

Stock Update

Positive revenue surprises, Maintain Buy

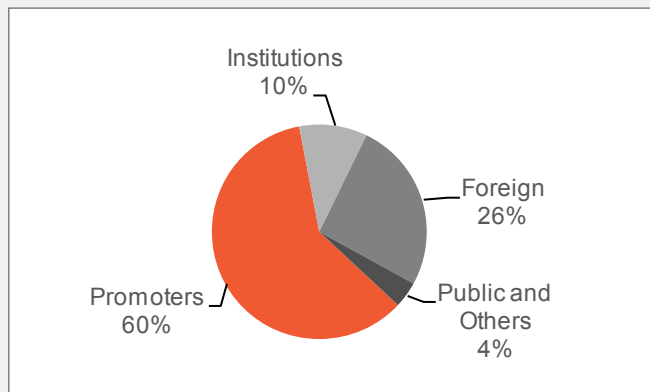
HCL Technologies

Reco: Buy | CMP: Rs958

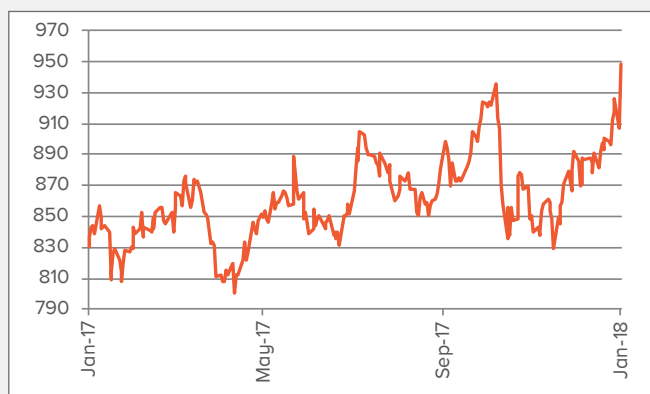
Company details

Price target:	Rs1,050
Market cap:	Rs133,330 cr
52-week high/low:	Rs965/778
NSE volume: (No of shares)	14.2 lakh
BSE code:	532281
NSE code:	HCLTECH
Sharekhan code:	HCLTECH
Free float: (No of shares)	55.6 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.8	3.6	8.9	15.2
Relative to Sensex	2.8	-4.4	-2.4	-12.1

Key points

- Positive revenue surprises, stable operational performance:** HCL Tech has reported better-than-expected revenue performance, with 3.3% sequential growth on CC basis to \$1,991.7 million, ahead of our expectations of 2.6% growth. The outperformance was led by better-than-expected performance in E&RD services (up 13.6% q-o-q), which took overall IT services growth to 6.1% q-o-q. Revenue performance was commendable, given the softness in India business and discontinuation of JV with DXC. Mode 2 and Mode 3 (Digital and Products/Platforms/IPs) contribute 25% to revenue, as compared to 19.5% in FY2017. EBIT margin for the quarter came at 19.6% vs. 19.7% in Q2FY2018, tad below our estimates, owing to higher-than-expected depreciation/amortisation cost. Net profit for the quarter stood at Rs. 2,194 crore, up 0.3% q-o-q. During the quarter, HCL Tech signed 20 transformational deals (vs. 15 deals in Q2FY2018) across verticals.
- Retains CC revenue growth guidance for FY2018, comfort at achieving the lower end of the guidance:** Management has maintained CC revenue growth guidance of 10.5-12.5% and EBIT margin guidance at 19.5-20.5% for FY2018. However, given the softness in IMS business (delivered muted growth in the past four preceding quarters, led by weakness in India business), management is more confident of achieving the lower end of the targeted revenue guidance for FY2018. Nevertheless, management expects IMS business to rebound in H1FY2019E. Further, strong order booking (highest-ever in the past 12 quarters) has given comfort in the acceleration of organic revenue growth in FY2019E, after a deceleration in FY2018. Management continues to remain confident on growth momentum in the E&RD space and BFSI vertical. Margins are expected to remain in the target band of 19.5-20.5% (for 9MFY2018, EBIT margin stood at 19.8%). HCL Tech continues to pursue inorganic growth opportunities. Management has indicated at a strong pipeline in the inorganic growth strategy for FY2019E as well.
- Maintain Buy with a revised price target of Rs. 1,050:** We have tweaked our earnings estimates for FY2018/FY2019E and have introduced FY2020E estimates in this note. We expect

