

HCL Technologies Ltd.



RESULT UPDATE

3rd May, 2018

HCL Technologies Ltd.

Weak Quarter heat Profitability, Strong growth Ahead

CMP INR 1000	Target INR 1263	Potential Upside 25.7%	Market Cap (INR Mn) 1,393,777	Recommendation BUY	Sector IT
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Result highlights

HCL Tech's Q4 FY18 results were below our estimates in terms of revenue as well as in profitability front owing to renewals of deals and decelerating revenue growth from Indian business. Europe and Asia-Pacific have outperformed as far as Geographies are concerned, with 7.2%/10.3% qoq growth, whereas Americas saw a decline of 0.5% qoq. Financial Services and Telecom have led the growth pack with 4.2% and 2.5% qoq respectively, which is primarily supported by Mode 2 services. Infrastructure Services led the growth pack with a 4.2% qoq followed by BPO service at 8.1% qoq. ER&D growth remained subdued amidst seasonal headwind on IP renewals and lesser support from organic components. The growth is expected to revive on the back of its previous acquisitions (Butler America & Geometric), which have supported its ER&D segment to grow by 32% yoy.

MARKET DATA

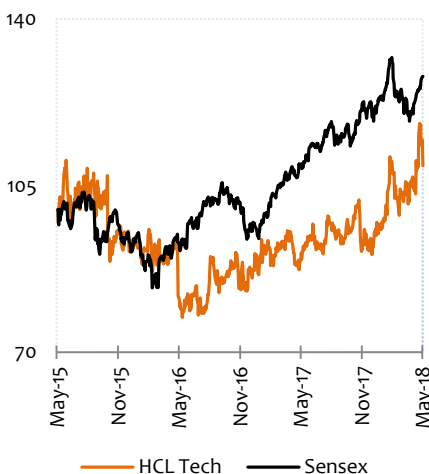
Shares Outs (Mn)	1392
Equity Cap (INR Mn)	2785
Mkt Cap (INR Mn)	1393777
52 Wk H/L (INR)	1107/811
Volume Avg (3m K)	2138.6
Face Value (INR)	2
Bloomberg Code	HCLT IN

KEY FINANCIALS

Particulars (INR Mn)	FY16	FY17	FY18	FY19E	FY20E
Net Sales	409,130	467,220	505,700	557,525	620,410
EBITDA	89,150	103,130	112,150	129,883	149,085
PAT	74,500	84,610	87,674	99,266	113,546
EPS	52.8	59.8	62.9	71.3	81.5
EBITDA Margin	24.7%	21.8%	22.1%	22.2%	23.3%
NPM	20.5%	18.2%	18.1%	17.3%	17.8%

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	35176
NIFTY	10718

Sluggish growth from Mode 3 service, Expected to Revive

The company reported good set of numbers in revenue front that grew by 2.9% qoq on the back of IMS (+4.2% qoq) and partly supported by Application and ER&D services. The ER&D segment has registered a lowest growth in Q4 FY18 compared to the previous six quarters owing to headwinds from Mode 3 service, which comprises revenues from IP-Led partnerships, Platforms & Products and other acquisitions in ER&D space. The management has guided that the growth from the segment remained sluggish owing to renewal of IP deals and the growth is expected to revive in a few couple of quarters, as the acquisitions have materialized fully and deliver a significant growth.

Infrastructure service that grew by 4.2% qoq supported the top-line growth on the back of large number of business enterprises migrating their workloads to Cloud infrastructure from on-premise IT infrastructure. The management has guided that Europe has shown significant growth in Cloud service, wherein 40% of the client base under IMS have adopted cloud migration through public infrastructure. However, the deal size remains small to register significant growth. The company has given a revenue guidance of 9.5% to 11.5% growth in FY19 which would be supported by its previous years' acquisitions as well as recent acquisition of C3i which is into Life Science and CPG verticals.

