

Stock Update

In-line quarter, maintain Buy

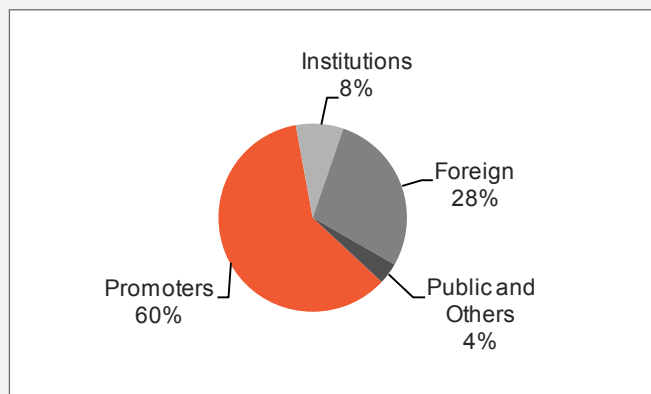
HCL Technologies

Reco: Buy | CMP: Rs953

Company details

Price target:	Rs1,215
Market cap:	Rs132,672 cr
52-week high/low:	Rs1,124/825
NSE volume: (No of shares)	20.3 lakh
BSE code:	532281
NSE code:	HCLTECH
Sharekhan code:	HCLTECH
Free float: (No of shares)	55.5 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.7	-1.7	-7.4	7.2
Relative to Sensex	-2.5	4.9	-7.3	0.6

Key points

- ♦ **Largely in-line numbers:** HCL Tech reported a stable quarter with an in-line performance in USD revenue and EBIT margin during Q2FY2019. CC revenue growth was slightly below expectations at 3% q-o-q and 10.5% y-o-y, led by healthy growth in IMS services (2.5% q-o-q) and ERD business (6.3% q-o-q). On a reported basis, USD revenues grew by 2.1% q-o-q to \$2,098.6 million (in-line with our estimates) in Q2FY2019. EBITDA margin improved by 30BPS q-o-q to 23.5%, a tad ahead of our expectations, driven by rupee tailwind (90 bps) and operational efficiencies (30 bps), partially offset by wage revision (70 bps) and higher SG&A expenses. Improved profitability along with higher-than-expected other income (19.6% q-o-q) was being partially offset by lower forex gains (down 51.7% q-o-q), resulted in 5.7% q-o-q growth in net profit to Rs. 2,540 crore (in-line with our estimates).
- ♦ **Guidance maintained; global IMS growth bounced back:** The management has retained its CC revenue growth guidance (9.5-11.5% y-o-y) and EBIT margin guidance (19.5-20.5%) for FY2019, in-line with our expectations. The management hopes that it would comfortably achieve the mid-point of revenue guidance for FY2019. Revenue from Mode 2 (digital services) and Mode 3 (product & platform) grew at 5.3% q-o-q and 10.4% q-o-q (despite weak seasonality) respectively, taking the combined revenue contribution to total revenues to 27.9% (vs 26.6% in Q1FY19). Global IMS delivered a strong growth of 3.3% q-o-q in CC, whereas ERD growth led by the technology and services, telecom and life sciences and healthcare along with revenue from the acquisition (Actian Corporation and recent IP acquired last quarter). Regionally, North America reported CC revenue growth of 4.4% q-o-q, while Europe declined by 0.9% q-o-q on CC terms owing to the weakness in the financial services. RoW business CC revenue grew by 4.9% q-o-q in Q2FY19. In vertical, Retail & CPG, life sciences and healthcare, public services and technology and services delivered 13%, 3.2%, 5.3% and 2.2% on sequential basis. Financial services revenue growth remained muted during Q2FY19 owing to headwinds in two of its clients. The company secured 17 transformational deals in Mode 1 and Mode 2 services, along with IMS, ERD and BPO Services, while the bookings during the quarter was higher than the average of last four quarters (include record high bookings in Q1F2019).

- ◆ **Remains optimistic for higher organic growth in FY2019:** The management cited that the organic contribution to overall growth would be better as compared to inorganic growth contribution for FY2019, though it mentioned at the the starting of the year that the growth would be evenly distributed between organic and inorganic. During Q2FY19, the organic growth was slightly lesser than 2%, while the remaining growth (around 1%) was mostly derived from Actian acquisition. Further, the ramp-up of deal wins in recent quarters and healthy growth momentum in ERD business would drive the organic growth in FY2019E. The management highlighted that Q3FY2019 is expected to be a strong quarter on account of strong seasonality in IP product business. We see a favorable set-up for better organic growth in FY2020E led by continued growth momentum in ERD business (driven by higher adoption of IoT, softwarisation and cloudification), lower

renewals in IMS services in FY2020 versus FY2019 and focus on organic IP products. The management believes that the margins would remain under guided range in FY2019 despite higher revenues from IP products in 2HFY2019, owing to continued investments on building up digital competencies and sales resources and higher subcontractor expenses.