organic revenue of HCL Tech to rebound in FY2019E, led by strong order booking in Mode 1 space. Moreover, successful inorganic strategy will keep the company in the top quadrant of growth among peers. Further, investment in the areas of digital technologies and products and platforms will help ride the changing industry demography in the coming years (management

expects Mode 2/3 to contribute 35-40% to revenue in the next three years). The stock is trading at inexpensive valuation of 13x its FY2020E earnings (30% discount to TCS and 7% discount to Infosys). We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,050 (rollover target multiple to FY2020).

Valuations

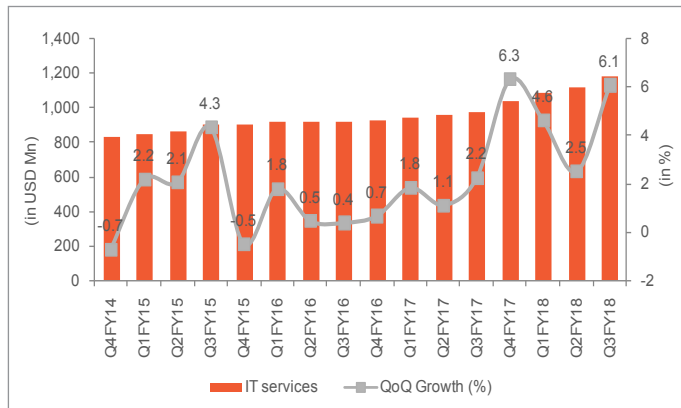
Rs cr

Particulars	FY17	FY18E	FY19E	FY20E
Net sales	46,722.0	50,316.1	54,789.9	60,589.0
EBITDA margin (%)	22.1	22.4	22.1	22.2
Net profit	8,456.0	8,669.6	9,193.0	10,165.8
EPS (Rs)	60.7	62.3	66.0	73.0
P/E (x)	15.8	15.4	14.5	13.1
EV/EBITDA (x)	13.2	10.5	9.5	8.3
RoE (%)	27.9	24.6	23.1	22.6
RoCE (%)	31.5	29.1	27.4	27.0

