

HCL Technologies

BUY

INDUSTRY IT

CMP (as on 27 Jul 2018) Rs 964

Target Price Rs 1,155

Nifty 11,278

Sensex 37,337

KEY STOCK DATA

Bloomberg HCLT IN

No. of Shares (mn) 1,392

MCap (Rs bn) / (\$ mn) 1,342/19,528

6m avg traded value (Rs mn) 2,201

STOCK PERFORMANCE (%)

52 Week high / low Rs 1,108 / 825

3M 6M 12M

Absolute (%) (7.5) (4.5) 8.3

Relative (%) (14.3) (8.1) (7.0)

SHAREHOLDING PATTERN (%)

Promoters 60.17

FIs & Local MFs 9.69

FPIs 26.24

Public & Others 3.90

Source : BSE

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Nearing inflection point

HCL Tech (HCLT) posted a soft 1Q. However, guidance/deal wins are indicative of acceleration ahead. Revenue at USD 2,055mn was 2.7/8.5% QoQ/YoY in CC with impact of India-SI business decline (USD 12mn, -0.6% QoQ impact). EBIT% was flat at 19.7%, 7bps QoQ as gross margin decline (C3i integration, deal transition) was offset by lower SG&A%. APAT at Rs 24.03bn was supported by a lower tax rate.

We maintain our positive outlook on HCLT based on (1) IMS recovery ahead (Nokia, P&G deal ramp-up), will bring back the infra service line into reckoning, (2) Strong deal wins providing growth visibility (27 transformational deal wins in 1Q – highest ever), (3) Digital upsurge across verticals (B2B from largely B2C earlier) and wins in existing/new logos, (4) Strong growth in Mode-2 and newer IPs (~40% of Mode-3 business) supported by increase in sales efforts, (5) Normalisation of the renewal compression and more large deals in the pipeline

Financial Summary

YE March (Rs bn)	1QFY19	1QFY18	YoY (%)	4QFY18	QoQ (%)	FY16	FY17	FY18	FY19E	FY20E
Net Sales	138.78	121.49	14.2	131.79	5.3	409.13	467.23	505.70	576.36	635.20
EBIT	27.30	24.45	11.7	25.83	5.7	82.27	94.74	99.88	113.26	127.13
APAT	24.03	21.71	10.7	22.27	7.9	73.52	81.54	87.80	95.71	104.43
Diluted AEPS (Rs)	17.3	15.2	13.4	16.0	7.9	54.2	60.1	64.8	70.6	77.0
P/E (x)						18.5	16.9	15.3	13.7	12.5
EV / EBITDA (x)						14.4	12.2	11.4	9.9	8.8
RoE (%)						28.4	27.0	25.3	25.2	24.8

Source: Company, HDFC sec Inst Research # Consolidated

and (6) Favourable risk-reward based on attractive valuations (12.5x FY20E).

Our rev/EPS growth at 9.6/9.1% CAGR over FY18-20E assumes USD revenue growth at 8.9/10.2% for FY19/20E and EBIT% at 19.7/20.0%. We've factored 9.4/7.6% CAGR for software services (incl ER&D) and IMS, respectively. Maintain BUY with TP of Rs 1,155 (15x FY20E).

Highlights of the quarter

- Mode-1 (73.3% of rev mix)/Mode-2 (15.6%)/Mode-3 (11%) grew 0.5/8.2/11.7% QoQ CC respectively. Revenue guidance was unchanged at 9.5 to 11.5% YoY in CC terms and EBIT% guidance at 19.5 to 20.5% for FY19E.
- Client metrics were strong with additions across large client bands. Vertical performance was weak in 1Q barring Healthcare & Life-sciences (acquisition-led) and Public services.
- Near-term outlook:** Growth to accelerate with strong large deal pipeline and ramp-up of large deals.