- ◆ **Maintain Buy with an unchanged price target of Rs. 1,215:** We have broadly maintained earnings estimates for FY2019/FY2020E and introduced FY2021E numbers in this note. We see positive setups for organic revenue growth in FY2020E on account of a ramp-up of infra related deals, incremental deal pipelines and traction in ERD services. At CMP, the stock price is trading at an attractive valuation of 12x of FY2020 EPS estimate, makes risk-reward ratio favorable. Thus, we maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,215.

Valuations

				Rs cr
Particulars	FY18	FY19E	FY20E	FY21E
Net sales	50,570.0	60,405.3	67,140.1	71,549.5
EBITDA margin (%)	22.6	23.3	23.3	23.1
Net profit	8,780.0	10,087.8	11,258.5	11,833.7
EPS (Rs.)	63.1	72.5	80.9	85.0
P/E (x)	15.1	13.1	11.8	11.2
EV/EBITDA (x)	11.3	9.2	8.2	7.8
RoE (%)	25.3	25.7	24.9	23.2
RoCE (%)	30.0	30.9	30.4	28.5

Results

					Rs cr
Particulars	Q2FY19	Q2FY18	Q1FY19	YoY (%)	QoQ (%)
Revenue (\$ mn)	2,098.6	1,928.0	2,054.5	8.8	2.1
Net sales	14,861.0	12,434.0	13,878.0	19.5	7.1
Direct costs	9,589.0	8,208.0	9,107.0	16.8	5.3
Gross profit	5,272.0	4,226.0	4,771.0	24.8	10.5
SG&A	1,773.0	1,467.0	1,546.0	20.9	14.7
EBITDA	3,499.0	2,759.0	3,225.0	26.8	8.5
Depreciation & amortisation	533.0	308.0	496.0	73.1	7.5
EBIT	2,966.0	2,451.0	2,729.0	21.0	8.7
Forex gain/(loss)	69.0	144.0	143.0	-52.1	-51.7
Other income	183.0	154.0	153.0	18.8	19.6
PBT	3,218.0	2,749.0	3,025.0	17.1	6.4
Tax provision	678.0	561.0	622.0	20.9	9.0
Net profit	2,540.0	2,188.0	2,403.0	16.1	5.7
EPS (Rs)	18.2	15.7	17.3	16.1	5.7
Margin (%)				BPS	BPS
EBITDA	23.5	22.2	23.2	136	31
EBIT	20.0	19.7	19.7	25	29
NPM	17.1	17.6	17.3	-51	-22

Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y	q-o-q	y-o-y
Revenues (\$ mn)	2,099	100	2.1	8.8	3.0	10.5
Geographic mix						
Americas	1,381	65.8	4.2	14.8	4.4	15.1
Europe	562	26.8	-2.6	0.2	-0.9	3.5
RoW	155	7.4	0.8	-5.2	4.9	0.7
Industry verticals						
Financial services	483	23.0	-1.3	0.1	0.1	2.3
Manufacturing	378	18.0	0.5	-44.7	1.7	-3.9
Technology & services	382	18.2	2.1	36.6	2.2	36.3
Retail & CPG	210	10.0	12.2	17.0	13.0	19.2
Telecommunications, media, publishing & entertainment	151	7.2	0.7	-0.8	1.1	-0.8
Lifesciences & healthcare	271	12.9	2.9	20.0	3.2	19.8
Public services	225	10.7	4.1	9.9	5.3	13.3
Service line						
Application services	695	33.1	-0.6	0.4	0.4	1.8
Infrastructure Services	755	36.0	1.6	1.8	2.5	4.4
ERD services	535	25.5	6.3	26.2	6.3	26.3
BPO	113	5.4	6.1	63.3	7.3	64.8
Clients Contribution						
Top 5	363	17.3	3.9	24.7	-	-
Top 10	520	24.8	3.0	17.9	-	-
Top 20	718	34.2	2.1	12.1	-	-

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