

# HCL Technologies Ltd.



# HCL Technologies Ltd.

## Robust Results Despite Seasonally Weak Quarter

CMP <b>INR 972</b>	Target <b>INR 1276</b>	Potential Upside <b>31.27%</b>	Market Cap (INR Mn) <b>1,333,349</b>	Recommendation <b>BUY</b>	Sector <b>IT</b>
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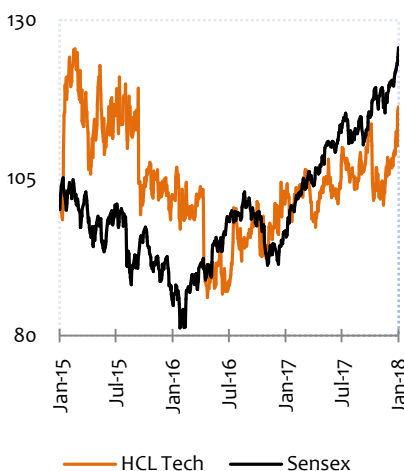
### Result highlights

HCL Tech's Q3 FY18 result was above our estimates in terms of revenue, however, in profitability front it was below our estimates due to increase in non-cash expenditure. Americas has outperformed as far as Geographies are concerned, with a 4.9% qoq growth followed by Europe at 1.7% qoq growth, whereas Asia-Pacific saw a significant decline of 10.5% qoq resulted from a decline in Indian business. Manufacturing and Retail led the growth pack with a 6.3% and 6.4% qoq, wherein the majority of the businesses came on the digital front. Engineering Services led the pack with a 13.4% qoq growth followed by BPO service at 5.9% qoq. ER&D growth was largely supported by the incremental revenues from recent acquisitions and IP-partnership.

### MARKET DATA

Shares Outs (Mn)	1392
Equity Cap (INR Mn)	2784
Mkt Cap (INR Mn)	1333349
52 Wk H/L (INR)	965/778
Volume Avg (3m K)	1731.8
Face Value (INR)	2
Bloomberg Code	HCLT IN

### SHARE PRICE PERFORMANCE



### MARKET INFO

SENSEX	35512
NIFTY	10895

### KEY FINANCIALS

Particulars (INR Mn)	FY16	FY17	FY18	FY19E	FY20E
Net Sales	409,130	467,220	505,037	559,121	622,767
EBITDA	89,150	103,130	111,341	127,926	147,625
PAT	74,500	84,610	88,139	102,898	118,580
EPS	52.8	59.8	63.2	73.8	85.1
OPM	20.4%	20.3%	19.7%	20.9%	21.8%
NPM	18.2%	18.1%	17.5%	18.4%	19.0%

Source: Company, KRChoksey Research

### Mode 1 and Mode 2 services exceed 25% to the overall revenues

Despite the seasonally weak quarter due to furloughs, the company saw a huge traction for digital services on Mode 1 and Mode 2 services. Retail and Manufacturing contributed the most during the quarter for the adoption of digital services. The company has increased its scale of offering in digital services from infrastructure services to a public cloud services, which cumulatively increased its bouquet of offerings. The adoption of cloud services is continuously been rising driven by changing in attitude of clients towards switching their applications and data from on-premise to cloud-based remote server. As a result, it gives better security from data compromising and optimizes the cost of maintenance.

Seasonally, it was a good quarter from the product and platform perspectives which resulted to increase in demand for Mode 2 services. The company won a large number of IP deals during the quarter which have again fueled the growth of Mode 3 services. However, the impact remains marginal in revenues as well as in profitability front.

### Margin remains sluggish

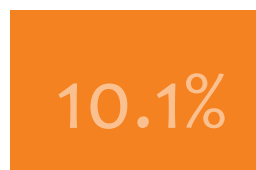
In Q3 FY18, there is a significant jump in the D&A expenditure of INR 1.4 bn which led the EBIT margin down by 140 bps. The impact was partly due to the amortization of its previous acquisition, whose full impact has been considered during this quarter. And other element is the amortization of products which have generated higher revenues during the quarter and as a result got capitalized at a greater proportion.

The company maintains the lower end of the revenue and EBITDA guidance of 10.5% and 19.5% respectively for FY18 owing to restructuring of DXC Technologies and sluggish demand from Indian businesses. The company expects the new IP-deals during this quarter would partially offset the headwinds above, but the impact would be marginal.

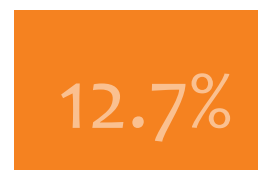
**Key Concall Highlights:** (i) Geometric and IP Partnership delivered 13.6% qoq growth in CC (ii) The quarter remains strong in terms of deal signing, where the company signed 20 deals across services (iii) Increases in compensation during Q3 FY18 had an impact of 50-60 bps on EBITDA margin (iv) The robust deal wins on IPs will have strong incremental revenues post FY18, which would further boost the overall contribution for digital services going forward.