Quarterly Consolidated Financials Snapshot

Particulars (Rs bn)	1QFY19	1QFY18	YoY (%)	4QFY18	QoQ (%)
Net Revenues (USD mn)	2,055	1,884	9.0	2,038	0.8
Net Revenues	138.78	121.49	14.2	131.79	5.3
Direct Costs	91.06	80.57	13.0	85.60	6.4
Gross Profit	47.72	40.92	16.6	46.19	3.3
SG&A Expenses	15.46	14.11	9.6	15.83	(2.3)
EBITDA	32.26	26.81	20.3	30.36	6.3
Depreciation	4.96	2.36	110.2	4.53	9.5
EBIT	27.30	24.45	11.7	25.83	5.7
Other Income	2.95	2.69	9.7	2.78	6.1
PBT	30.25	27.14	11.5	28.61	5.7
Tax	6.22	5.43	14.5	6.34	(1.9)
APAT	24.03	21.71	10.7	22.27	7.9
E/o (adj for tax)	-	-	-	-	-
RPAT	24.03	21.71	10.7	22.27	7.9

Source: Company, HDFC sec Inst Research

Margin Analysis

	1QFY19	1QFY18	YoY (bps)	4QFY18	QoQ (bps)
Direct Costs % Net Revenues	65.6	66.3	(70)	65.0	66
Gross Profit Margin (%)	34.4	33.7	70	35.0	(66)
SG&A Expenses % Net Revenues	11.1	11.6	(47)	12.0	(87)
EBITDA Margin (%)	23.2	22.1	118	23.0	21
EBIT Margin (%)	19.7	20.1	(45)	19.6	7
Tax Rate (%)	20.6	20.0	55	22.2	(160)
APAT Margin (%)	17.3	17.9	(55)	16.9	42

Source: Company, HDFC sec Inst Research

Revenue came at USD 2,055mn, 2.7/8.5% QoQ/YoY in CC with impact of India-SI business decline

Organic CC growth was 0.7% QoQ and C3i impact was 2% QoQ

EBIT% was flat at 19.7%, 7bps QoQ supported by lower SG&A (87bps QoQ)

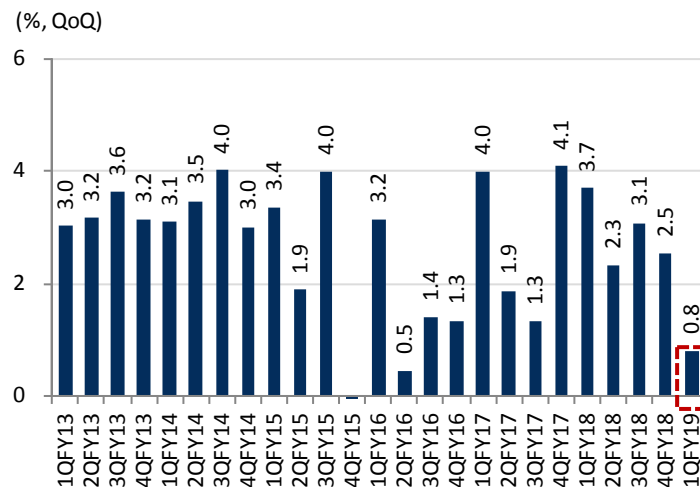
APAT at Rs 24.03bn was supported by lower ETR (20.6% vs 22.2% in 4Q)

EBIT margin for Mode-1 at 19.9%, Mode-2 at 14.8%, Mode-3 at 25.2% and company aggregate at 19.7% in 1Q

