HCL Technologies Ltd.

RESULT UPDATE

26th October, 2017

HCL Technologies Ltd.

Tepid performance, but great potential ahead !!

CMP	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 865	**INR 1075**	**24.3%**	**1,212,206**	**Buy**	**IT**

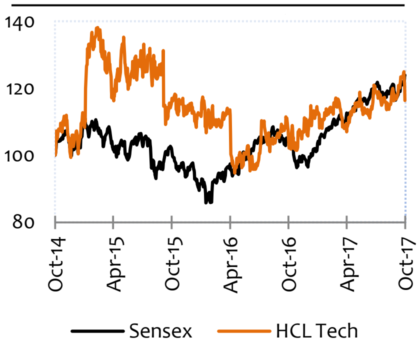
Result highlights

HCL Tech's Q2 FY18 result was largely in line with our estimates in revenue, however, in profitability front it was below our estimates. Europe has outperformed as far as Geographies are concerned, with a 8.7% qoq growth followed by the US of 1.7% qoq , whereas Asia-Pacific declined by 5.0% qoq, largely due to decline of $20m revenue from Indian business . Manufacturing and Financial Services led the growth pack with a 3.8% and 2.7% qoq. Engineering Services led the pack with a 4.7% qoq growth followed by BPO service at 2.3% qoq. ER&D growth was largely supported by existing clients and IP-partnership. The management expects the material impact of its recent acquisitions can only be seen after FY18.

MARKET DATA

Shares Outs (Mn)	1392
Equity Cap (INR Mn)	2784
Mkt Cap (INR Mn)	1212206
52 Wk H/L (INR)	941/731
Volume Avg (3m K)	1475.6
Face Value (INR)	2
Bloomberg Code	HCLT IN

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	33147
NIFTY	10344

KEY FINANCIALS

Particulars (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	357,090	409,130	467,220	506,592	570,187
EBITDA	88,190	89,150	103,130	112,147	127,554
PAT	73,101	74,500	84,610	89,707	99,979
EPS	51.7	52.8	59.8	64.3	71.7
OPM	23.3%	20.4%	20.3%	20.0%	20.2%
NPM	20.5%	18.2%	18.1%	17.7%	17.5%

Source: Company, KRChoksey Research

Strengthening pipeline for Mode 1 and Mode 2 deals

The company has bagged a deal from Philips Lightning for smart lightning installation in Europe. The company would be opening remote operation centre in Bangalore to serve its client. We believe the remote centre would broaden its scale of operations and improve its infrastructure service delivery for connected devices.

On Cloud space, the company bagged 30 deals in Q2 FY18, and signed first cloud program in UK for Utility Industry for delivering full end-to-end infrastructure and application migration service from legacy system to Amazon Web Service (AWS).

Restructuring JV and Traditional services to drag Top-Line

The company has decided to discontinue its JV with DXC Technologies, and instead chose to form an IP partnership with it. The conversion will have a material impact of $22 mn on its H2 revenue. Moreover, in Q1 FY18, the Infrastructure service and Application services saw a decline of $20m from Indian projects due to completion of large deals. The management expects, the spill-over effects to continue in the upcoming quarters and expect a decline in revenues of around ~$70 mn from Indian business in H2. Hence, considering the above two factors, we expect the overall impact of ~$100 mn on its top-line in FY18.

Key Concall Highlights: (i) The decline in margin for Q1 FY18 was primarily due to a wage hike of 5% in offshore and 1.5% onsite, which has impacted the overall margin by 50 bps (ii) Maintained guidance of 10.5-12.5% growth in INR revenues, whereas in dollar terms it is expected to be within a range of 12.1% to 14.1% in FY18 (iii) ER&D growth supported by existing clients and IP-partnership, whereas BPO market is undergoing repositioning. (v) The company does not see any incremental revenue before March 2018 from its recent acquisitions.