### SHARE HOLDING PATTERN (%)

Particulars	Dec 17	Sep 17	Jul 17
Promoters	60.19	60.05	59.88
FIIIs	25.62	25.31	25.5
DIIIs	10.51	9.91	10.6
Others	3.69	4.73	4.02
Total	100	100	100



Revenue CAGR between FY 17 and FY 20E



EBITDA CAGR between FY 17 and FY 20E

### ANALYST

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## Valuation and view

The company has witnessed a strong traction for its digital services driven by Mode 2 and Mode 3 services coupled with large number of IP partnership. Going ahead, we expect the ER&D space continues to witness a double-digit growth led by major contribution from Geometric and Butler America. We believe that the renewal of IP partnerships on digital space, strong adoption of next-gen technologies, and monetization of its previous acquisitions, would broaden its revenue stream for digital services. However, we expect the restructuring of DXC technologies would continue to put pressure on margins for the next couple of quarters. **We have a “BUY” rating on the stock and we have assigned a multiple of 15x to its FY20E EPS of INR 85.1 to arrive at a price target of INR 1,276, an upside of 31.27% compared to CMP.**

## Exhibit 1: Q3 FY18 Result Snapshot

INR Mn	Q3 FY18	Q2 FY18	Q-o-Q change %	Q3 FY17	Y-o-Y change %	Q3 FY18 estimates	Deviation %
<b>Revenues (\$)</b>	<b>1,988</b>	<b>1,928</b>	<b>3.1%</b>	<b>1,745</b>	<b>13.9%</b>	<b>1,973</b>	<b>0.7%</b>
<b>Revenues (INR)</b>	<b>128,090</b>	<b>124,330</b>	<b>3.0%</b>	<b>118,140</b>	<b>8.4%</b>	<b>127,387</b>	<b>0.6%</b>
Direct Cost	84,560	84,640	(0.1%)	78,090	8.3%	87,425	(3.3%)
<b>Gross Profit</b>	<b>43,530</b>	<b>39,690</b>	<b>9.7%</b>	<b>40,050</b>	<b>8.7%</b>	<b>39,962</b>	<b>8.9%</b>
SG&A	15,850	12,390	27.9%	13,770	15.1%	12,484	27.0%
<b>EBITDA</b>	<b>27,680</b>	<b>27,300</b>	<b>1.4%</b>	<b>26,280</b>	<b>5.3%</b>	<b>27,478</b>	<b>0.7%</b>
Depreciation & Amortisation	4,310	2,960	45.6%	2,200	95.9%	3,185	35.3%
<b>EBIT</b>	<b>23,370</b>	<b>24,340</b>	<b>(4.0%)</b>	<b>24,080</b>	<b>(2.9%)</b>	<b>24,293</b>	<b>(3.8%)</b>
Foreign Exchange Gains/(Loss)	0	1,606	(100.0%)	430	(100.0%)	0	
Other Income, net	2,700	1,408	91.8%	1,880	43.6%	3,088	
<b>PreTax Income</b>	<b>26,070</b>	<b>27,354</b>	<b>(4.7%)</b>	<b>26,390</b>	<b>(1.2%)</b>	<b>27,381</b>	<b>(4.8%)</b>
<b>Adjusted Pretax Income</b>	<b>26,070</b>	<b>27,354</b>	<b>(4.7%)</b>	<b>26,390</b>	<b>(1.2%)</b>	<b>27,381</b>	
Tax	5,320	5,720	(7.0%)	5,680	(6.3%)	5,726	
Share of Minority Interest	0	0		0		0	
<b>Net Profit</b>	<b>20,750</b>	<b>21,634</b>	<b>(4.1%)</b>	<b>20,710</b>	<b>0.2%</b>	<b>21,655</b>	<b>(4.2%)</b>
<b>Adjusted Net Profit</b>	<b>20,750</b>	<b>21,634</b>	<b>(4.1%)</b>	<b>20,710</b>	<b>0.2%</b>	<b>21,655</b>	<b>(4.2%)</b>
<b>Diluted EPS (Rs)</b>	<b>14.5</b>	<b>15.5</b>	<b>(6.7%)</b>	<b>14.7</b>	<b>(1.3%)</b>	<b>15.1</b>	
<b>Adjusted Diluted EPS</b>	<b>14.5</b>	<b>15.5</b>	<b>(6.7%)</b>	<b>14.7</b>	<b>(1.3%)</b>	<b>15.1</b>	<b>(4.2%)</b>
No.of Shares (mn) - Diluted	1,434	1,395		1,412		1,434	
<b>Margin Analysis %</b>			<b>Change in bps</b>	<b>Change in bps</b>			
Gross Profit Margin (%)	34.0%	31.9%	206	33.9%	8	31.4%	261
Operating Profit Margin (%)	18.2%	19.6%	(133)	20.4%	(214)	19.1%	(83)
EBITDA Margin (%)	21.6%	22.0%	(35)	22.2%	(63)	21.6%	4
Net Profit Margin (%)	16.2%	17.4%	(120)	17.5%	(133)	17.0%	(80)
Adjusted NPM (%)	16.2%	17.4%	(120)	17.5%	(133)	17.0%	(80)
Effective Tax rate (%)	20.4%	20.9%	(50)	21.5%	(112)	20.9%	(50)
<b>Cost Analysis %</b>			<b>Change in bps</b>	<b>Change in bps</b>			
Direct cost as % of Sales	66.0%	68.1%	(206)	66.1%	(8)	68.6%	(261)
SG&A as % of Sales	12.4%	10.0%	241	11.7%	72	9.8%	257