Mode-2 margins expected to improve gradually

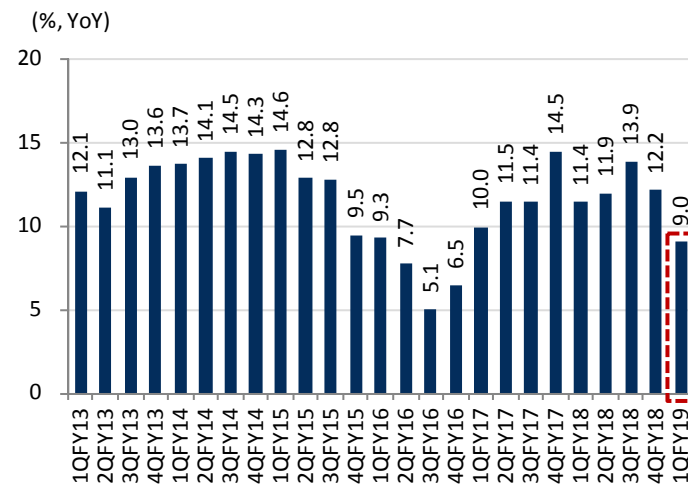
40% of Mode-3 business comprises high-growth IPs including 'Drylce' automation platform

QoQ USD Revenue Growth Trajectory



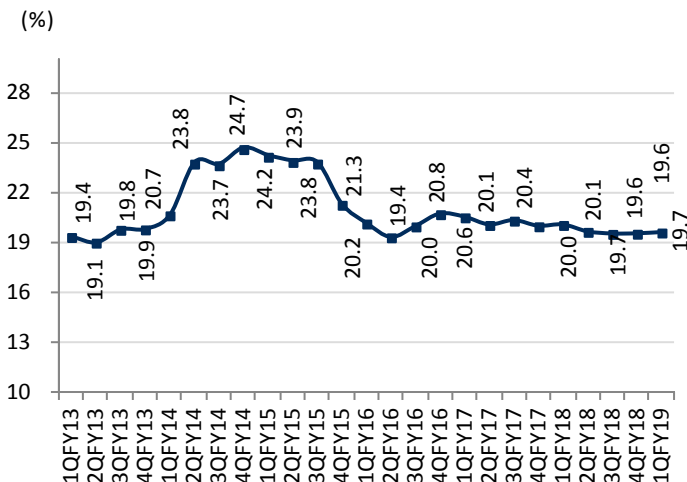
Source: Company, HDFC sec Inst Research, *1QFY17 organic

YoY USD Revenue Growth Trajectory



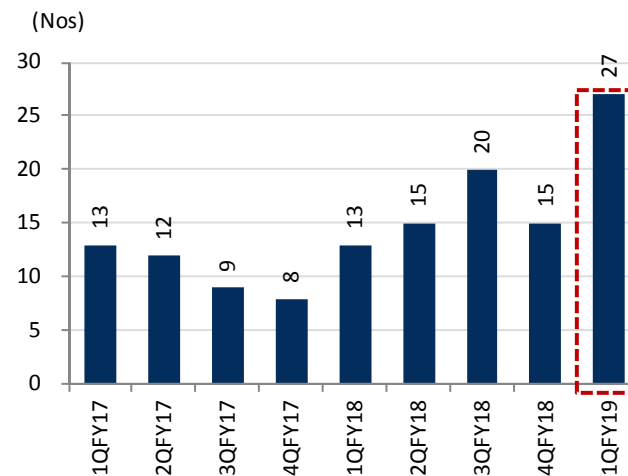
Source: Company, HDFC sec Inst Research

EBIT Margin Trajectory



Source: Company, HDFC sec Inst Research

Transformational Deals Trend



Source: Company, HDFC sec Inst Research,

Life-science & healthcare and Public services verticals led the growth

Strong pipeline and wins in BFSI expected to revive growth

Vertical Revenue Break-up

(% of rev)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Manufacturing	33.9	34.6	34.9	35.4	36.5	36.0	36.5
Financial Services	24.3	24.2	24.9	25.0	24.6	25.0	23.8
Life Sciences and Health Care	12.0	11.5	11.8	11.7	11.7	11.5	12.8
Public Services	11.2	11.7	11.1	10.6	10.2	10.5	10.5
Telecom, Media, Publishing & Entertainment	8.9	8.4	7.9	7.9	7.4	7.4	7.3
Retail & CPG	9.4	9.2	9.5	9.3	9.6	9.6	9.1
Others	0.3	0.4	0.0	0.1	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, HDFC Sec Inst Research