Margins Remain Pressurized

In Q4 FY18, the operating margin remained pressurized owing to increase in D&A expenditure driven by Licensed IPRs. Going ahead, we expect the IPs to impose further pressure on operating margin and provide lesser headroom to improve. However, the other operational levers such as Utilization, Automation and changes in revenue mix (margin accretive business) to overweigh the margins going forward. Considering the factors above, we have envisaged the company to report the operating margin of 20.5%/21.2% in FY19E/FY20E.

The Net margin is reported at 16.9% in Q4FY18 Vs 19.3% in Q4 FY17, primarily due to increase in Effective Tax Rate from 11.5% in Q4 FY17 to 22.1% Q4 FY 18. The company is expected to maintain its operating margin within a range of 19.5%/20.5% in FY19. The company has given a guidance that the ETR is expected to fall within a range of 20.5% to 22.5% owing to increase in onsite hiring, capitalizing IPs and other acquisitions.

SHARE HOLDING PATTERN (%)

Particulars	Mar 18	Dec 17	Sep 17
Promoters	60.18	60.19	60.05
FIIIs	26.54	25.62	25.31
DIIIs	9.78	10.51	9.91
Others	3.51	3.69	4.73
Total	100	100	100

10.8%

Revenue CAGR between FY 18 and FY 20E

13.8%

PAT CAGR between FY 18 and FY 20E

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Key Concall Highlights: (i) In Q4FY18, Mode 2 and Mode 3 service contributed 14.7% and 8.7% in FY18 respectively, which reported a growth of 29.4% and 68.3% yoy respectively (ii) The quarter remains strong in terms of deal signing, where the company signed 15 deals across services (iii) The revenue from newly acquired company (C3i Solutions) is on a declining stage, which is expected to improve post FY19 and the EBITDA margin is reported at 6% (iv) The robust deal wins on IPs will have strong incremental revenues post FY18, which would further boost the overall contribution for mode-3 services.

Valuation and view

The company has witnessed a strong traction for its digital services driven by Mode 2 and Mode 3 (yoy) services coupled with large number of IP partnership. Going ahead, we expect the ER&D space continues to witness a double-digit growth (yoy) 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 that the company thrust to grow inorganic (through acquisitions) and broaden IP portfolio through in-house and IP-partnerships, 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 15.5x to its FY20E EPS of INR 81.5 to arrive at a price target of INR 1,263, an upside of 25.7% compared to CMP.**

Exhibit 1: Q4 FY18 Result Snapshot

YE March (Rs mn)	Q4 FY18	Q3 FY18	Q-o-Q change %	Q4 FY17	Y-o-Y change %	Q4 FY18 Estimates	Deviation %
Revenues (\$)	2,038	1,988	2.5%	1,817	12.2%	2,053	(0.7%)
Revenues (INR)	131,790	128,090	2.9%	120,530	9.3%	132,235	(0.3%)
Direct Cost	85,600	84,560	1.2%	79,870	7.2%	87,101	(1.7%)
Gross Profit	46,190	43,530	6.1%	40,660	13.6%	45,133	2.3%
SG&A	15,830	15,850	(0.1%)	14,170	11.7%	15,207	4.1%
EBITDA	30,360	27,680	9.7%	26,490	14.6%	29,926	1.4%
Depreciation & Amortisation	4,530	4,310	5.1%	2,330	94.4%	3,035	49.3%
EBIT	25,830	23,370	10.5%	24,160	6.9%	26,892	(3.9%)
Other Income, net	2,800	2,700	3.7%	1,670	67.7%	3,205	
PreTax Income	28,630	27,360	4.6%	26,310	8.8%	30,097	(4.9%)
Adjusted Pretax Income	28,630	27,360	4.6%	26,310	8.8%	30,097	
Tax	6,340	5,320	19.2%	3,030	109.2%	6,294	
Share of Minority Interest	0	0		0		0	
Net Profit	22,290	22,040	1.1%	23,280	(4.3%)	23,803	(6.4%)
Adjusted Net Profit	22,290	22,040	1.1%	23,280	(4.3%)	23,803	(6.4%)
Diluted EPS (Rs)	15.5	14.9	4.4%	16.5	(5.6%)	16.6	
Adjusted Diluted EPS	15.5	14.9	4.4%	16.5	(5.6%)	16.6	(6.4%)
No.of Shares (mn) - Diluted	1,434	1,480		1,414		1,434	
Margin Analysis (%)			Change in bps	Change in bps			
Gross Profit Margin (%)	35.0%	34.0%	106	33.7%	131	34.1%	92
Operating Profit Margin (%)	19.6%	18.2%	135	20.0%	(45)	20.3%	(74)
EBITDA Margin (%)	23.0%	21.6%	143	22.0%	106	22.6%	41
Net Profit Margin (%)	16.9%	17.2%	(29)	19.3%	(240)	18.0%	(109)
Adjusted NPM (%)	16.9%	17.2%	(29)	19.3%	(240)	18.0%	(109)
Effective Tax rate (%)	22.1%	19.4%	270	11.5%	1063	20.9%	123
Cost Analysis (%)			Change in bps	Change in bps			
Direct cost as % of Sales	65.0%	66.0%	(106)	66.3%	(131)	65.9%	(92)
SG&A as % of Sales	12.0%	12.4%	(36)	11.8%	26	11.5%	51

