

IMS growth momentum back on track

HCLT reported USD revenue growth of 2.1% QoQ (CC growth of 3% QoQ) to USD 2,099mn (DCMe: 2,106mn) primarily driven by healthy growth in IMS & ERD services. INR revenue grew 7.1% QoQ to ₹ 148.6bn (DCMe: ₹ 147.7bn) helped by INR depreciation. EBIT margin improved 22bps QoQ at 19.9% (DCMe: 20.5%) helped by INR dep (+90bps), Productivity improvement (+80bps) which was partial offset by negative impact of Wage hike (-70bps), SG&A expense (-50bps) and others (-30bps). PAT grew by 5.2% QoQ to ₹ 25.2bn (DCMe: ₹ 25.9bn) on back of lower forex gain during the quarter.

US continues to outperform; Healthy growth in IMS & ERD

US grew 4.4% QoQ while Europe underperformed with a decline of 0.9% QoQ due to some client specific issue and ROW improved 4.9% QoQ (all in CC terms). Among the services, Application services improved 0.4% QoQ and IMS grew 2.5% QoQ; Engineering services reported healthy growth of 6.3% QoQ and business services grew 7.3% QoQ (all in CC terms). Among the verticals, Retail grew 13% QoQ, Life science grew 3.2% QoQ, Technology grew 2.2% QoQ and Manufacturing grew 1.7% QoQ (all in CC terms).

Product & Platform will drive growth in Mode 3 services

Mode 2 and 3 revenues which together contributes 28% witnessed robust growth of 7.1% QoQ. Mode 2 operates at EBIT margin of 10.8% while Mode 3 has EBIT margin of 24.4% which is higher than company's avg. margin. Company expects margins in Mode 3 services to be in the range of 24-25% going ahead since Product & Platforms is more or less seasonal in nature. Company witnesses Mode 3 services at real inflection point and growth will be driven with the help of Product & Platform business.

View

The management maintained its revenue guidance for FY19 at 9.5%-11.5% in CC terms which translates to 8.2%-10.2% in USD terms. HCLT expects its revenue to be at the mid-point of the guided range; we have estimated USD revenue growth of 9% in FY19 driven by healthy recovery in IMS.

Q2FY19 Result (₹ Mn)

Particulars	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)
Revenue	148,581	124,356	19.5	138,679	7.1
Total Expense	113,719	96,763	17.5	106,441	6.8
EBITDA	34,862	27,593	26.3	32,238	8.1
Depreciation	5,310	3,083	72.2	4,961	7.0
EBIT	29,552	24,510	20.6	27,277	8.3
Other Income	2,478	2,973	(16.7)	2,957	(16.2)
Interest	0	0		0	
EBT	32,030	27,483	20.6	30,233	5.9
Tax	6,783	5,612	20.9	6,224	9.0
RPAT	25,247	21,872	15.4	24,010	5.2
APAT	25,247	21,872	15.4	24,010	5.2
			(bps)		(bps)
Gross Margin (%)	35.4	34.0	144	34.4	105
EBITDA Margin (%)	23.5	22.2	127	23.2	22
NPM (%)	17.0	17.6	(60)	17.3	(32)
Tax Rate (%)	21.2	20.4	76	20.6	59
EBIT Margin (%)	19.9	19.7	18	19.7	22

CMP	₹ 952
Target / Upside	₹ 1,300 / 37%
BSE Sensex	33,847
NSE Nifty	10,147

Script Details

Equity / FV	₹ 1,010mn / ₹ 2
Market Cap	₹ 1,310bn
	US\$ 18bn
52-week High/Low	₹ 1,125/₹ 825
Avg. Volume (no)	2,333,910
NSE Symbol	HCLTECH
Bloomberg Code	HCLT IN

Shareholding Pattern Sep'18(%)

Promoters	60.2
MF/Banks/FIs	8.2
FIIIs	28.0
Public / Others	3.7

Valuation (x)

	FY19E	FY20E	FY21E
P/E	12.5	11.1	9.9
EV/EBITDA	8.5	7.6	6.6
ROE (%)	26.2	24.4	22.8
RoACE (%)	(6.5)	(6.2)	(5.8)

Estimates (₹ mn)

	FY19E	FY20E	FY21E
Revenue	602,865	693,295	785,296
EBITDA	145,077	163,618	186,900
PAT	105,111	118,074	132,414
EPS (₹)	76.4	85.8	96.2

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HCLT has guided for more of organic growth as compared inorganic growth; organic growth is expected to be driven by healthy growth in Engineering/IMS services and strong deal pipeline. Company expects Q3FY19 to be solid quarter on back of many deals signed earlier and also H&D International (Germany company) which was acquired will have full quarter revenue impact. During the quarter, HCLT signed 17 transformational deals which help in driving the revenue growth momentum ahead. The management has maintained its EBIT margin guidance of 19.5%-20.5% for FY19; we expect HCLT to report margins towards upper end of its guidance helped by strong traction in Mode 2 & Mode 3 services. HCLT is trading at fair valuations of 11.1x based on FY20 earnings estimates, which is a steep discount of 44% vs TCS; expect the discount to narrow in near term driven by growth in digital services and recovery in IMS. We largely maintain our estimates and BUY rating with a revised TP of ₹ 1,300 based on 14.5x one-year fwd. PER.