Valuation and view

The company is in a transition phase to recover from its restructuring activities. The IP-Deals, and its two acquisition would impact its margin to some extent in the form of Amortization. However, we strongly believe that the incremental revenues from its investments would overweigh the cost, post FY18. We expect that the strong client addition during the quarter, strengthen IP-Led revenues, and gaining traction for its Mode 2 services, would bring radical changes to its overall business. We have a "BUY" rating on the stock and we have assigned a multiple of 15x to its FY19E EPS of INR 71.7 to arrive at a price target of INR 1,075.

SHARE HOLDING PATTERN (%)

Particulars	Sep 17	Jul 17	Mar 17
Promoters	60.05	59.88	59.68
FIIs	25.31	25.5	25.28
DIIs	9.91	10.6	10.51
Others	4.73	4.02	4.53
Total	100	100	100

10.5%

Revenue CAGR between FY 17 and FY 19E

11.2%

EBITDA CAGR between FY 17 and FY 19E

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Q2FY18 Result Snapshot

Exhibit 1: Quarterly Income Statement

INR Mn	Q2 FY18	Q1 FY18	Q-o-Q change %	Q2 FY17	Y-o-Y change %	Q2 FY18 estimates	Deviation %
Revenues ($)	1,928	1,884	2.3%	1,722	11.9%	1,938	(0.5%)
Revenues (INR)	124,330	121,490	2.3%	115,190	7.9%	124,986	(0.5%)
Direct Cost	84,640	80,570	5.1%	76,530	10.6%	82,751	2.3%
Gross Profit	39,690	40,920	(3.0%)	38,660	2.7%	42,235	(6.0%)
SG&A	12,390	14,110	(12.2%)	13,550	(8.6%)	14,516	(14.6%)
EBITDA	**27,300**	**26,810**	**1.8%**	**25,110**	**8.7%**	**27,719**	**(1.5%)**
Depreciation & Amortisation	2,960	2,360	25.4%	1,930	53.4%	2,428	21.9%
EBIT	**24,340**	**24,450**	**(0.4%)**	**23,180**	**5.0%**	**25,291**	**(3.8%)**
Foreign Exchange Gains/(Loss)	1,070	1,070	0.0%	310	245.2%	1,070	
Other Income, net	1,620	1,620	0.0%	2,040	(20.6%)	1,620	
PreTax Income	27,030	27,140	(0.4%)	25,530	5.9%	27,981	(3.4%)
Adjusted Pretax Income	27,030	27,140	(0.4%)	25,530	5.9%	27,981	
Tax	5,720	5,430	5.3%	5,380	6.3%	5,614	
Share of Minority Interest	0	0		0		0	
Net Profit	**21,310**	**21,710**	**(1.8%)**	**20,150**	**5.8%**	**22,367**	**(4.7%)**
Adjusted Net Profit	**21,310**	**21,710**	**(1.8%)**	**20,150**	**5.8%**	**22,367**	**(4.7%)**
Diluted EPS (Rs)	**14.9**	**15.1**	**(1.8%)**	**14.3**	**4.2%**	**15.6**	
Adjusted Diluted EPS	**14.9**	**15.1**	**(1.8%)**	**14.3**	**4.2%**	**15.6**	**(4.7%)**
No.of Shares (mn) - Diluted	1,434	1,434		1,413		1,434	
Margin Analysis %			*Change in bps*		*Change in bps*		
Gross Profit Margin (%)	31.9%	33.7%	(176)	33.6%	(164)	33.8%	(187)
Operating Profit Margin (%)	19.6%	20.1%	(55)	20.1%	(55)	20.2%	(66)
EBITDA Margin (%)	22.0%	22.1%	(11)	21.8%	16	22.2%	(22)
Net Profit Margin (%)	17.1%	17.9%	(73)	17.5%	(35)	17.9%	(76)
Adjusted NPM (%)	17.1%	17.9%	(73)	17.5%	(35)	17.9%	(76)
Effective Tax rate (%)	21.2%	20.0%	115	21.1%	9	20.1%	110
Cost Analysis %			*Change in bps*		*Change in bps*		
Direct cost as % of Sales	68.1%	66.3%	176	66.4%	164	66.2%	187
SG&A as % of Sales	10.0%	11.6%	(165)	11.8%	(180)	11.6%	(165)

Source: Company, KRChoksey Research

- The Tax rate for the quarter stood 21.2% in Q2 FY18
- Operating margin declined by 55 bps qoq.
- Announced dividend of INR 2 per share
- ROE stood at 27%

HCL Technologies Ltd.

