
Per Share Data (Rs)				
EPS	40.0	60.8	64.6	73.6
CEPS	42.7	66.2	70.6	80.0
DPS	17.0	24.0	28.0	32.0
BV	201.3	240.6	272.4	308.5
Valuation				
P/E (x)	16.7	14.6	13.8	12.1
P/BV (x)	4.4	3.7	3.3	2.9
EV/EBITDA (x)	12.8	10.9	10.1	8.6
OCF/EV (%)	4.6	8.6	6.8	9.6
FCF/EV (%)	3.7	7.5	5.5	8.0
FCFE/mkt cap (%)	3.4	6.8	4.9	6.9
Dividend Yield (%)	1.9	2.7	3.1	3.6

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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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