Stock Update

Organic growth to accelerate, upgrade to Buy

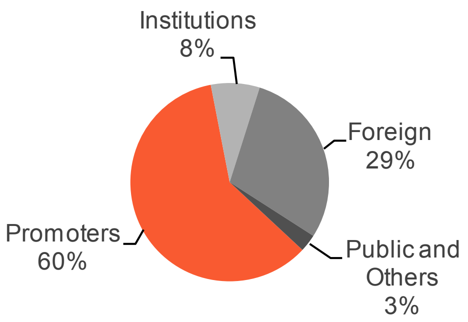
HCL Technologies

Reco: Buy | CMP: Rs1,132

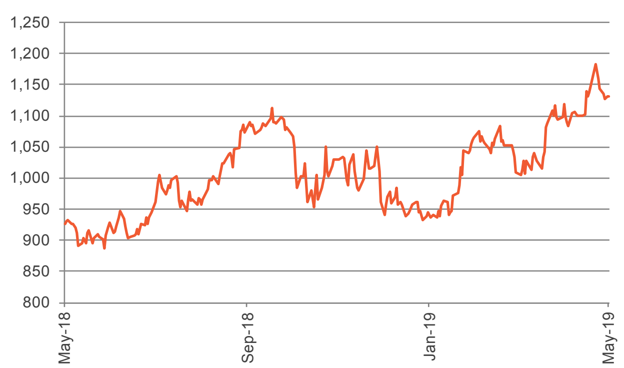
Company details

Price target:	Rs1,250
Market cap:	Rs153,544 cr
52-week high/low:	Rs1,190/880
NSE volume: (No of shares)	20.4 lakh
BSE code:	532281
NSE code:	HCLTECH
Sharekhan code:	HCLTECH
Free float: (No of shares)	54.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	6.0	10.0	24.1
Relative to Sensex	5.8	2.4	2.4	14.2

Key points

- **Good quarter, strong deal closure continued:** HCL Tech has reported yet another strong revenue growth performance along with highest ever deal bookings (third time record order bookings during FY2019) in Q4FY2019, while operating profitability missed our estimates. HCL Tech impressed with strong constant currency (CC) revenue growth of 3.3% q-o-q and 15.3% y-o-y, led by strong growth in IMS (7.3% q-o-q and 21.9% y-o-y CC) and application services (5.2% q-o-q and 8.4% y-o-y CC). On a reported basis, USD revenue grew by 3.5% q-o-q to $2,277.8 million in Q4FY2019. EBIT margin contracted by ~63BPS q-o-q to 18.9%, below our expectations, owing to forex impact including rupee appreciation (-43 bps) and soft seasonality in product business (-20 bps). Lower profitability was partially offset by higher-than-expected forex gains that resulted in 1.6% q-o-q decline in net profit to Rs. 2,568 crore.

- **Continued revenue momentum in FY2019, beat top-end of organic growth guidance:** For last three years (FY17-FY19), HCL Tech has been delivering industry-leading revenue growth among the large peers, with a CAGR of 11.2% in USD terms. In FY2019, the company delivered strong CC revenue growth of 11.8% y-o-y, higher than its guidance range of 9.5-11.5%, led by strong growth in IMS (11.1% CC), business services (51.5% CC), engineering and R&D (19.5% CC). However, application services CC revenue growth remained soft at 3.5% y-o-y owing to client-specific issues in financial vertical in Europe. Baring financial and manufacturing, technology (30.7% CC), lifesciences (22.5% CC), telecommunications (17.5% CC), retail & CPG (16.8% CC) and public services (11.6% CC) verticals led the overall growth during FY2019. Further, the company's organic growth (~6.5% CC) exceeded its estimates of 4.25-6.25% in CC provided at the beginning of FY2019. Though Mode 1 (core service) grew 4.5% y-o-y in CC terms in FY2019, Mode 2 (next-gen services including digital) and Mode 3 (products & platform) grew by 28.7% and 48.4% on y-o-y basis. Mode 2 and Mode 3 revenues together accounted for 28.4% of total revenues in FY2019, which is expected to increase to 35% of total revenues in FY2020E.

