

HCL Technologies

BUY

INDUSTRY IT

CMP (as on 25 Oct 2017) Rs 907

Target Price Rs 1,000

Nifty 10,295

Sensex 33,043

KEY STOCK DATA

Bloomberg HCLT IN

No. of Shares (mn) 1,427

MCap (Rs bn) / (\$ mn) 1,294/19,925

6m avg traded value (Rs mn) 1,405

STOCK PERFORMANCE (%)

52 Week high / low Rs 944 / 731

3M 6M 12M

Absolute (%) 1.3 10.6 12.7

Relative (%) (1.2) 0.3 (4.9)

SHAREHOLDING PATTERN (%)

Promoters 60.05

FIs & Local MFs 9.91

FPIs 25.31

Public & Others 4.73

Source : BSE

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Digital gaining scale

HCL Tech (HCLT) posted in-line revenue and operating performance in 2QFY18. Revenue stood at USD 1,928mn, 2.3% QoQ (0.9% CC and +140bps cross currency). Growth was impacted by a decline in India business (USD 20mn impact), with an additional decline USD 50mn expected in 2H, owing to completion of SI projects. HCLT also extended its IP partnership with IBM and new IP partnerships (DXC, Alpha Insights) to grow its Mode-3 business. EBIT% of 19.7%, -41bps was impacted by wage hike (-40bps impact), with onsite/offshore hikes of 1.5/5% respectively. HCLT maintained its revenue guidance of 10.5 to 12.5% (12.1 to 14.1% in USD terms), implying a wide range of 2.6 to 4.9% CQGR over 3Q/4QFY18. Management indicated to revenue growth at the lower band of guidance. Management also maintained margin guidance at 19.5 to 20.5%.

We maintain our positive outlook on HCLT, based on (1) Increasing digital deal size and deal wins (28 deals in 1H as compared to 42 in FY17), (2) 'Drylce' automation supporting Mode-1 services, (3)

Financial Summary

YE March (Rs bn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	124.34	115.19	7.9	121.49	2.3	409.13	467.23	505.91	560.33	615.62
EBIT	24.51	23.18	5.7	24.45	0.2	82.27	94.74	99.10	108.76	120.78
APAT	21.88	20.14	8.6	21.71	0.8	73.52	81.54	87.07	93.91	104.07
Diluted EPS (Rs)	15.7	14.3	10.1	15.2	3.3	52.2	57.6	62.5	67.5	74.7
P/E (x)						17.4	15.9	14.5	13.4	12.1
EV / EBITDA (x)						14.6	12.3	11.6	10.4	9.4
RoE (%)						28.4	27.0	26.1	26.2	25.8

Source: Company, HDFC sec Inst Research # Consolidated

Recovery in IMS going ahead, and (4) Scale dominance and IP strategy driving ER&D. Expect revenue/EPS growth at 11/9% CAGR respectively over FY17-20E (highest in large-cap IT), factoring in USD revenue growth of 12/10.3/9.9% for FY18/19/20E respectively and EBIT% at 19.4/19.2/19.5% respectively. Maintain BUY with a TP of Rs 1,000, 14x FY19E.

Highlights of the quarter

- HCLT won 15 transformational deals in 2Q, as compared to 13 in 1Q. Client metrics were healthy, with two additions in the >USD40mn band, and one in the >USD 100mn band. The Top-5 accounts grew 7.9% QoQ. Management alluded to strong order bookings in 1H, including several cloud-based deals. IP investments stood at USD 60mn in 2Q.
- Near-term outlook:** IMS is expected to recover going ahead, while ER&D will be the growth driver. HCLT's growth is at a premium to peers (1.4x), and valuations at marginal discount.