Exhibit 1: Q2FY19 Performance

₹ mn	Q2FY19	DCMe	Difference (%)	Q1FY19	QoQ(%)	Q2FY18	YoY(%)
USD revenue (USD mn)	2,099	2,106	(0.4)	2,055	2.1	1,928	8.8
Revenue	148,581	147,657	0.6	138,679	7.1	124,356	19.5
EBIT	29,552	30,270	(2.4)	27,277	8.3	24,510	20.6
Net Profit	25,247	25,950	(2.7)	24,010	5.2	21,872	15.4
EPS (₹)	18.3	18.8	(2.7)	17.4	5.2	15.9	15.4
Margins (%) (Incl Adj)							
EBIT Margin	19.9	20.5	(61)	19.7	22	19.7	18
Net Margin	17.0	17.6	(58)	17.3	(32)	17.6	(60)

Source: DART, Company

Exhibit 2: Revenue CC Growth

	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Revenue (USD mn)	1,738	1,774	1,811	1,864	1,902	1,992	2,012	2,094	2,116
Growth QoQ%	2.8	3.0	3.8	2.6	0.9	3.3	1.2	2.7	3.0

Source: DART, Company

Exhibit 3: Geographic CC Growth

	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
America	5.5	1.7	5.3	3.8	1.5	4.9	(0.7)	5.9	4.4
Europe	(2.1)	6.8	(3.0)	(0.4)	4.4	1.9	3.6	(1.0)	(0.9)
ROW	2.0	(0.5)	15.8	3.1	(12.0)	(3.9)	8.1	(7.1)	4.9

Source: DART, Company

Exhibit 4: Service CC Growth

Services (QoQ%)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Application Services	1.4	2.0	1.8	1.6	0.0	1.6	(0.9)	0.8	0.4
Infrastructure Services	4.4	2.1	0.9	1.7	(0.2)	(1.2)	2.5	0.6	2.5
BPO services	2.1	2.9	0.2	(6.7)	2.9	5.0	5.3	38.8	7.3
Engineering and R&D Serv.	2.3	7.1	14.6	7.9	4.4	13.6	1.7	3.1	6.3

Source: DART, Company

Exhibit 5: Vertical CC Growth

Verticals (QoQ%)	Q1FY19	Q2FY19
Financial Services	(1.4)	0.1
Manufacturing	(1.3)	1.7
Technology & Services	9.3	2.2
Retail & CPG	(1.6)	13
Telecom & Media	0.2	1.1
Lifesciences & Healthcare	13.4	3.2
Public services	3.5	5.3

Source: DART, Company

Exhibit 6: Geographic Split

Revenue (USD mn)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
US	1,203	1,325	1,381	4.2	14.8
Europe	561	577	562	(2.6)	0.2
Asia Pacific	164	154	155	0.8	(5.2)
% Total					
US	62.4	64.5	65.8	130 bps	340 bps
Europe	29.1	28.1	26.8	(130 bps)	(230 bps)
Asia Pacific	8.5	7.5	7.4	(10 bps)	(110 bps)

Source: DART, Company

Exhibit 7: Service Split

Revenue (USD mn)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
Application Services	692	699	695	(0.6)	0.4
Engineering and R&D Services	424	503	535	6.3	26.2
Infrastructure Services	742	744	755	1.6	1.8
BPO services	69	107	113	6.1	63.3
% Total					
Application Services	35.9	34.0	33.1	(90 bps)	(280 bps)
Engineering and R & D services	22.0	24.5	25.5	100 bps	350 bps
Infrastructure Services	38.5	36.2	36.0	(20 bps)	(250 bps)
BPO services	3.6	5.2	5.4	20 bps	180 bps

Source: DART, Company

Exhibit 8: Vertical Split

Revenue (USD mn)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
Financial Services	482	489	483	(1.3)	0.1
Manufacturing	403	376	378	0.5	(6.3)
Technology & Services	280	374	382	2.1	36.6
Retail & CPG	179	187	210	12.2	17.0
Telecom, Media & Entertainment	152	150	151	0.7	(0.8)
Life science & Healthcare	226	263	271	2.9	20.0
Public Services	204	216	225	4.1	9.9
% of Total Revenue					
Financial Services	25.0	23.8	23.0	(80 bps)	(200 bps)
Manufacturing	20.9	18.3	18.0	(30 bps)	(290 bps)
Technology & Services	14.5	18.2	18.2	0 bps	370 bps
Retail & CPG	9.3	9.1	10.0	90 bps	70 bps
Telecom, Media & Entertainment	7.9	7.3	7.2	(10 bps)	(70 bps)
Life science & Healthcare	11.7	12.8	12.9	10 bps	120 bps
Public Services	10.6	10.5	10.7	20 bps	10 bps