Source: Company, KRChoksey Research

## ANALYST

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## Exhibit 2: Profit & Loss Statement

INR Mn	FY16	FY17	FY18	FY19E	FY20E
<b>Total Revenues</b>	<b>409,130</b>	<b>467,220</b>	<b>505,037</b>	<b>559,121</b>	<b>622,767</b>
Revenue Growth (Y-o-Y)	14.6%	14.2%	8.1%	10.7%	11.4%
<b>Less:</b>					
Employees Cost	267,810	308,890	336,528	367,455	404,147
SG&A	52,170	55,200	57,167	63,740	70,995
<b>Total Op. Expenditure</b>	<b>319,980</b>	<b>364,090</b>	<b>393,696</b>	<b>431,195</b>	<b>475,142</b>
<b>EBIDTA</b>	<b>89,150</b>	<b>103,130</b>	<b>111,341</b>	<b>127,926</b>	<b>147,625</b>
EBIDTA Growth (Y-o-Y)	1.1%	15.7%	8.0%	14.9%	15.4%
Less: Depreciation	5,690	8,340	11,957	10,816	12,016
<b>Operating Profit</b>	<b>83,460</b>	<b>94,790</b>	<b>99,384</b>	<b>117,111</b>	<b>135,609</b>
Operating Profit Growth (Y-o-Y)	0.4%	13.6%	4.8%	17.8%	15.8%
Non-operating Income	10,090	9,340	11,582	12,994	14,324
<b>Profit Before tax</b>	<b>93,550</b>	<b>104,130</b>	<b>110,967</b>	<b>130,105</b>	<b>149,932</b>
Tax	19,050	19,520	22,828	27,207	31,353
Share of Minority Interest	0	0	0	0	0
<b>Net Profit</b>	<b>74,500</b>	<b>84,610</b>	<b>88,139</b>	<b>102,898</b>	<b>118,580</b>
Adjusted Net Profit	74,500	84,610	88,139	102,898	118,580
<b>Diluted EPS (Rs.)</b>	<b>52.8</b>	<b>59.8</b>	<b>63.2</b>	<b>73.8</b>	<b>85.1</b>
Growth (Y-o-Y) %	1.9%	13.4%	5.7%	16.7%	15.2%
<b>Adjusted Diluted EPS</b>	<b>52.8</b>	<b>59.8</b>	<b>63.2</b>	<b>73.8</b>	<b>85.1</b>
Growth (Y-o-Y) %	1.9%	13.4%	5.7%	16.7%	15.2%