Vertical-wise Revenue Growth

(QoQ, %)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Manufacturing	6.7	6.2	4.5	3.9	6.3	1.1	2.2
Financial Services	2.2	3.7	6.5	2.9	1.4	4.2	(4.0)
Life Sciences and Health Care	(3.5)	(0.2)	6.4	1.5	3.1	0.8	12.2
Public Services	4.1	8.7	(1.6)	(2.3)	(0.8)	5.6	0.8
Telecom, Media, Publishing & Entertainment	(4.1)	(1.8)	(2.5)	2.3	(3.4)	2.5	(0.5)
Retail & CPG	(8.4)	1.9	7.1	0.2	6.4	2.5	(4.4)
Total	1.3	4.1	3.7	2.3	3.1	2.5	0.8

Source: Company, HDFC Sec Inst Research

Among services, IMS and Application services grew 0.8% and 0.6% QoQ in CC terms

Growth was led by Americas while decline in RoW (-7.1% QoQ) impacted by India SI business

Service Line Break-up

(% of rev)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Software Services (Apps + Engg)	56.1	57.3	57.8	57.9	59.6	58.8	58.5
Infrastructure Services	39.8	38.8	38.6	38.5	36.7	37.3	36.2
Business Services	4.0	3.9	3.6	3.6	3.7	3.9	5.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, HDFC Sec Inst Research

Service Line Growth

(QoQ, %)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Software Services (Apps + Engg)	2.3	6.2	4.7	2.4	6.1	1.2	0.4
Infrastructure Services	0.0	1.5	3.2	2.0	(1.6)	4.2	(2.1)
Business Services	0.9	0.5	(5.7)	4.5	5.2	6.8	36.4
Total	1.3	4.1	3.7	2.3	3.1	2.5	0.8

Source: Company, HDFC Sec Inst Research

Geographic Revenue Break-up

(% of rev)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Americas	61.9	62.6	62.8	62.4	63.5	61.5	64.5
Europe	29.6	27.7	27.4	29.1	28.7	30.0	28.1
Rest of the World	8.5	9.7	9.8	8.5	7.9	8.5	7.5
Total	100.0	100.0	100.0	100.0	100.1	100.0	100.1

Source: Company, HDFC Sec Inst Research

Geographic Revenue Growth

(QoQ, % CC)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Americas	1.7	5.3	3.8	1.5	4.9	(0.7)	5.9
Europe	6.8	(3.0)	(0.4)	4.4	1.9	3.6	(1.0)
Rest of the World	(0.5)	15.8	3.1	(12.0)	(3.9)	8.1	(7.1)
Total	3.0	3.8	2.6	0.9	3.3	1.2	2.7

Source: Company, HDFC Sec Inst Research

Utilisation was flat at 85.5% in 1Q (85.9% in 4Q) and attrition increased to 16.3% on seasonality

Headcount, Attrition And Utilisation Data

(Nos.)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Total headcount	111,092	115,973	117,781	119,040	119,291	120,081	124,121
Technical	101,154	105,547	107,029	108,351	108,831	109,565	113,404
Support	9,938	10,426	10,752	10,689	10,460	10,516	10,717
Gross Additions	8,467	10,605	9,462	8,645	7,113	8,476	12,558
Net Additions	1,297	4,881	1,808	1,259	251	790	4,040
Voluntary LTM Attrition (%)	17.9	16.9	16.2	15.7	15.2	15.5	16.3
Utilisation Excluding Trainees (%)	84.6	85.7	86.0	86.0	85.8	85.9	85.5