Source: DART, Company

Exhibit 9: Contract Split

Revenue by Contract Type (USD mn)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
Time & Material	763	781	802	2.7	5.0
Fixed Price Projects	1,165	1,274	1,297	1.8	11.4
% of total Revenue					
Time & Material	39.6	38.0	38.2	20 bps	(140 bps)
Fixed Price Projects	60.4	62.0	61.8	(20 bps)	140 bps

Source: DART, Company

Exhibit 10: Large Clients

Number of million-dollar clients (LTM)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
US\$ 100mn +	9	9	9	0.0	0.0
US\$ 50mn +	25	32	31	(3.1)	24.0
US\$ 20mn +	84	87	90	3.4	7.1
US\$ 10mn +	157	162	165	1.9	5.1
US\$ 5mn +	259	267	269	0.7	3.9
US\$ 1mn +	536	571	575	0.7	7.3

Source: DART, Company

Exhibit 11: Client Concentration

Revenue (USD mn)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
Top 5 Clients	291	349	363	3.9	24.7
Top 10 Clients	442	505	520	3.0	17.9
Top 20 Clients	640	703	718	2.1	12.1
% of Total Revenue					
Top 5 Clients	15.1	17.0	17.3	30 bps	220 bps
Top 10 Clients	22.9	24.6	24.8	20 bps	190 bps
Top 20 Clients	33.2	34.2	34.2	0 bps	100 bps

Source: DART, Company

Exhibit 12: Headcount Metrics

Headcount	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
Utilisation offshore (incl. trainees) - Software Services	86.0	85.5	86.7	120 bps	70 bps
Attrition LTM - IT Services (Software + Infrastructure)	15.7	16.3	17.1	80 bps	140 bps
Attrition LTM - BPO	6.3	7.0	8.5	150 bps	220 bps
Total headcount	119,040	124,121	127,875	3.0	7.4
Gross Addition - Total	8,645	12,558	11,683	(7.0)	35.1

Source: DART, Company

Exhibit 13: Client Data & Business

Client data and business (LTM)	Q2FY18	Q1FY19	Q2FY19	QoQ(%)	YoY(%)
New business	2.6	3.1	3.1	0 bps	50 bps
Repeat Business	97.4	96.9	96.9	0 bps	(50 bps)

Source: DART, Company

Exhibit 14: Estimate Revision

(₹ mn, YE March)	New			Old			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	603,282	693,295	785,296	588,860	677,571	775,914	2.4	2.3	1.2
EBIT	123,012	138,689	155,964	120,875	136,098	154,515	1.8	1.9	0.9
Pre-Tax Profit	133,543	150,412	168,681	132,469	147,406	168,733	0.8	2.0	(0.0)
Net Profit	105,212	118,074	132,414	103,754	114,976	131,612	1.4	2.7	0.6
EPS (₹)	76.4	85.8	96.2	75.4	83.5	95.6	1.4	2.7	0.6
Margins (%)									
EBIT Margin	20.4	20.0	19.9	20.5	20.1	19.9			
Net margin	17.4	17.0	16.9	17.6	17.0	17.0			

Source: DART, Company

Profit and Loss Account

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Revenue	505,728	602,865	693,295	785,296
Total Expense	391,338	457,788	529,677	598,395
COGS	332,388	390,772	448,562	509,657
Employees Cost	0	0	0	0
Other expenses	58,950	67,016	81,115	88,738
EBIDTA	114,390	145,077	163,618	186,900
Depreciation	14,531	22,240	24,928	30,937
EBIT	99,859	122,837	138,689	155,964
Interest	0	0	0	0
Other Income	11,079	10,560	11,723	12,717
Exc. / E.O. items	0	0	0	0
EBT	110,938	133,397	150,412	168,681
Tax	23,171	28,286	32,339	36,266
RPAT	87,767	105,111	118,074	132,414
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	87,767	105,111	118,074	132,414

Balance Sheet

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Sources of Funds				
Equity Capital	1,010	1,114	1,160	1,189
Minority Interest	0	0	0	0
Reserves & Surplus	364,579	436,283	528,255	629,833
Net Worth	365,590	437,397	529,415	631,022
Total Debt	0	0	0	0
Net Deferred Tax Liability	0	0	0	0
Total Capital Employed	365,590	437,397	529,415	631,022