Revenue stood at USD 1,928mn, 2.3% QoQ supported by 0.9% QoQ CC and +140bps QoQ on cross currency as compared to (2.9% CC in 1Q)

EBIT margin came in at 19.7%, (-41bps QoQ), largely impacted by wage increase

Quarterly Consolidated Financials Snapshot

Particulars (Rs bn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
Net Revenues (USD mn)	1,928	1,722	11.9	1,884	2.3
Net Revenues	124.34	115.19	7.9	121.49	2.3
Direct Costs	82.08	76.53	7.3	80.57	1.9
Gross Profit	42.26	38.66	9.3	40.92	3.3
SG&A Expenses	14.67	13.55	8.3	14.11	4.0
EBITDA	27.59	25.11	9.9	26.81	2.9
Depreciation	3.08	1.93	59.6	2.36	30.5
EBIT	24.51	23.18	5.7	24.45	0.2
Other Income	2.98	2.34	27.4	2.69	10.8
PBT	27.49	25.52	7.7	27.14	1.3
Tax	5.61	5.38	4.3	5.43	3.3
APAT	21.88	20.14	8.6	21.71	0.8
E/o (adj for tax)	-	-	-	-	-
RPAT	21.88	20.14	8.6	21.71	0.8

Source: Company, HDFC sec Inst Research

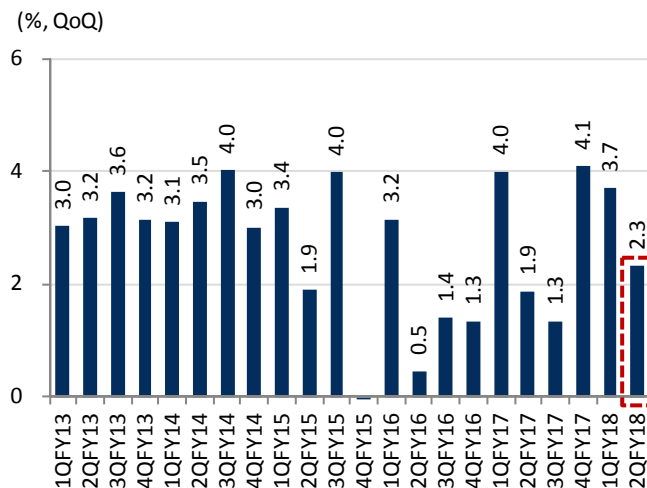
Margin Analysis

	2QFY18	2QFY17	YoY (bps)	1QFY18	QoQ (bps)
Direct Costs % Net Revenues	66.0	66.4	(43)	66.3	(31)
Gross Profit Margin (%)	34.0	33.6	43	33.7	31
SG&A Expenses % Net Revenues	11.8	11.8	4	11.6	18
EBITDA Margin (%)	22.2	21.8	39	22.1	12
EBIT Margin (%)	19.7	20.1	(41)	20.1	(41)
Tax Rate (%)	20.4	21.1	(67)	20.0	40
APAT Margin (%)	17.6	17.5	11	17.9	(27)

Source: Company, HDFC sec Inst Research

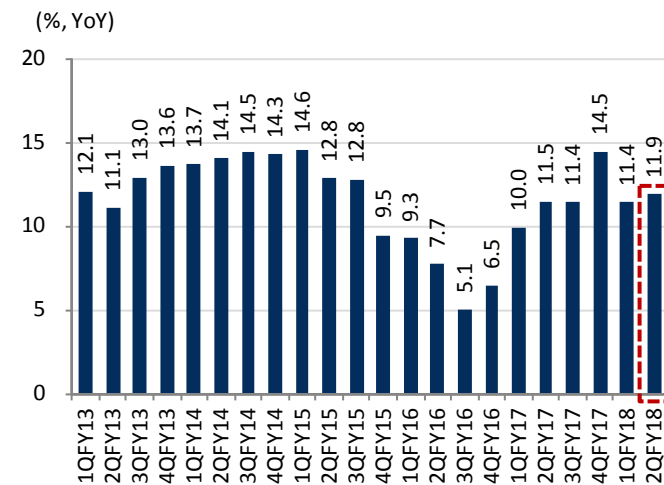
YoY revenue growth in 2Q was 11.9% (10.7% CC YoY) and 1HFY18 growth at 11.7% (11.4% CC YoY)

