Stock Update

Stable quarter

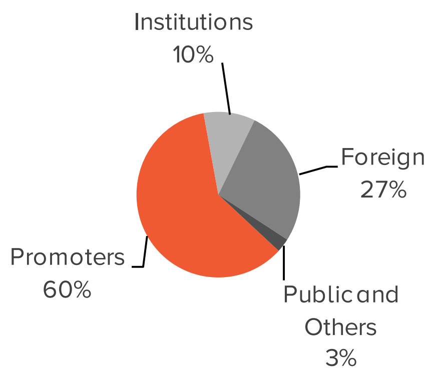
HCL Technologies

Reco: Buy | CMP: Rs1,001

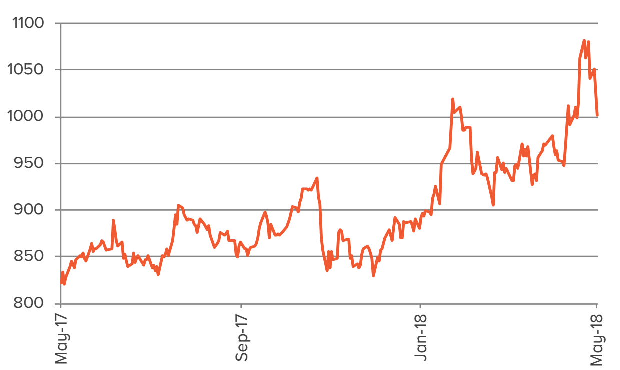
Company details

Price target:	Rs1,120
Market cap:	Rs139,370 cr
52-week high/low:	Rs1,106/811
NSE volume: (No of shares)	17.6 lakh
BSE code:	532281
NSE code:	HCLTECH
Sharekhan code:	HCLTECH
Free float: (No of shares)	55.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.7	6.7	23.5	31.1
Relative to Sensex	1.9	9.0	16.4	10.2

Key points

- **Steady quarter, strong digital momentum in FY2018:** HCL Tech reported largely in-line revenue performance with 1.2% q-o-q growth on constant currency (CC) basis to $2,011.7 million. Growth was driven by IMS (up 2.5% q-o-q CC), E&RD (up 1.7% q-o-q CC) and BPO services (up 5.3% q-o-q CC). On reported basis, dollar revenue grew by 2.5% q-o-q during the quarter. EBIT margin for the quarter remained flat on sequential basis at 19.6%, tad below our estimates. Higher-than-expected forex gains (up 25% q-o-q) are being partially offset by higher tax rate, leading to 1.5% q-o-q growth in net profit at Rs. 2,227 crore in Q4FY2018. In FY2018, overall CC revenue grew by 10.5% y-o-y, which remained at the lower end of the FY2018 targeted revenue guidance. Notably, Mode 2 (digital/analytics) and Mode 3 (products/platforms) together contributed 23.4% to FY2018 revenue (vs. 18.6% in FY2017), registering growth of 41.5% y-o-y.

- **Acquisition spree continues, capital allocation needs to be watched out:** During Q4FY2018, HCL Tech had announced two acquisitions of C3i (offers services for the life sciences and CPG industries) and Actian Corporation (a hybrid data management company). While C3i's acquisition was in legacy area, Actian Corporation's acquisition was in Mode 3 space. Though revenue for both the companies has declined by 5-8% y-o-y in CY2017, management expects these acquired entities to deliver better revenue and margin performance in FY2020 compared to FY2019 (expects largely stable performance on a y-o-y basis). In the past three years, the company has completed seven IP deals and 12 acquisitions (including in the ERD space), which shows its growth strategy through the inorganic route. Although certain acquisitions in the past have done well for the company, we expect HCL Tech to remain cautious in its aggressive capital allocation towards inorganic initiatives.