Source: Company, HDFC Sec Inst Research

Key Assumptions

Particulars	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Software Services USD Rev. Growth (%)	4.5	9.1	4.8	6.4	16.9	9.2	9.6
IMS USD Rev. Growth (%)	37.9	16.6	10.3	25.0	6.9	4.2	11.2
BPO USD Rev. Growth (%)	14.7	27.5	13.0	(14.8)	2.7	54.0	10.6
Total USD Revenue Growth (%)	14.1	12.4	7.1	11.9	12.4	8.9	10.2
USD/INR Rate	59.6	61.5	65.6	67.0	64.5	67.5	67.5
EBIT Margin (%)	23.3	23.3	20.1	20.3	19.8	19.7	20.0

Source: Company, HDFC Sec Inst Research

Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
	FY19E		
Revenue (USD mn)	8,737	8,537	(2.3)
Revenue (Rs bn)	588.67	576.36	(2.1)
EBIT (Rs bn)	118.53	113.26	(4.4)
EBIT margin (%)	20.1	19.7	(48) bps
EPS (Rs)	71.2	70.6	(0.9)
	FY20E		
Revenue (USD mn)	9,544	9,410	(1.4)
Revenue (Rs bn)	644.22	635.20	(1.4)
EBIT (Rs bn)	128.03	127.13	(0.7)
EBIT margin (%)	19.9	20.0	14bps
EPS (Rs)	77.5	77.0	(0.6)

Peer Set Comparison

Company	Mcap (Rs bn)	CMP (Rs)	Reco.	TP (Rs)	EPS (Rs)				P/E (x)				RoE (%)			
					FY17	FY18	FY19E	FY20E	FY17	FY18	FY19E	FY20E	FY17	FY18	FY19E	FY20E
TCS	7,294	1,944	BUY	2,130	66.7	67.5	79.5	88.8	29.1	28.8	24.4	21.9	33.4	30.1	35.5	37.6
Infosys	2,985	1,373	BUY	1,415	66.0	67.7	72.2	78.5	20.8	20.3	19.0	17.5	22.0	24.5	24.1	25.7
Wipro	1,242	275	NEU	270	18.8	17.7	19.0	20.8	14.6	15.5	14.4	13.2	16.4	16.5	16.5	16.6
HCL Tech	1,342	964	BUY	1,155	60.1	64.8	70.6	77.0	16.0	14.9	13.7	12.5	27.0	25.3	25.2	24.8
TechM	575	645	BUY	780	31.6	42.7	45.9	51.8	20.4	15.1	14.1	12.5	18.1	21.5	20.3	20.2

Source: HDFC sec Inst Research

Consolidated Income Statement

YE March (Rs bn)	FY16	FY17	FY18	FY19E	FY20E
Net Revenues (USD mn)	6,235	6,975	7,838	8,537	9,410
Growth (%)	7.1	11.9	12.4	8.9	10.2
Net Sales	409.13	467.23	505.70	576.36	635.20
Growth (%)	14.6	14.2	8.2	14.0	10.2
Cost of Revenue	269.00	308.90	332.37	379.00	417.08
SG&A Expenses	52.17	55.24	58.93	64.02	69.39
EBITDA	87.96	103.09	114.40	133.34	148.74
EBITDA (%)	21.5	22.1	22.6	23.1	23.4
EBITDA Growth (%)	(0.3)	17.2	11.0	16.6	11.5
Depreciation	5.69	8.35	14.52	20.08	21.60
EBIT	82.27	94.74	99.88	113.26	127.13
Other Income	11.03	10.24	11.78	9.64	7.73
Interest	0.95	0.89	0.69	0.76	0.98
PBT	92.35	104.09	110.97	122.14	133.88
Tax (incl deferred)	18.83	19.52	23.17	26.44	29.45
RPAT	73.52	84.57	87.80	95.71	104.43
APAT	73.52	81.54	87.80	95.71	104.43
APAT Growth (%)	0.6	10.9	7.7	9.0	9.1
AEPS (Rs)	54.2	60.1	64.8	70.6	77.0
EPS Growth (%)	0.6	10.9	7.7	9.0	9.1