Source: Company, KRChoksey Research

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Exhibit 2: Profit & Loss Statement

INR Mn	FY16	FY17	FY18	FY19E	FY20E
Total Revenues	409,130	467,220	505,700	557,525	620,410
Revenue Growth (Y-o-Y)	14.6%	14.2%	8.2%	10.2%	11.3%
Less:					
Employees Cost	267,810	308,890	335,370	364,084	400,598
SG&A	52,170	55,200	58,180	63,558	70,727
Total Op. Expenditure	319,980	364,090	393,550	427,642	471,324
EBIDTA	89,150	103,130	112,150	129,883	149,085
EBIDTA Growth (Y-o-Y)	1.1%	15.7%	8.7%	15.8%	14.8%
Less: Depreciation	5,690	8,340	14,160	15,763	17,513
Operating Profit	83,460	94,790	97,990	114,120	131,572
Operating Profit Growth (Y-o-Y)	0.4%	13.6%	3.4%	16.5%	15.3%
Non-operating Income	10,090	9,340	12,494	13,381	14,269
Profit Before tax	93,550	104,130	110,484	127,501	145,842
Tax	19,050	19,520	22,810	28,235	32,296
Share of Minority Interest	0	0	0	0	0
Net Profit	74,500	84,610	87,674	99,266	113,546
Adjusted Net Profit	74,500	84,610	87,674	99,266	113,546
Diluted EPS (Rs.)	52.8	59.8	62.9	71.3	81.5
Growth (Y-o-Y) %	1.9%	13.4%	5.2%	13.2%	14.4%
Adjusted Diluted EPS	52.8	59.8	62.9	71.3	81.5
Growth (Y-o-Y) %	1.9%	13.4%	5.2%	13.2%	14.4%

Source: Company, KRChoksey Research

Exhibit 3: Balance Sheet

INR Mn	FY16	FY17	FY18	FY19E	FY20E
Equity Capital	3,758	3,728	3,668	3,668	3,668
Reserves & Surplus	271,577	327,530	361,572	421,132	489,259
Equity	275,335	331,258	365,240	424,800	492,927
Net Worth	275,335	331,258	365,240	424,800	492,927
Minority Interest	2,093	1,720	0	0	0
Net Deferred tax liability/(Asset)	1,051	0	342	1,673	1,861
Other Non-current Liabilities	11,279	8,886	11,479	13,938	27,918
Total Loans	10,795	5,778	5,527	4,371	4,371
Capital Employed	300,552	347,640	382,587	444,781	527,078
Assets					
Gross Block	82,165	90,856	101,092	112,592	125,092
Less: Depreciation	39,368	44,323	49,650	65,413	82,926
Net Block	42,797	46,533	51,441	47,179	42,166
Investments	1,603	1,591	3,006	4,006	5,006
Intangible Assets	63,550	113,592	142,927	142,927	142,927
Other Non-current Assets	20,034	17,499	21,802	28,991	32,261
Deferred Income Tax Assets	18,365	16,000	17,753	25,500	29,168
Current Assets					
Inventories	2,618	2,740	1,709	1,995	2,195
Sundry Debtors	106,156	107,397	121,568	129,835	144,479
Cash and Bank Balance	97,683	101,230	63,179	128,188	193,698
Other Current Assets	40,898	51,694	57,101	39,027	43,429
Total Current Assets	247,355	263,061	243,557	299,045	383,801
Less: Current Liabilities					
Sundry Creditors	8,988	26,005	17,928	19,950	21,951
Provisions	10,307	7,385	6,838	7,650	8,751
Other Current Liabilities	73,857	77,246	73,133	75,266	77,551
Total Current Liabilities	93,152	110,636	97,899	102,866	108,252
Capital Applied	300,552	347,640	382,587	444,781	527,078

