

View: IMS Continues to outperform

The management maintained its revenue guidance for FY19 at 9.5%-11.5% in CC terms, which translates to 7.9%-9.9% in USD terms. HCLT expects its revenue to be at the upper end of the guided range. We estimate a USD revenue growth of 9.7% in FY19, driven by healthy recovery in IMS and the core business (Mode 1). HCLT believes that organic component will contribute more, as compared to inorganic growth in FY19. On the its upper end of the guided range, organic growth would be around 6.5% and remaining 5% would be inorganic. During the quarter, HCLT signed 17 transformational deals that should help drive revenue growth. The management has maintained its EBIT margin guidance of 19.5%-20.5% for FY19. We expect HCLT to report margins in the midpoint of its guidance, due to continuing investment in Mode 2 and Mode 3 services. HCLT is trading at fair valuations of 11.3x/9.9x, based on FY20/FY21 earnings estimates. We upgrade our earnings estimates by 1.8%/3.3% for FY20/FY21, factoring likely future margin improvement. We maintain our BUY rating, with a revised TP of ₹ 1,350, based on 14x one-year fwd. PER.

USD revenue above expectation, but margins dipped

HCLT's USD revenue rose 4.9% QoQ (CC growth of 5.6% QoQ) to USD 2,202mn (DCMe: 2,145mn), primarily driven by a healthy growth in IMS and ERD services. The USD revenue, included a 1% QoQ (inorganic) growth on account of the H&D acquisition. INR revenue grew 6% QoQ to ₹ 157.4bn (DCMe: ₹ 154.5bn), helped by INR depreciation. The EBIT margin fell 33bps QoQ to 19.6% (DCMe: 20%), due to wage hike (-45bps), offset by the positive impact of INR dep (+15bps). PAT grew 3.1% QoQ to ₹ 26bn (DCMe: ₹ 26.3bn), due to a lower tax rate (18%) in the quarter.

Better margins in Mode 3 services

Mode 2 and 3 revenues, which together contributes 29%, rose 13.1% and 6.2%, QoQ, respectively, in CC terms. Mode 2 operates at an EBIT margin of 12.3%, while Mode 3's is 23%, which is higher than the company's average. Company continues similar investments in Mode 2 and Mode 3 services as in the past and expects better margins in Mode 3 services in FY20. The company also expects the deal with IBM to close by mid-June 2019 and believes that the product acquired will help revenue growth in Mode 3 services from Q2FY20 onwards.

Q3FY19 Result (₹ Mn)

Particulars	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Revenue	157,363	127,995	22.9	148,518	6.0
Total Expense	120,958	98,384	22.9	113,671	6.4
EBITDA	36,405	29,611	22.9	34,847	4.5
Depreciation	5,625	4,547	23.7	5,308	6.0
EBIT	30,779	25,064	22.8	29,539	4.2
Other Income	1,029	2,634	(60.9)	2,477	(58.4)
Interest	0	0		0	
EBT	31,809	27,698	22.8	32,016	(0.6)
Tax	5,640	5,790	(2.6)	6,780	(16.8)
RPAT	26,169	21,909	19.4	25,237	3.7
APAT	26,169	21,909	19.4	25,237	3.7
			(bps)		(bps)
Gross Margin (%)	35.3	34.3	95	35.4	(16)
EBITDA Margin (%)	23.1	23.1	0	23.5	(33)
NPM (%)	16.6	17.1	(49)	17.0	(36)
Tax Rate (%)	17.7	20.9	(317)	21.2	(345)
EBIT Margin (%)	19.6	19.6	(2)	19.9	(33)

CMP	₹ 988
Target / Upside	₹ 1,350 / 37%
BSE Sensex	35,593
NSE Nifty	10,652

Scrip Details

Equity / FV	₹ 1,093mn / ₹ 2
Market Cap	₹ 1,360bn
	US\$ 19bn
52-week High/Low	₹ 1,125/₹ 880
Avg. Volume (no)	2,006,160
NSE Symbol	HCLTECH
Bloomberg Code	HCLT IN

Shareholding Pattern Dec'18(%)

Promoters	60.2
MF/Banks/FIs	8.2
FII's	28.3
Public / Others	3.4

Valuation (x)

	FY19E	FY20E	FY21E
P/E	13.2	11.3	9.9
EV/EBITDA	9.0	7.4	6.2
ROE (%)	26.8	26.4	24.5
RoACE (%)	26.8	26.4	24.5

Estimates (₹ mn)

	FY19E	FY20E	FY21E
Revenue	601,063	696,625	783,153
EBITDA	141,592	165,797	186,390
PAT	103,115	120,129	136,754
EPS (₹)	74.9	87.3	99.4

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Europe outperformed among geographies; strong IMS and ERD growth