Source: Company, HDFC sec Inst Research

Consolidated Balance Sheet

YE March (Rs bn)	FY16	FY17	FY18	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	2.82	2.85	2.78	2.71	2.71
Reserves	271.09	326.64	361.08	392.42	444.78
Total Shareholders' Funds	273.91	329.50	363.86	395.13	447.49
Total Debt	9.52	4.45	3.80	7.78	8.57
Long-term Provisions & Others (Net)	(4.27)	(5.57)	(6.45)	(5.55)	(4.25)
TOTAL SOURCES OF FUNDS	279.16	328.38	361.21	397.36	451.81
APPLICATION OF FUNDS					
Net Block	35.95	39.98	44.37	51.81	59.76
CWIP	6.11	4.48	5.55	6.51	7.44
Goodwill & Other Intangible Assets	61.21	112.38	144.44	169.60	193.35
Investments	1.62	1.60	3.03	3.03	3.03
LT Loans & Advances, Others	20.59	18.04	22.52	25.74	28.49
Total Non Current Assets	125.48	176.48	219.92	256.69	292.07
Debtors	77.21	83.01	96.39	109.86	121.07
Cash & Equivalents	98.71	101.90	60.11	45.96	57.14
Other Current Assets	73.89	79.79	85.44	97.37	107.30
Total Current Assets	249.82	264.70	241.94	253.19	285.51
Creditors	7.03	8.01	9.18	10.39	11.41
Other Current Liabilities & Provns	89.11	104.79	91.47	102.13	114.35
Total Current Liabilities	96.14	112.80	100.65	112.52	125.77
Net Current Assets	153.68	151.90	141.29	140.67	159.74
TOTAL APPLICATION OF FUNDS	279.16	328.38	361.21	397.36	451.81

Source: Company, HDFC sec Inst Research

Consolidated Cash Flow

YE March (Rs bn)	FY16	FY17	FY18	FY19E	FY20E
Reported PBT	92.35	104.09	110.97	122.14	133.88
Non-operating & EO items	(1.26)	2.20	(3.54)	0.22	0.72
Interest expenses	0.95	0.89	0.69	0.76	0.98
Depreciation	5.69	8.35	14.52	20.08	21.60
Working Capital Change	(23.16)	4.96	(31.17)	(13.52)	(7.90)
Tax paid	(18.83)	(19.52)	(23.17)	(26.44)	(29.45)
OPERATING CASH FLOW (a)	55.75	100.97	68.30	103.24	119.83
Capex	(18.06)	(58.52)	(58.36)	(42.67)	(40.30)
<i>Free cash flow (FCF)</i>	<i>37.70</i>	<i>42.45</i>	<i>9.94</i>	<i>60.56</i>	<i>79.53</i>
Investments	(7.49)	(0.83)	0.41	(14.18)	(16.67)
INVESTING CASH FLOW (b)	(25.54)	(59.35)	(57.96)	(56.86)	(56.97)
Debt Issuance	4.28	(5.07)	(0.65)	3.98	0.79
Interest expenses	(0.95)	(0.89)	(0.69)	(0.76)	(0.98)
<i>FCFE</i>	<i>41.02</i>	<i>36.49</i>	<i>8.60</i>	<i>63.78</i>	<i>79.34</i>
Share capital Issuance	0.01	0.03	(0.07)	(0.07)	-
Dividend/ Buyback	(34.66)	(41.10)	(55.05)	(64.41)	(52.07)
FINANCING CASH FLOW (c)	(31.32)	(47.03)	(56.46)	(61.26)	(52.25)
NET CASH FLOW (a+b+c)	(1.12)	(5.40)	(46.12)	(14.87)	10.60
Closing Cash & Equivalents	98.71	101.90	60.11	45.96	57.14