Source: Company, KRChoksey Research

## Exhibit 3: Balance Sheet

INR Mn	FY16	FY17	FY18E	FY19E	FY20E
Equity Capital	3,758	3,763	3,720	3,720	3,720
Reserves & Surplus	271,577	323,995	378,600	442,348	515,811
<b>Equity</b>	<b>275,335</b>	<b>327,759</b>	<b>382,320</b>	<b>446,068</b>	<b>519,531</b>
<b>Net Worth</b>	<b>275,335</b>	<b>327,759</b>	<b>382,320</b>	<b>446,068</b>	<b>519,531</b>
Minority Interest	2,093	2,093	2,093	2,093	2,093
Net Deferred tax liability/(Asset)	1,051	1,402	1,515	1,677	1,868
Other Non-current Liabilities	11,279	21,025	22,727	25,160	28,025
Total Loans	10,795	7,918	3,590	3,590	3,590
<b>Capital Employed</b>	<b>300,552</b>	<b>360,196</b>	<b>412,245</b>	<b>478,589</b>	<b>555,107</b>
<b>Assets</b>					
Gross Block	82,165	90,665	101,165	112,665	125,165
Less: Depreciation	39,368	47,708	59,665	70,481	82,496
<b>Net Block</b>	<b>42,797</b>	<b>42,957</b>	<b>41,500</b>	<b>42,184</b>	<b>42,669</b>
<b>Investments</b>	<b>1,603</b>	<b>2,603</b>	<b>3,603</b>	<b>4,603</b>	<b>5,603</b>
Intangible Assets	63,550	63,550	63,550	63,550	63,550
Other Non-current Assets	20,034	24,295	26,262	29,074	32,384
Deferred Income Tax Assets	18,365	20,826	22,193	26,021	29,986
<b>Current Assets</b>					
Inventories	2,618	3,808	4,149	4,530	4,983
Sundry Debtors	106,156	108,805	117,611	130,206	145,028
<b>Cash and Bank Balance</b>	<b>97,683</b>	<b>157,148</b>	<b>202,170</b>	<b>255,528</b>	<b>320,515</b>
Other Current Assets	40,898	32,705	35,353	39,138	43,594
<b>Total Current Assets</b>	<b>247,355</b>	<b>302,467</b>	<b>359,282</b>	<b>429,403</b>	<b>514,120</b>
<b>Less: Current Liabilities</b>					
Sundry Creditors	8,988	8,463	9,220	10,067	11,073
Provisions	10,307	15,620	16,645	19,516	22,490
Other Current Liabilities	73,857	72,419	78,281	86,664	99,643
<b>Total Current Liabilities</b>	<b>93,152</b>	<b>96,501</b>	<b>104,146</b>	<b>116,247</b>	<b>133,205</b>
<b>Capital Applied</b>	<b>300,552</b>	<b>360,196</b>	<b>412,245</b>	<b>478,589</b>	<b>555,107</b>

Source: Company, KRChoksey Research

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## Exhibit 4: Ratio Analysis

INR Mn	FY16	FY17	FY18E	FY19E	FY20E
<b>Key Operating Ratios</b>					
EBITDA Margin (%)	21.8%	22.1%	22.0%	22.9%	23.7%
Tax / PBT (%)	20.4%	18.7%	20.6%	20.9%	20.9%
Net Profit Margin (%)	18.2%	18.1%	17.5%	18.4%	19.0%
RoE (%)	27.5%	26.6%	23.7%	23.7%	23.5%
RoCE (%)	25.5%	24.4%	21.9%	22.1%	22.0%
Current Ratio (x)	2.7x	3.1x	3.4x	3.7x	3.9x
Dividend Payout (%)	38.0%	38.0%	38.0%	38.0%	38.0%
BV Per Share (Rs.)	195.0	231.7	274.3	320.1	372.8
<b>Financial Leverage Ratios</b>					
Debt/ Equity (x)	0.04	0.02	0.01	0.01	0.01
Sales Growth (%)	14.6%	14.2%	8.1%	10.7%	11.4%
EBITDA Growth (%)	1.1%	15.7%	8.0%	14.9%	15.4%
Net Profit Growth (%)	1.9%	13.6%	4.2%	16.7%	15.2%
Diluted EPS Growth (%)	1.9%	13.4%	5.7%	16.7%	15.2%
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	FY17	FY18E	FY19E	FY20E
<b>EBITA</b>	94,790	99,384	117,111	135,609
Less: Adjusted Taxes	17,769	20,445	24,489	28,358
<b>NOPLAT</b>	77,021	78,939	92,621	107,251
Plus: Depreciation	8,340	11,957	10,816	12,016
<b>Gross Cashflow</b>	85,361	90,896	103,437	119,267
Less: Increase in Working Capital	(5,960)	5,285	6,284	4,680
<b>Operating Cashflow</b>	91,321	85,611	97,154	114,587
Less: Net Capex	8,500	10,500	11,500	12,501
Less: Increase in Net Other Assets	(3,376)	1,519	4,044	4,220
<b>FCF From Operation</b>	86,197	73,593	81,610	97,866
Less: Inc./(Dec.) in Investment	1,000	1,000	1,000	1,000
<b>FCF after Investment</b>	85,197	72,593	80,610	96,866
Plus: Gain/(loss) on Extraordinary Items	0	0	0	0
Plus: Foreign currency Translation Effect				
<b>Total FCF</b>	85,197	72,593	80,610	96,866

Source: Company, KRChoksey Research

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Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
22-Jan-18	972	1276	BUY	Buy	More than 15%
31-Oct-17	865	1,075	BUY	Accumulate	5% – 15%
31-July-17	890	1,063	BUY	Hold	0 – 5%
12-May-17	931	1,068	ACCUMULATE	Reduce	-5% – 0
25-Jan-17	848	985	BUY	Sell	Less than – 5%
24-Oct-16	832	909	ACCUMULATE		
04-Aug-16	826	924	ACCUMULATE		

**ANALYST CERTIFICATION:**

We, Vaibhav Chowdhry (B.Com, MBA), research analyst and Pritesh Thakkar (MBA, B.Com), research associate, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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