Exhibit 2: Profit & Loss Statement

INR Mn	FY15	FY16	FY17	FY18E	FY19E
Total Revenues	**357,090**	**409,130**	**467,220**	**506,592**	**570,187**
Revenue Growth (Y-o-Y)	*13.5%*	*14.6%*	*14.2%*	*8.4%*	*12.6%*
Less:					
Employees Cost	225,830	267,810	308,890	341,957	385,812
SG&A	43,070	52,170	55,200	52,487	56,821
Total Op. Expenditure	**268,900**	**319,980**	**364,090**	**394,444**	**442,633**
EBIDTA	**88,190**	**89,150**	**103,130**	**112,147**	**127,554**
EBIDTA Growth (Y-o-Y)	*9.3%*	*1.1%*	*15.7%*	*8.7%*	*13.7%*
Less: Depreciation	5,030	5,690	8,340	11,057	12,544
Operating Profit	**83,160**	**83,460**	**94,790**	**101,090**	**115,009**
Operating Profit Growth (Y-o-Y)	*13.3%*	*0.4%*	*13.6%*	*6.6%*	*13.8%*
Non-operating Income	8,580	10,090	9,340	12,025	11,404
Profit Before tax	**91,740**	**93,550**	**104,130**	**113,115**	**126,413**
Tax	18,640	19,050	19,520	23,408	26,435
Share of Minority Interest	1	0	0	0	0
Net Profit	**73,101**	**74,500**	**84,610**	**89,707**	**99,979**
Adjusted Net Profit	73,101	74,500	84,610	89,707	99,979
Diluted EPS (Rs.)	**51.7**	**52.8**	**59.8**	**64.3**	**71.7**
Growth (Y-o-Y) %	*27.7%*	*1.9%*	*13.4%*	*7.5%*	*11.5%*
Adjusted Diluted EPS	**51.7**	**52.8**	**59.8**	**64.3**	**71.7**
Growth (Y-o-Y) %	*27.7%*	*1.9%*	*13.4%*	*7.5%*	*11.5%*

Source: Company, KRChoksey Research

Exhibit 3: Balance Sheet

INR Mn	FY15	FY16	FY17E	FY18E	FY19E
Equity Capital	3,504	3,758	3,763	3,725	3,725
Reserves & Surplus	234,930	271,577	323,995	379,571	441,510
Equity	**238,435**	**275,335**	**327,759**	**383,296**	**445,236**
Net Worth	**238,435**	**275,335**	**327,759**	**383,296**	**445,236**
Minority Interest	6	2,093	2,093	2,093	2,093
Net Deferred tax liability/(Asset)	524	1,051	1,402	1,520	1,711
Other Non-current Liabilities	10,832	11,279	21,025	22,797	25,658
Total Loans	6,240	10,795	7,918	3,590	3,590
Capital Employed	**256,037**	**300,552**	**360,196**	**413,296**	**478,288**
Assets					
Gross Block	73,905	82,165	90,665	99,165	107,665
Less: Depreciation	37,109	39,368	47,708	58,765	71,309
Net Block	**36,795**	**42,797**	**42,957**	**40,400**	**36,356**
Investments	**95**	**1,603**	**2,603**	**3,603**	**4,603**
Intangible Assets	50,131	63,550	63,550	63,550	63,550
Other Non-current Assets	18,615	20,034	24,295	26,343	29,650
Deferred Income Tax Assets	10,921	18,365	20,826	22,623	25,283
Current Assets					
Inventories	1,518	2,618	3,808	4,216	4,757
Sundry Debtors	91,379	106,156	108,805	117,973	132,783
Cash and Bank Balance	102,067	97,683	157,148	203,984	259,305
Other Current Assets	32,497	40,898	32,705	35,461	39,913
Total Current Assets	**227,461**	**247,355**	**302,467**	**361,635**	**436,758**
Less: Current Liabilities					
Sundry Creditors	8,976	8,988	8,463	9,369	10,570
Provisions	9,727	10,307	15,620	16,967	18,962
Other Current Liabilities	69,278	73,857	72,419	78,522	88,379
Total Current Liabilities	**87,981**	**93,152**	**96,501**	**104,858**	**117,911**
Capital Applied	**256,037**	**300,552**	**360,196**	**413,296**	**478,288**

Source: Company, KRChoksey Research

HCL Technologies Ltd.