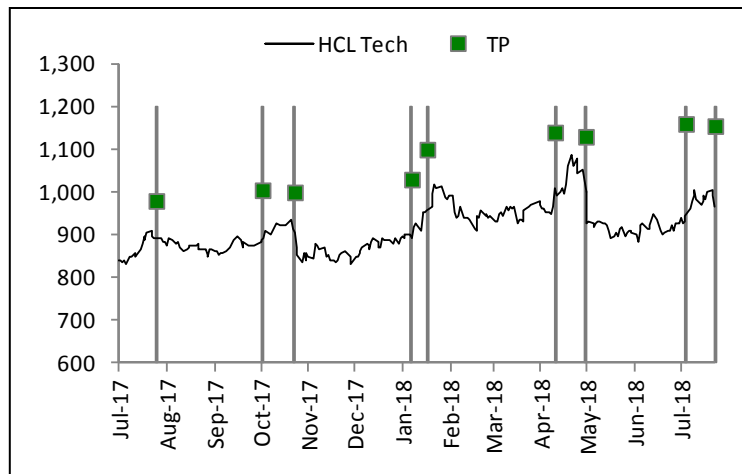
Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18	FY19E	FY20E
PROFITABILITY (%)					
EBITDA Margin	21.5	22.1	22.6	23.1	23.4
APAT Margin	18.0	17.5	17.4	16.6	16.4
RoE	28.4	27.0	25.3	25.2	24.8
RoIC or Core RoCE	41.1	37.8	30.0	27.2	26.6
RoCE	28.2	26.9	25.5	25.3	24.6
EFFICIENCY					
Tax Rate (%)	20.4	18.8	20.9	21.6	22.0
Fixed Asset Turnover (x)	5.7	6.0	6.0	5.8	5.6
<i>Debtors (days)</i>	<i>69</i>	<i>65</i>	<i>70</i>	<i>70</i>	<i>70</i>
<i>Other current assets (days)</i>	<i>66</i>	<i>62</i>	<i>62</i>	<i>62</i>	<i>62</i>
<i>Payables (days)</i>	<i>6</i>	<i>6</i>	<i>7</i>	<i>7</i>	<i>7</i>
<i>Other current liab & prov (days)</i>	<i>79</i>	<i>82</i>	<i>66</i>	<i>65</i>	<i>66</i>
Cash Conversion Cycle (days)	51	41	60	61	60
Net Debt/EBITDA (x)	(1.0)	(0.9)	(0.5)	(0.3)	(0.3)
Net Debt/Equity (x)	(0.3)	(0.3)	(0.2)	(0.1)	(0.1)
Interest Coverage (x)	86.2	106.3	144.8	149.7	129.5
PER SHARE DATA					
EPS (Rs/sh)	54.2	60.1	64.8	70.6	77.0
CEPS (Rs/sh)	56.1	63.0	73.5	85.4	93.0
DPS (Rs/sh)	21.0	24.0	12.0	15.0	32.0
BV (Rs/sh)	195.6	232.1	261.3	291.4	330.0
VALUATION					
P/E	18.5	16.9	15.3	13.7	12.5
P/BV	4.9	4.2	3.7	3.3	2.9
EV/EBITDA	14.4	12.2	11.4	9.9	8.8
OCF/EV (%)	4.4	8.0	5.2	7.8	9.1
FCF/EV (%)	3.0	3.4	0.8	4.6	6.1
FCFE/mkt cap (%)	3.0	2.7	0.6	4.7	5.8
Dividend Yield (%)	2.2	2.5	1.2	1.6	3.3

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
27-Jul-17	890	BUY	980
4-Oct-17	883	BUY	1,005
26-Oct-17	907	BUY	1,000
10-Jan-18	894	BUY	1,030
19-Jan-18	958	BUY	1,100
12-Apr-18	967	BUY	1,140
2-May-18	1,101	BUY	1,130
6-Jul-18	944	BUY	1,160
28-Jul-18	964	BUY	1,155

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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