US rose 2.7% QoQ, while Europe outperformed with a growth of 12.9% QoQ, due to resolution of client specific issue faced earlier. ROW improved 4.5% QoQ (all in CC terms). Among the services, Application and IMS rose 2.3% and 10.4% QoQ, respectively. Engineering services reported a growth of 5.1% QoQ, while business services de-grew 3.7% QoQ (all in CC terms). Among the verticals, Telecom rose 35.4% QoQ. A few of the others grew as follows QoQ: Retail 8.4%, Technology 7.5%, and Manufacturing 3.9% (all in CC terms). However, the BFSI vertical was muted (-0.6% QoQ in CC terms), on account of a fall in two large accounts. The healthy growth in IMS and Telecom was driven by the ramp up in three large deals announced earlier. The company expects the growth momentum to continue in the next few quarters.

Exhibit 1: Q3FY19 Performance

₹ mn	Q3FY19	DCMe	Difference (%)	Q2FY19	QoQ(%)	Q3FY18	YoY(%)
USD revenue (USD mn)	2,202	2,145	2.6	2,099	4.9	1,988	10.8
Revenue	157,363	154,496	1.9	148,518	6.0	127,995	22.9
EBIT	30,779	30,899	(0.4)	29,539	4.2	25,064	22.8
Net Profit	26,019	26,297	(1.1)	25,237	3.1	21,909	18.8
EPS (₹)	18.9	19.1	(1.1)	18.3	3.1	15.9	18.8
Margins (%)			bps		bps		bps
EBIT Margin	19.6	20.0	(44)	19.9	(33)	19.6	(2)
Net Margin	16.5	17.0	(49)	17.0	(46)	17.1	(58)

Source: DART, Company

Exhibit 2: Revenue CC Growth

	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Revenue (USD mn)	1,774	1,811	1,864	1,902	1,992	2,012	2,094	2,116	2216
Growth QoQ%	3.0	3.8	2.6	0.9	3.3	1.2	2.7	3.0	5.6

Source: DART, Company

Exhibit 3: Geographic CC Growth

	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
America	1.7	5.3	3.8	1.5	4.9	(0.7)	5.9	4.4	2.7
Europe	6.8	(3.0)	(0.4)	4.4	1.9	3.6	(1.0)	(0.9)	12.9
ROW	(0.5)	15.8	3.1	(12.0)	(3.9)	8.1	(7.1)	4.9	4.5

Source: DART, Company

Exhibit 4: Service CC Growth

Services (QoQ%)	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Application Services	2.0	1.8	1.6	0.0	1.6	(0.9)	0.8	0.4	2.3
Infrastructure Services	2.1	0.9	1.7	(0.2)	(1.2)	2.5	0.6	2.5	10.4
BPO services	2.9	0.2	(6.7)	2.9	5.0	5.3	38.8	7.3	(3.7)
Engineering and R&D Serv.	7.1	14.6	7.9	4.4	13.6	1.7	3.1	6.3	5.1

Source: DART, Company

Exhibit 5: Vertical CC Growth

Verticals (QoQ%)	Q1FY19	Q2FY19	Q3FY19
Financial Services	(1.4)	0.1	(0.6)
Manufacturing	(1.3)	1.7	3.9
Technology & Services	9.3	2.2	7.5
Retail & CPG	(1.6)	13	8.4
Telecom & Media	0.2	1.1	35.4
Lifesciences & Healthcare	13.4	3.2	5.8
Public services	3.5	5.3	(4.4)

Source: DART, Company

Exhibit 6: Geographic Split

Revenue (USD mn)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
US	1262	1381	1418	2.7	12.3
Europe	570	562	621	10.4	8.8
Asia Pacific	157	155	161	3.5	2.4
% Total					
US	63.5	65.8	64.4	(140 bps)	90 bps
Europe	28.7	26.8	28.2	140 bps	(50 bps)
Asia Pacific	7.9	7.4	7.3	(10 bps)	(60 bps)

Source: DART, Company

Exhibit 7: Service Split

Revenue (USD mn)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
Application Services	702	695	704	1.4	0.4
Engineering and R&D Services	481	535	561	4.9	16.7
Infrastructure Services	729	755	826	9.3	13.2
BPO services	74	113	110	(2.9)	49.7
% Total					
Application Services	35.3	33.1	32.0	(110 bps)	(330 bps)
Engineering and R & D services	24.2	25.5	25.5	0 bps	130 bps
Infrastructure Services	36.7	36.0	37.5	150 bps	80 bps
BPO services	3.7	5.4	5.0	(40 bps)	130 bps