Applications of Funds

Net Block	199,467	289,164	371,650	447,915
CWIP	0	0	0	0
Investments	37,681	44,091	45,904	47,052
Current Assets, Loans & Advances	243,796	264,754	282,050	313,546
Inventories	0	0	0	0
Receivables	146,703	186,988	218,871	237,129
Cash and Bank Balances	97,092	77,766	63,179	76,417
Loans and Advances	0	0	0	0
Other Current Assets	0	0	0	0
Less: Current Liabilities & Provisions	115,353	160,613	170,189	177,490
Payables	0	0	0	0
Other Current Liabilities	115,353	160,613	170,189	177,490
Net Current Assets	128,442	104,142	111,861	136,055
Total Assets	365,590	437,397	529,415	631,022

E – Estimates

Important Ratios

Particulars	FY18A	FY19E	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	34.3	35.2	35.3	35.1
EBIDTA Margin	22.6	24.1	23.6	23.8
EBIT Margin	19.7	20.4	20.0	19.9
Tax rate	20.9	21.2	21.5	21.5
Net Profit Margin	17.4	17.4	17.0	16.9
(B) As Percentage of Net Sales (%)				
COGS	65.7	64.8	64.7	64.9
Employee	0.0	0.0	0.0	0.0
Other	11.7	11.1	11.7	11.3
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage				
Inventory days	0	0	0	0
Debtors days	106	113	115	110
Average Cost of Debt				
Payable days	0	0	0	0
Working Capital days	93	63	59	63
FA T/O	2.5	2.1	1.9	1.8
(D) Measures of Investment				
AEPS (₹)	63.8	76.4	85.8	96.2
CEPS (₹)	74.3	92.5	103.9	118.7
DPS (₹)	8.0	25.6	32.0	32.0
Dividend Payout (%)	12.5	33.5	37.3	33.3
BVPS (₹)	265.6	317.8	384.7	458.5
RoANW (%)	24.7	26.2	24.4	22.8
RoACE (%)	(5.9)	(6.5)	(6.2)	(5.8)
RoAIC (%)	41.4	39.1	33.6	30.6
(E) Valuation Ratios				
CMP (₹)	952	952	952	952
P/E	14.9	12.5	11.1	9.9
Mcap (₹ Mn)	1,309,635	1,309,635	1,309,635	1,309,635
MCap/ Sales	3.6	3.0	2.5	2.1
EV	1,212,543	1,231,869	1,246,456	1,233,219
EV/Sales	2.4	2.0	1.8	1.6
EV/EBITDA	10.6	8.5	7.6	6.6
P/BV	3.6	3.0	2.5	2.1
Dividend Yield (%)	0.8	2.7	3.4	3.4
(F) Growth Rate (%)				
Revenue	8.2	19.2	15.0	13.3
EBITDA	10.9	26.8	12.8	14.2
EBIT	5.3	23.0	12.9	12.5
PBT	6.5	20.2	12.8	12.1
APAT	3.7	19.8	12.3	12.1
EPS	3.7	19.8	12.3	12.1

Cash Flow

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
CFO	81,192	100,588	118,695	151,128
CFI	(46,163)	(118,348)	(109,227)	(108,350)
CFF	(68,472)	(1,567)	(24,055)	(29,541)
FCFF	(3,969)	3,407	12,090	44,438
Opening Cash	130,535	97,092	77,766	63,179
Closing Cash	97,092	77,766	63,179	76,417

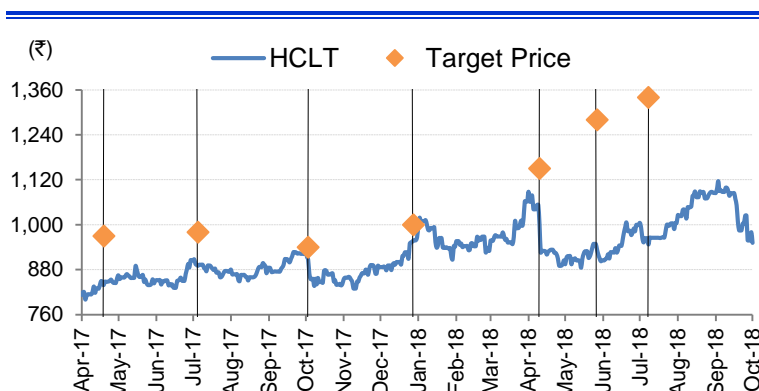
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹) *
May-17	Buy	970	839
Jul-17	Accumulate	980	890
Oct-17	Reduce	940	907
Jan-18	Accumulate	1,000	958
May-18	Accumulate	1,150	1,001
Jun-18	Buy	1,280	933
Jul-18	Buy	1,340	947

*Price as on Recommendation Date

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