Source: Company, KRChoksey Research

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Exhibit 4: Ratio Analysis

INR Mn	FY16	FY17	FY18	FY19E	FY20E
Key Operating Ratios					
EBITDA Margin (%)	21.8%	22.1%	22.2%	23.3%	24.0%
Tax / PBT (%)	20.4%	18.7%	20.6%	22.1%	22.1%
Net Profit Margin (%)	18.2%	18.1%	17.3%	17.8%	18.3%
RoE (%)	27.5%	26.5%	24.6%	23.9%	23.6%
RoCE (%)	25.5%	24.9%	23.5%	22.9%	22.3%
Current Ratio (x)	2.7x	2.4x	2.5x	2.9x	3.5x
Dividend Payout (%)	38.0%	38.0%	19.0%	40.0%	40.0%
BV Per Share (Rs.)	195.0	234.2	262.2	305.0	353.9
Financial Leverage Ratios					
Debt/ Equity (x)	0.04	0.02	0.02	0.01	0.01
Sales Growth (%)	11.2%	10.6%	11.3%	11.4%	11.1%
EBITDA Growth (%)	14.6%	14.2%	8.2%	10.2%	11.3%
Net Profit Growth (%)	1.1%	15.7%	8.7%	15.8%	14.8%
Diluted EPS Growth (%)	1.9%	13.6%	3.6%	13.2%	14.4%
Debtors days	95	84	88	85	85
Creditors days	10	26	17	17	17
Inventory Days	3	3	2	2	2

Source: Company, KRChoksey Research

Exhibit 5: Free Cash Flow Analysis

INR Mn	FY16	FY17	FY18	FY19E	FY20E
EBITA	83,460	94,790	97,990	114,120	131,572
Less: Adjusted Taxes	16,995	17,769	20,231	25,271	29,136
NOPLAT	66,465	77,021	77,759	88,849	102,436
Plus: Depreciation	5,690	8,340	14,160	15,763	17,513
Gross Cashflow	72,155	85,361	91,919	104,611	119,949
Less: Increase in Working Capital	20,668	(3,583)	32,439	(12,934)	15,746
Operating Cashflow	51,486	88,943	59,480	117,546	104,203
Less: Net Capex	11,692	12,076	19,068	11,500	12,501
Less: Increase in Net Other Assets	19,222	48,959	34,175	11,146	(7,231)
FCF From Operation	20,572	27,908	6,237	94,900	98,932
Less: Inc./ (Dec.) in Investment	1,508	(123)	(1,214)	1,000	1,000
FCF after Investment	19,064	28,031	7,451	93,900	97,932
Total FCF	19,064	28,031	7,451	93,900	97,932

Source: Company, KRChoksey Research

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HCL Technologies Ltd.				Rating Legend	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
03-May-18	1000	1263	BUY	Buy	More than 15%
22-Jan-18	972	1276	BUY	Accumulate	5% – 15%
31-Oct-17	865	1,075	BUY	Hold	0 – 5%
31-July-17	890	1,063	BUY	Reduce	-5% – 0
12-May-17	931	1,068	ACCUMULATE	Sell	Less than – 5%
25-Jan-17	848	985	BUY		
24-Oct-16	832	909	ACCUMULATE		
04-Aug-16	826	924	ACCUMULATE		

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