Source: DART, Company

Exhibit 8: Vertical Split

Revenue (USD mn)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
Financial Services	489	483	476	(1.5)	(2.7)
Manufacturing	396	378	390	3.2	(1.5)
Technology & Services	332	382	412	7.8	24.0
Retail & CPG	191	210	225	7.0	17.7
Telecom, Media & Entertainment	147	151	203	34.0	37.7
Life science & Healthcare	233	271	286	5.7	23.1
Public Services	203	225	214	(4.9)	5.3
% of Total Revenue					
Financial Services	24.6	23.0	21.6	(140 bps)	(300 bps)
Manufacturing	19.9	18.0	17.7	(30 bps)	(220 bps)
Technology & Services	16.7	18.2	18.7	50 bps	200 bps
Retail & CPG	9.6	10.0	10.2	20 bps	60 bps
Telecom, Media & Entertainment	7.4	7.2	9.2	200 bps	180 bps
Life science & Healthcare	11.7	12.9	13.0	10 bps	130 bps
Public Services	10.2	10.7	9.7	(100 bps)	(50 bps)

Source: DART, Company

Exhibit 9: Contract Split

Revenue by Contract Type (USD mn)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
Time & Material	779	802	808	0.8	3.7
Fixed Price Projects	1208	1297	1394	7.4	15.3
% of total Revenue					
Time & Material	39.2	38.2	36.7	(150 bps)	(250 bps)
Fixed Price Projects	60.8	61.8	63.3	150 bps	250 bps

Source: DART, Company

Exhibit 10: Large Clients

Number of million-dollar clients (LTM)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
US\$ 100mn +	9	9	10	11.1	11.1
US\$ 50mn +	25	31	29	(6.5)	16.0
US\$ 20mn +	85	90	95	5.6	11.8
US\$ 10mn +	156	165	164	(0.6)	5.1
US\$ 5mn +	261	269	276	2.6	5.7
US\$ 1mn +	552	575	597	3.8	8.2

Source: DART, Company

Exhibit 11: Client Concentration

Revenue (USD mn)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
Top 5 Clients	314	363	383	5.5	22.0
Top 10 Clients	467	520	546	4.9	16.9
Top 20 Clients	666	718	751	4.6	12.8
% of Total Revenue					
Top 5 Clients	15.8	17.3	17.4	10 bps	160 bps
Top 10 Clients	23.5	24.8	24.8	0 bps	130 bps
Top 20 Clients	33.5	34.2	34.1	(10 bps)	60 bps

Source: DART, Company

Exhibit 12: Headcount Metrics

Headcount	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
Utilisation offshore (incl. trainees) - Software Services	85.8	86.7	86.6	(10 bps)	80 bps
Attrition LTM - IT Services (Software + Infrastructure)	15.2	17.1	17.8	70 bps	260 bps
Attrition LTM - BPO	5.5	8.5	8.3	(20 bps)	280 bps
Total headcount	119,291	127,875	132,328	3.5	10.9
Gross Addition - Total	7,113	11,683	13,191	12.9	85.4

Source: DART, Company

Exhibit 13: Client Data & Business

Client data and business (LTM)	Q3FY18	Q2FY19	Q3FY19	QoQ(%)	YoY(%)
New business	3.1	3.1	3.8	70 bps	70 bps
Repeat Business	96.9	96.9	96.2	(70 bps)	(70 bps)

Source: DART, Company

Exhibit 14: Estimate Revision

(₹ mn, YE March)	New			Old			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	601,317	696,953	783,153	603,282	693,295	785,296	(0.3)	0.5	(0.3)
EBIT	120,090	141,946	161,159	123,012	138,689	155,964	(2.4)	2.3	3.3
Pre-Tax Profit	129,548	153,112	174,209	133,543	150,412	168,681	(3.0)	1.8	3.3
Net Profit	103,124	120,193	136,754	105,212	118,074	132,414	(2.0)	1.8	3.3
EPS (₹)	74.9	87.3	99.4	76.4	85.8	96.2	(2.0)	1.8	3.3
Margins (%)									
EBIT Margin	20.0	20.4	20.6	20.4	20.0	19.9			
Net margin	17.1	17.2	17.5	17.4	17.0	16.9			

Source: DART, Company

Profit and Loss Account

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Revenue	505,728	601,063	696,625	783,153
Total Expense	391,338	459,471	530,828	596,762
COGS	332,388	390,091	450,716	506,700
Employees Cost	0	0	0	0
Other expenses	58,950	69,380	80,112	90,063
EBIDTA	114,390	141,592	165,797	186,390
Depreciation	14,531	21,549	23,920	25,231
EBIT	99,859	120,043	141,876	161,159
Interest	0	0	0	0
Other Income	11,079	9,512	11,154	13,050
Exc. / E.O. items	0	0	0	0
EBT	110,938	129,554	153,030	174,209
Tax	23,171	26,293	32,902	37,455
RPAT	87,767	103,115	120,129	136,754
Minority Interest	0	147	0	0
Profit/Loss share of associates	0	0	0	0
APAT	87,767	103,115	120,129	136,754