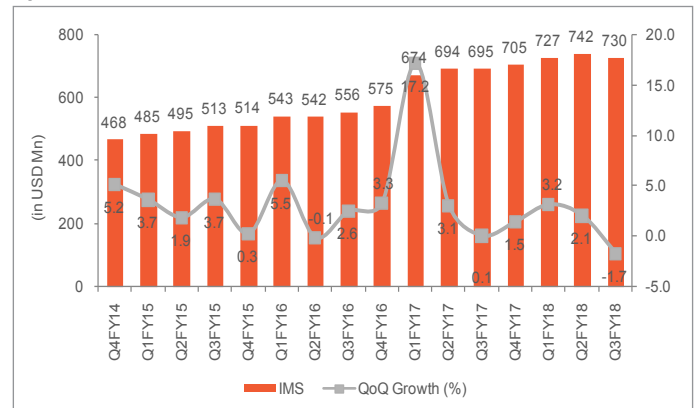
Results

Rs cr

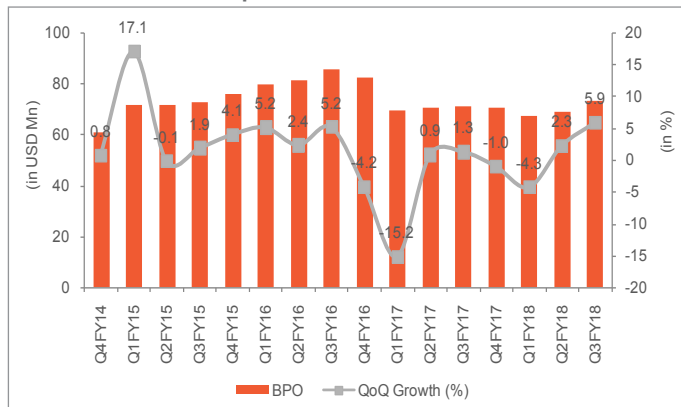
Particulars	Q3FY18	Q3FY17	Q2FY18	YoY (%)	QoQ (%)
Revenues (\$ mn)	1,987.5	1,745.3	1,928.0	13.9	3.1
Net sales	12,808.0	11,814.0	12,434.0	8.4	3.0
Direct costs	8,412.0	7,809.0	8,208.0	7.7	2.5
Gross profit	4,396.0	4,005.0	4,226.0	9.8	4.0
SG&A	1,432.0	1,377.0	1,467.0	4.0	-2.4
EBITDA	2,964.0	2,628.0	2,759.0	12.8	7.4
Depreciation & amortisation	455.0	220.0	308.0	106.8	47.7
EBIT	2,509.0	2,408.0	2,451.0	4.2	2.4
Forex gain/(loss)	129.0	43.0	144.0	200.0	-10.4
Other income	135.0	188.0	154.0	-28.2	-12.3
PBT	2,773.0	2,639.0	2,749.0	5.1	0.9
Tax provision	579.0	568.0	561.0	1.9	3.2
Net profit	2,194.0	2,070.0	2,188.0	6.0	0.3
EPS (Rs)	15.8	14.9	15.7	6.0	0.3
Margin (%)				BPS	BPS
EBITDA	23.1	22.2	22.2	90	95
EBIT	19.6	20.4	19.7	-79	-12
NPM	17.1	17.5	17.6	-39	-47

IT services growth led by ERD services (up 13.6% q-o-q)

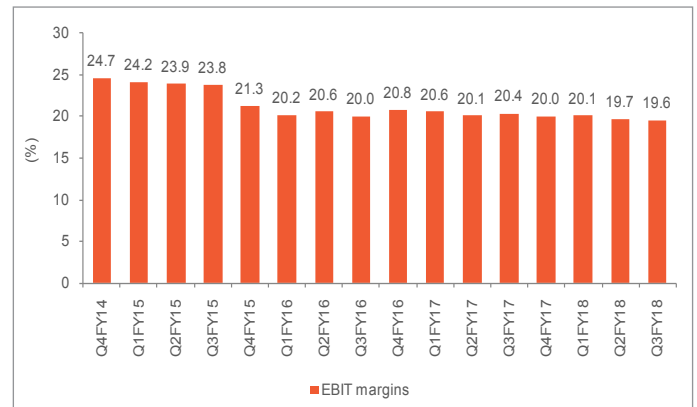
Source: Company, Sharekhan research

IMS business continues to remain soft; Expected to witness uptick in H1FY2019E

Source: Company, Sharekhan research

BPO up 5% on CC terms; led by full quarter consolidation of Urban Fulfillment acquisition

Source: Company, Sharekhan research

EBIT margin at 19.6%, stable qoq

Source: Company, Sharekhan research

Other result highlights

- ◆ Cash and cash equivalents stood at \$1,341 million in Q3FY2018 as against \$1,489.2 million in Q2FY2018. Borrowings stood at \$80 million as against \$111.4 million in the previous quarter.
- ◆ Days sales outstanding (DSO) (ex-unbilled receivables) increased by two days to 66 days sequentially.
- ◆ Total headcount stood at 119,291 (net addition of 251 q-o-q). Gross addition for Q3FY2018 stood at 7,113 employees. Attrition rate further improved by 50 BPS q-o-q to 15.2%. Blended utilisation rate for Q3FY2018 remained flat at 85.8% vs. 86%.
- ◆ HCL Tech signed 20 transformational deals in Q3FY2018 against 15 deals in Q2FY2018, across verticals.