QoQ USD Revenue Growth Trajectory



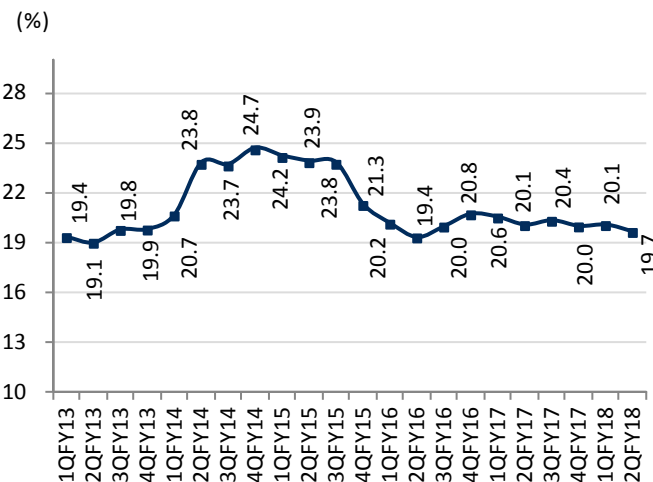
Source: Company, HDFC sec Inst Research, *1QFY17 organic

YoY USD Revenue Growth Trajectory



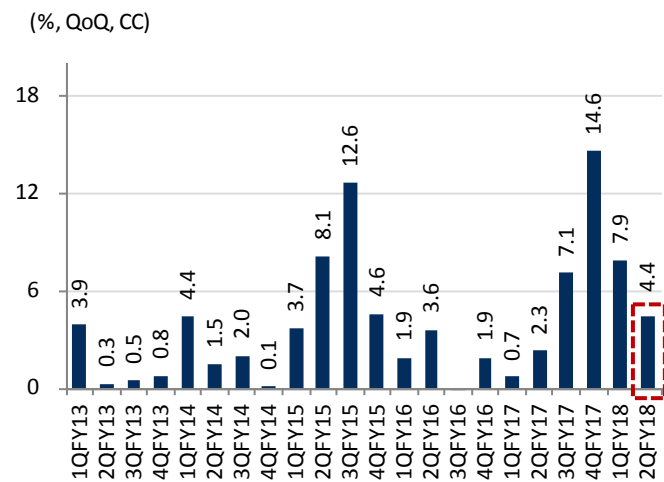
Source: Company, HDFC sec Inst Research

EBIT Margin Trajectory



Source: Company, HDFC sec Inst Research

QoQ ER&D USD Revenue Trajectory



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

Public services vertical and Retail & CPG vertical were muted, while BFSI, manufacturing and LS & Healthcare grew above company avg.

Vertical Revenue Break-up

(% of rev)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Manufacturing	31.4	33.2	32.2	33.9	34.6	34.9	35.4
Financial Services	25.0	23.6	24.1	24.3	24.2	24.9	25.0
Life Sciences and Health Care	12.8	11.9	12.6	12.0	11.5	11.8	11.7
Public Services	11.1	11.7	10.9	11.2	11.7	11.1	10.6
Telecom, Media, Publishing & Entertainment	9.9	9.1	9.4	8.9	8.4	7.9	7.9
Retail & CPG	9.2	10.0	10.4	9.4	9.2	9.5	9.3
Others	0.6	0.5	0.4	0.3	0.4	0.0	0.1
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, %)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Manufacturing	1.0	12.6	(1.2)	6.7	6.2	4.5	3.9
Financial Services	(2.2)	0.6	4.0	2.2	3.7	6.5	2.9
Life Sciences and Health Care	6.3	(1.0)	7.9	(3.5)	(0.2)	6.4	1.5
Public Services	6.1	12.3	(5.1)	4.1	8.7	(1.6)	(2.3)
Telecom, Media, Publishing & Entertainment	3.4	(2.1)	5.2	(4.1)	(1.8)	(2.5)	2.3
Retail & CPG	(1.9)	15.8	6.0	(8.4)	1.9	7.1	0.2
Total	1.3	6.5	1.9	1.3	4.1	3.7	2.3