- **Hopes pinned on IMS revival, India business remains a dampener for FY2019:** Management has provided FY2019 revenue growth guidance of 9.5-11.5% y-o-y on CC basis, implying a 2.3-2.8% CQGR, inclusive of revenue from recent acquisitions (C3i Solutions and Actian Corp). Management expects revenue growth in FY2019E would be evenly distributed among organic and inorganic (4.25-6.25%), as revenue from acquisitions in FY2018 will be largely offset by the decline in India business, smaller deal sizes in legacy business and headwinds during renewals. However, IMS business is expected to rebound in H1FY2019E based on recent deal contracts, which has been laggard for the past seven quarters (CQGR of 1.5%), owing to higher exposure to data centre management, cloud adoption and automation initiatives. We believe the anticipated revival in IMS business along with continued revenue momentum in digital technologies could drive organic revenue growth in FY2020E.

- **Maintain Buy with a revised price target of Rs. 1,120:** We have tweaked our earnings estimates for FY2019/FY2020E on account of USD/INR reset to Rs. 66 (earlier at Rs. 64.5). Though organic revenue growth guidance in FY2019E remains below expectations (owing to the decline in India business and headwinds in renewal), we see positive setups for organic revenue growth in FY2020E on account of anticipated turnaround in IMS division (37.8% of FY2018 revenue), healthy deal pipelines and strong momentum in digital revenue. Further, successful inorganic strategy will keep the company in the top quadrant of growth among peers. However, we restrict ourselves from any upward revision of target multiple, given slower organic revenue growth (similar to Infosys) in FY2019 and aggressive capital allocation toward inorganic growth (IP investments). We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,120.

Valuations Rs cr

Particulars	FY17	FY18	FY19E	FY20E
Net sales	46,722.0	50,570.0	57,682.7	63,827.5
EBITDA margin (%)	22.1	22.6	22.3	22.2
Net profit	8,456.0	8,780.0	9,407.3	10,338.4
EPS (Rs.)	60.7	63.1	67.6	74.3
P/E (x)	16.6	16.0	15.0	13.6
EV/EBITDA (x)	13.9	12.0	10.6	9.7
RoE (%)	27.9	25.3	24.2	23.5
RoCE (%)	31.5	30.0	29.3	28.6

Results Rs cr

Particulars	Q4FY18	Q4FY17	Q3FY18	yoy (%)	qoq (%)
Revenue ($ mn)	**2,038.0**	**1,816.8**	**1,987.5**	**12.2**	**2.5**
Net sales	**13,179.0**	**12,053.0**	**12,808.0**	**9.3**	**2.9**
Direct costs	8,560.0	7,987.0	8,412.0	7.2	1.8
Gross profit	4,619.0	4,066.0	4,396.0	13.6	5.1
SG&A	1,583.0	1,417.0	1,432.0	11.7	10.5
EBITDA	**3,036.0**	**2,649.0**	**2,964.0**	**14.6**	**2.4**
Depreciation & amortisation	453.0	233.0	455.0	94.4	-0.4
EBIT	**2,583.0**	**2,416.0**	**2,509.0**	**6.9**	**2.9**
Forex gain/(loss)	161.0	48.0	129.0	235.4	24.8
Other income	119.0	167.0	135.0	-28.7	-11.9
PBT	**2,863.0**	**2,631.0**	**2,773.0**	**8.8**	**3.2**
Tax provision	634.0	303.0	579.0	109.2	9.5
Net profit	2,227.0	2,325.0	2,194.0	-4.2	1.5
EPS (Rs)	16.0	16.7	15.8	-4.2	1.5
Margin (%)				**BPS**	**BPS**
EBITDA	23.0	22.0	23.1	106	-11
EBIT	19.6	20.0	19.6	-45	1
NPM	16.9	19.3	17.1	-239	-23

Other result highlights

- Cash and cash equivalents stood at $1,575.8 million in Q4FY2018 as against $1,341 million in Q3FY2018. Borrowings stood at $67 million as against $80 million in the previous quarter.
- Days sales outstanding (DSO) (ex-unbilled receivables) declined by one day to 65 days sequentially.
- Total headcount stood at 120,081 (net addition of 790 q-o-q). Gross addition for Q4FY2018 stood at 8,476 employees. Blended utilisation rate increased by 10BPS q-o-q to 85.9%.
- HCL Tech signed 15 transformational deals in Q4FY2018 against 20 deals in Q3FY2018 across verticals.
- Capital allocation was skewed towards IP investments in the past two years (nine IP deals of $1.1 billion).

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