Exhibit 4: Ratio Analysis

INR Mn	FY15	FY16	FY17E	FY18E	FY19E
Key Operating Ratios					
EBITDA Margin (%)	24.7%	21.8%	22.1%	22.1%	22.4%
Tax / PBT (%)	20.3%	20.4%	18.7%	20.7%	20.9%
Net Profit Margin (%)	20.5%	18.2%	18.1%	17.7%	17.5%
RoE (%)	31.2%	27.5%	26.6%	24.1%	23.1%
RoCE (%)	28.7%	25.5%	24.4%	22.2%	21.5%
Current Ratio (x)	2.6x	2.7x	3.1x	3.4x	3.7x
Dividend Payout (%)	38.0%	38.0%	38.0%	38.0%	38.0%
BV Per Share (Rs.)	168.8	195.0	231.7	274.7	319.1
Financial Leverage Ratios					
Debt/ Equity (x)	0.03	0.04	0.02	0.01	0.01
Growth Indicators %					
Gross Block Growth (%)	8.4%	11.2%	10.3%	9.4%	8.6%
Sales Growth (%)	13.5%	14.6%	14.2%	8.4%	12.6%
EBITDA Growth (%)	9.3%	1.1%	15.7%	8.7%	13.7%
Net Profit Growth (%)	27.6%	1.9%	13.6%	6.0%	11.5%
Diluted EPS Growth (%)	27.7%	1.9%	13.4%	7.5%	11.5%
Turnover Ratios					
Debtors days	93	95	85	85	85
Creditors days	12	10	8	9	9
Inventory Days	2	3	4	4	4

Source: Company, KRChoksey Research

Exhibit 5: Free Cash Flow Analysis

INR Mn	FY15	FY16	FY17E	FY18E	FY19E
EBITA	**83,160**	**83,460**	**94,790**	**101,090**	**115,009**
Less: Adjusted Taxes	16,897	16,995	17,769	20,920	24,050
NOPLAT	**66,263**	**66,465**	**77,021**	**80,170**	**90,960**
Plus: Depreciation	5,030	5,690	8,340	11,057	12,544
Gross Cashflow	**71,293**	**72,155**	**85,361**	**91,227**	**103,504**
Less: Increase in Working Capital	15,469	20,668	(5,960)	5,157	8,657
Operating Cashflow	**55,825**	**51,486**	**91,321**	**86,070**	**94,847**
Less: Net Capex	10,091	11,692	8,500	8,500	8,500
Less: Increase in Net Other Assets	5,715	19,222	(3,376)	1,954	2,914
FCF From Operation	**40,018**	**20,572**	**86,197**	**75,616**	**83,433**
Less: Inc./(Dec.) in Investment	(69)	1,508	1,000	1,000	1,000
FCF after Investment	**40,087**	**19,064**	**85,197**	**74,616**	**82,433**
Plus: Gain/(loss) on Extraordinary Items	0	0	0	0	0
Plus: Foreign currency Translation Effect					
Total FCF	**40,087**	**19,064**	**85,197**	**74,616**	**82,433**

Source: Company, KRChoksey Research

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HCL Technologies Ltd.

HCL Technologies Ltd.				Rating Legend	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
31-Oct-17	865	1,075	BUY	**Buy**	More than 15%
31-July-17	890	1,063	BUY	**Accumulate**	5% – 15%
12-May-17	931	1,068	ACCUMULATE	**Hold**	0 – 5%
25-Jan-17	848	985	BUY	**Reduce**	-5% – 0
24-Oct-16	832	909	ACCUMULATE	**Sell**	Less than – 5%
04-Aug-16	826	924	ACCUMULATE		

ANALYST CERTIFICATION:

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