Source: Company, HDFC Sec Inst Research

IMS was flat, ER&D grew 4.4% and BPM 2.9%

Europe led growth at 4.4% QoQ, and Americas grew 1.5%

Service Line Break-up

(% of rev)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Software Services (Apps + Engg)	58.6	56.1	55.6	56.1	57.3	57.8	57.9
Infrastructure Services	36.2	39.8	40.3	39.8	38.8	38.6	38.5
Business Services	5.2	4.1	4.1	4.0	3.9	3.6	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, %)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Software Services (Apps + Engg)	0.7	1.9	1.1	2.3	6.2	4.7	2.4
Infrastructure Services	3.5	17.1	3.2	0.0	1.5	3.2	2.0
Business Services	(4.9)	(15.6)	0.3	0.9	0.5	(5.7)	4.5
Total	1.3	6.5	1.9	1.3	4.1	3.7	2.3

Source: Company, HDFC Sec Inst Research

Geographic Revenue Break-up

(% of rev)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Americas	62.5	59.9	61.9	61.9	62.6	62.8	62.4
Europe	28.4	31.4	29.3	29.6	27.7	27.4	29.1
Rest of the World	9.1	8.7	8.8	8.5	9.7	9.8	8.5
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)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Americas	3.7	2.0	5.5	1.7	5.3	3.8	1.5
Europe	(2.4)	16.9	(2.1)	6.8	(3.0)	(0.4)	4.4
Rest of the World	1.3	0.0	2.0	(0.5)	15.8	3.1	(12.0)
Total	1.7	6.0	2.8	3.0	3.8	2.6	0.9

Source: Company, HDFC Sec Inst Research

Headcount, Attrition And Utilisation Data

(Nos.)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Total headcount	104,896	107,968	109,795	111,092	115,973	117,781	119,040
<i>Technical</i>	<i>95,649</i>	<i>98,225</i>	<i>99,897</i>	<i>101,154</i>	<i>105,547</i>	<i>107,029</i>	<i>108,351</i>
<i>Support</i>	<i>9,247</i>	<i>9,743</i>	<i>9,898</i>	<i>9,938</i>	<i>10,426</i>	<i>10,752</i>	<i>10,689</i>
Gross Additions	9,280	10,515	9,083	8,467	10,605	9,462	8,645
Net Additions	1,200	3,072	1,827	1,297	4,881	1,808	1,259
Voluntary LTM Attrition (%)	17.3	17.8	18.6	17.9	16.9	16.2	15.7
Utilisation Excluding Trainees (%)	85.6	85.8	85.3	84.6	85.7	86.0	86.0

Source: Company, HDFC Sec Inst Research

Key Assumptions

Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Software Services USD Rev. Growth (%)	4.5	9.1	4.8	6.4	15.9	11.7	10.2
IMS USD Rev. Growth (%)	37.9	16.6	10.3	25.0	7.9	8.7	9.6
BPO USD Rev. Growth (%)	14.7	27.5	13.0	(14.8)	(1.7)	5.8	6.2
Total USD Revenue Growth (%)	14.1	12.4	7.1	11.9	12.0	10.3	9.9
USD/INR Rate	59.58	61.48	65.61	67.0	64.8	65.0	65.0
EBIT Margin (%)	23.3	23.3	20.1	20.3	19.4	19.2	19.5

Source: Company, HDFC Sec Inst Research

Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
	FY18E		
Revenue (USD mn)	7,815	7,813	(0.0)
Revenue (Rs bn)	505.07	505.91	0.2
EBIT (Rs bn)	101.32	98.14	(3.1)
EBIT margin (%)	20.1	19.4	(66)bps
EPS (Rs)	61.7	62.2	0.7
FY19E			
Revenue (USD mn)	8,674	8,620	(0.6)
Revenue (Rs bn)	570.42	560.33	(1.8)
EBIT (Rs bn)	111.94	107.82	(3.7)
EBIT margin (%)	19.6	19.2	(38)bps
EPS (Rs)	67.4	66.9	(0.6)

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	4,904	2,562	NEU	2,570	133.4	133.9	144.2	19.2	19.1	17.8	33.4	30.2	30.7
Infosys	2,033	935	NEU	1,000	62.8	64.9	69.0	14.9	14.4	13.6	22.0	23.1	25.3
Wipro	1,347	299	NEU	280	18.8	19.7	20.4	15.9	15.2	14.6	16.4	16.1	15.1
HCL Tech.	1,294	907	BUY	1,000	57.6	62.2	66.9	15.7	14.6	13.5	27.0	25.9	26.1
Tech Mahindra	416	468	NEU	440	31.6	33.8	35.3	14.8	13.8	13.2	18.1	17.4	16.5