Operating metrics

Particulars	Q3FY18	Q3FY17	Q2FY18	YoY (%)	QoQ (%)	Comments
Geographic mix (%)						
Americas	63.5	61.9	62.4	16.8	4.9	U.S. continued the strong growth momentum, grew by 4.9% q-o-q on CC basis. Europe delivered 1.9% sequential growth on top of 4.4% growth in Q2FY2018.
in \$ mn	1,262.1	1,080.3	1,203.1			
Europe	28.7	29.6	29.1	10.4	1.7	
in \$ mn	570.4	516.6	561.0			
Rest of World	7.9	8.5	8.5	5.8	-4.2	
in \$ mn	157.0	148.4	163.9			
Service offering (%)						
Engineering and R&D services	24.2	18.6	22.0	48.4	13.6	ERD services grew by 13.6%, expect momentum to continue in the coming quarters.
in \$ mn	481.8	324.6	424.2			
Industry application services	35.3	37.5	35.9	7.3	1.5	
in \$ mn	702.4	654.5	692.2			
Infrastructure services	36.7	39.8	38.5	5.1	-1.7	
in \$ mn	729.8	694.6	742.3			
BPO services	3.7	4.0	3.6	5.3	5.9	
in \$ mn	73.5	69.8	69.4			
Industry verticals (%)						
Financial services	24.6	24.3	25.0	15.3	1.4	Manufacturing, retail/CPG and healthcare verticals delivered strong growth, while financial services continued to remain stable after back-to-back quarters of impressive growth.
in \$ mn	488.9	424.1	482.0			
Manufacturing	36.5	33.9	35.4	22.6	6.3	
in \$ mn	725.4	591.7	682.5			
Telecom, media & entertainment	7.4	8.9	7.9	-5.3	-3.4	
in \$ mn	147.1	155.3	152.3			
Retail & consumer product group	9.6	9.4	9.3	16.3	6.4	
in \$ mn	190.8	164.1	179.3			
Healthcare	11.7	12.0	11.7	11.0	3.1	
in \$ mn	232.5	209.4	225.6			
Public services	10.2	11.2	10.6	3.7	-0.8	
in \$ mn	202.7	195.5	204.4			
Others	0.0	0.4	0.1	NM	NM	
in \$ mn	0.0	7.0	1.9			
Client contribution (%)						
Top 5 clients	15.8	14.2	15.1	26.7	7.9	Revenue from the top five clients' bucket was up by 7.9% q-o-q; continuing its growth momentum.
in \$ mn	314.0	247.8	291.1			
Top 10 clients	23.5	21.7	22.9	23.3	5.8	
in \$ mn	467.1	378.7	441.5			
Top 20 clients	33.5	31.9	33.2	19.6	4.0	
in \$ mn	665.8	556.8	640.1			
Revenues by contract type (%)						
Managed Services & FPP	60.8	63.2	60.4	9.6	3.8	Managed services and fixed price projects (FPP) at 60.8%, up by 40 BPS q-o-q.
in \$ mn	1,208.4	1,103.0	1,164.5			
Time and materials	39.2	36.8	39.6	21.3	2.0	
in \$ mn	779.1	642.3	763.5			
Number of clients						
1 million dollar +	552	496	536	56	16	Overall client addition remained strong.
5 million dollar +	261	241	259	20	2	
10 million dollar +	156	148	157	8	-1	
20 million dollar +	85	87	84	-2	1	
30 million dollar +	56	48	52	8	4	
40 million dollar +	40	35	37	5	3	
50 million dollar +	25	24	25	1	0	
100 million dollar +	9	8	9	1	0	

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