Balance Sheet

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Sources of Funds				
Equity Capital	1,010	1,093	1,157	1,186
Minority Interest	0	0	0	0
Reserves & Surplus	364,579	403,883	504,415	609,737
Net Worth	365,590	404,976	505,572	610,923
Total Debt	0	0	0	0
Net Deferred Tax Liability	0	0	0	0
Total Capital Employed	365,590	404,976	505,572	610,923

Applications of Funds

Net Block	199,467	244,766	280,345	308,642
CWIP	0	0	0	0
Investments	37,681	49,590	52,492	53,804
Current Assets, Loans & Advances	243,796	270,501	344,937	428,022
Inventories	0	0	0	0
Receivables	146,703	178,662	210,325	224,321
Cash and Bank Balances	97,092	91,839	134,611	203,701
Loans and Advances	0	0	0	0
Other Current Assets	0	0	0	0
Less: Current Liabilities & Provisions	115,353	159,881	172,202	179,546
Payables	0	0	0	0
Other Current Liabilities	115,353	159,881	172,202	179,546
Net Current Assets	128,442	110,620	172,735	248,476
Total Assets	365,590	404,976	505,572	610,923

E – Estimates

Important Ratios

Particulars	FY18A	FY19E	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	34.3	35.1	35.3	35.3
EBIDTA Margin	22.6	23.6	23.8	23.8
EBIT Margin	19.7	20.0	20.4	20.6
Tax rate	20.9	20.3	21.5	21.5
Net Profit Margin	17.4	17.2	17.2	17.5
(B) As Percentage of Net Sales (%)				
COGS	65.7	64.9	64.7	64.7
Employee	0.0	0.0	0.0	0.0
Other	11.7	11.5	11.5	11.5
(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	108	110	105
Average Cost of Debt				
Payable days	0	0	0	0
Working Capital days	93	67	91	116
FA T/O	2.5	2.5	2.5	2.5
(D) Measures of Investment				
AEPS (₹)	63.8	74.9	87.3	99.4
CEPS (₹)	74.3	90.6	104.7	117.7
DPS (₹)	8.0	23.0	31.9	32.0
Dividend Payout (%)	12.5	30.7	36.5	32.2
BVPS (₹)	265.6	294.2	367.3	443.9
RoANW (%)	24.7	26.8	26.4	24.5
RoACE (%)	24.7	26.8	26.4	24.5
RoAIC (%)	41.4	41.3	41.5	41.4
(E) Valuation Ratios				
CMP (₹)	988	988	988	988
P/E	15.5	13.2	11.3	9.9
Mcap (₹ Mn)	1,360,421	1,360,421	1,360,421	1,360,421
MCap/ Sales	2.7	2.3	2.0	1.7
EV	1,263,329	1,268,583	1,225,810	1,156,720
EV/Sales	2.5	2.1	1.8	1.5
EV/EBITDA	11.0	9.0	7.4	6.2
P/BV	3.7	3.4	2.7	2.2
Dividend Yield (%)	0.8	2.3	3.2	3.2
(F) Growth Rate (%)				
Revenue	8.2	18.9	15.9	12.4
EBITDA	10.9	23.8	17.1	12.4
EBIT	5.3	20.2	18.2	13.6
PBT	6.5	16.8	18.1	13.8
APAT	3.7	17.5	16.5	13.8
EPS	3.7	17.5	16.5	13.8

Cash Flow

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
CFO	81,192	100,286	121,555	153,908
CFI	(46,163)	(78,758)	(62,402)	(54,841)
CFF	(68,472)	(26,782)	(16,380)	(29,978)
FCFF	(3,969)	32,081	62,264	100,474
Opening Cash	130,535	97,092	91,839	134,611
Closing Cash	97,092	91,839	134,611	203,701

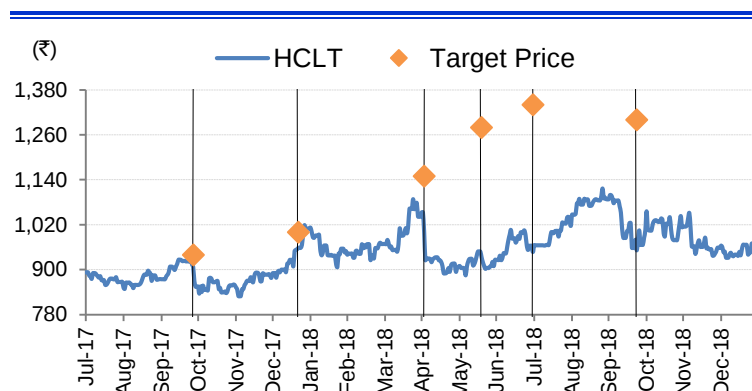
E – Estimates

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 (₹)
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
Oct-18	Buy	1,300	952

*Price as on recommendation date

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