Source: HDFC sec Inst Research

Consolidated Income Statement

YE March (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues (US\$m)	6,235	6,975	7,813	8,620	9,471
Growth (%)	7.1	11.9	12.0	10.3	9.9
Net Sales	409.13	467.23	505.91	560.33	615.62
Growth (%)	14.6	14.2	8.3	10.8	9.9
Cost of Revenue	269.00	308.90	335.13	372.73	409.77
SG&A Expenses	52.17	55.24	59.97	66.26	72.63
EBITDA	87.96	103.09	110.82	121.34	133.22
EBITDA (%)	21.5	22.1	21.9	21.7	21.6
EBITDA Growth (%)	(0.3)	17.2	7.5	9.5	9.8
Depreciation	5.69	8.35	12.68	13.52	12.91
EBIT	82.27	94.74	98.14	107.82	120.31
Other Income	11.03	10.24	12.75	13.97	15.23
Interest	0.95	0.89	0.63	0.77	0.87
PBT	92.35	104.09	110.25	121.02	134.68
Tax (incl deferred)	18.83	19.52	24.04	27.83	30.94
Minority Interest and associate profit	-	-	-	-	-
RPAT	73.52	84.57	86.21	93.19	103.74
APAT	73.52	81.54	86.21	93.19	103.74
APAT Growth (%)	0.6	10.9	5.7	8.1	11.3
EPS	52.2	57.6	62.2	66.9	74.4
EPS Growth (%)	0.5	10.4	7.9	7.6	11.2

Source: Company, HDFC sec Inst Research

Consolidated Balance Sheet

YE March (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	2.82	2.85	2.78	2.78	2.78
Reserves	271.09	326.64	332.83	375.90	421.18
Total Shareholders' Funds	273.91	329.50	335.61	378.69	423.96
Total Debt	9.52	4.45	5.88	6.51	7.15
Long-term Provisions & Others	(4.27)	(5.57)	(4.77)	(3.66)	(2.56)
TOTAL SOURCES OF FUNDS	279.16	328.38	336.72	381.54	428.56
APPLICATION OF FUNDS					
Net Block	35.95	39.98	48.87	54.46	61.45
CWIP	6.11	4.48	5.17	5.81	6.53
Goodwill & Other Intangible Assets	61.21	112.38	126.88	143.26	160.57
Investments	1.62	1.60	1.60	1.60	1.60
LT Loans & Advances, Others	20.59	18.04	19.53	21.63	23.77
Total Non Current Assets	125.48	176.48	202.05	226.77	253.92
Debtors	77.21	83.01	89.89	99.55	109.38
Cash & Equivalents	98.71	101.90	82.24	96.76	111.15
Other Current Assets	73.89	79.79	86.40	95.71	105.15
Total Current Assets	249.82	264.70	258.53	292.02	325.68
Creditors	7.03	8.01	8.69	9.65	10.61
Other Current Liabilities & Provns	89.11	104.79	115.17	127.59	140.43
Total Current Liabilities	96.14	112.80	123.86	137.24	151.04
Net Current Assets	153.68	151.90	134.67	154.77	174.64
TOTAL APPLICATION OF FUNDS	279.16	328.38	336.72	381.54	428.56

Source: Company, HDFC sec Inst Research

Consolidated Cash Flow

YE March (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	92.35	104.09	110.25	121.02	134.68
Non-operating & EO items	(1.26)	2.20	0.61	0.85	0.83
Interest expenses	0.95	0.89	0.63	0.77	0.87
Depreciation	5.69	8.35	12.68	13.52	12.91
Working Capital Change	(23.16)	4.96	(2.43)	(5.58)	(5.48)
Tax paid	(18.83)	(19.52)	(24.04)	(27.83)	(30.94)
OPERATING CASH FLOW (a)	55.75	100.97	97.71	102.74	112.88
Capex	(18.06)	(58.52)	(22.07)	(18.65)	(19.70)
<i>Free cash flow (FCF)</i>	<i>37.70</i>	<i>42.45</i>	<i>75.64</i>	<i>84.09</i>	<i>93.17</i>
Investments	(7.49)	(0.83)	(16.19)	(19.58)	(20.35)
INVESTING CASH FLOW (b)	(25.54)	(59.35)	(38.25)	(38.23)	(40.06)
Debt Issuance	4.28	(5.07)	1.43	0.63	0.64
Interest expenses	(0.95)	(0.89)	(0.63)	(0.77)	(0.87)
<i>FCFE</i>	<i>41.02</i>	<i>36.49</i>	<i>76.44</i>	<i>83.95</i>	<i>92.95</i>
Share capital Issuance	0.00	0.02	(0.04)	-	-
Dividend	(34.66)	(41.10)	(45.10)	(50.11)	(58.46)
FINANCING CASH FLOW (c)	(31.33)	(47.04)	(79.34)	(50.25)	(58.69)
NET CASH FLOW (a+b+c)	(1.12)	(5.42)	(19.88)	14.25	14.13
Closing Cash & Equivalents	98.71	101.90	82.24	96.76	111.15

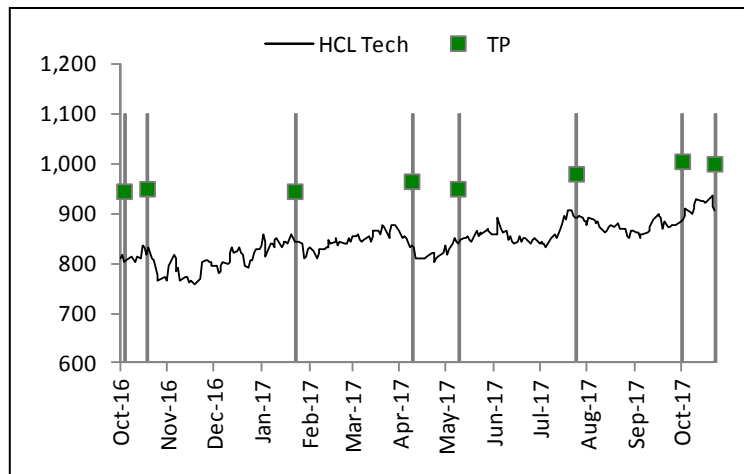
Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
EBITDA Margin	21.5	22.1	21.9	21.7	21.6
APAT Margin	18.0	17.5	17.0	16.6	16.9
RoE	28.4	27.0	25.9	26.1	25.8
RoIC or Core RoCE	41.1	37.8	31.9	30.8	30.8
RoCE	28.2	26.9	26.0	26.0	25.7
EFFICIENCY					
Tax Rate (%)	20.4	18.8	21.8	23.0	23.0
Fixed Asset Turnover (x)	5.7	6.0	5.5	5.4	5.3
Debtors (days)	69	65	65	65	65
Payables (days)	6	6	6	6	6
Cash Conversion Cycle (days)	65	61	61	61	61
Net Debt/EBITDA (x)	(1.0)	(0.9)	(0.7)	(0.7)	(0.8)
Net Debt/Equity (x)	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)
Interest Coverage (x)	86.2	106.3	155.2	139.9	138.8
PER SHARE DATA					
EPS (Rs/sh)	52.2	57.6	62.2	66.9	74.4
CEPS (Rs/sh)	56.1	63.0	71.0	76.7	83.8
DPS (Rs/sh)	21.0	24.0	27.0	30.0	35.0
BV (Rs/sh)	195.6	232.1	242.3	273.3	305.8
VALUATION					
P/E	17.4	15.9	14.6	13.5	12.2
P/BV	4.6	3.9	3.7	3.3	3.0
EV/EBITDA	14.6	12.3	11.7	10.5	9.5
OCF/EV (%)	4.3	7.9	7.6	8.0	8.9
FCF/EV (%)	2.9	3.3	5.9	6.6	7.4
FCFE/mkt cap (%)	3.2	2.9	6.0	6.6	7.3
Dividend Yield (%)	2.3	2.6	3.0	3.3	3.9

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
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
4-Oct-17	883	BUY	1,005
26-Oct-17	907	BUY	1,000

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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