- **Revenue guidance for FY2020E remains strong, but cut margin guidance:** The management has provided strong CC revenue growth guidance of 14-16% for FY2020E, including revenues from the acquisition of seven products from IBM (transaction is expected to close in May

2019) and full year incremental revenues from other acquisitions (Strong-Bridge Envision, H&D International group and Actian Corporation). The organic revenue contribution to overall FY2020E revenue is expected to be accelerated to 7-9% (6.5% y-o-y in FY2019) though it would be mostly back-ended, led by strong deals wins, healthy deal pipeline (up 10% y-o-y), addition of large clients, continued robust growth momentum in IMS and increasing spending in digital transformation (grew 18% in FY2019 across industry). Further, the management expects acceleration in growth in manufacturing vertical in FY2020E (flattish in FY2019). Despite a strong growth outlook, the management cautioned about the challenges to revenue growth owing to geopolitical factors including delays in visa processing, delays in demand fulfillment owing to talent supply crunch, adverse impact on clients' spending owing to tariff wars and BREXIT. The margins guidance lowered to 18.5-19.5% for FY2020E versus the earlier guidance of 19.5-20.5% for FY2019, attributed to below guided margin range performance in Q1FY2020E (full quarter transition impact due to IBM seven product acquisition against one month incremental revenue and wage revision), higher investments for building capabilities, steps to control attrition rate and transition impact of large deal ramp-ups.

- **Organic growth to accelerate, upgrade to Buy:** We have fine-tuned our earnings estimates for FY2020E/FY2021E factoring in incremental revenue contribution from the acquisitions, while lowering the operating margins owing to cut in guidance and constraints around talent supply. Strong large deal momentum and pipeline along with large addressable opportunity in IMS provides strong visibility of acceleration of organic revenues in FY2020E. Further, the revenue contribution from products business could help in improving margins once it stabilised. At CMP, the stock trades at 14x/13x of its FY2020/FY2021E earnings estimates, looks inexpensive valuation considering impressive revenue growth over FY2019-FY2021E. Therefore, we upgrade our rating to Buy on HCL Tech with a revised PT of Rs. 1,250.

Valuations Rs cr

Particulars	FY18	FY19	FY20E	FY21E
Net sales	50,570.0	60,427.0	69,968.7	78,029.2
EBITDA margin (%)	22.6	23.1	22.0	22.2
Net profit	8,780.0	10,123.0	10,836.3	12,096.8
EPS (Rs.)	63.1	73.6	78.8	87.9
P/E (x)	18.0	15.4	14.4	12.9
EV/EBITDA (x)	13.4	11.0	10.0	8.9
RoE (%)	25.3	25.9	24.4	24.2
RoCE (%)	30.0	29.8	27.4	27.2

Results Rs cr

Particulars	Q4FY19	Q4FY18	Q3FY19	y-o-y (%)	q-o-q (%)
Revenue ($ mn)	**2,277.8**	**2,038.0**	**2,201.5**	**11.8**	**3.5**
Net sales	**15,990.0**	**13,179.0**	**15,699.0**	**21.3**	**1.9**
Direct costs	10,421.0	8,560.0	10,152.0	21.7	2.6
Gross profit	**5,569.0**	**4,619.0**	**5,547.0**	**20.6**	**0.4**
SG&A	1,972.0	1,583.0	1,900.0	24.6	3.8
EBITDA	**3,597.0**	**3,036.0**	**3,647.0**	**18.5**	**-1.4**
Depreciation and amortisation	558.0	453.0	561.0	23.2	-0.5
EBIT	**3,039.0**	**2,583.0**	**3,086.0**	**17.7**	**-1.5**
Forex gain/(loss)	23.0	161.0	-54.0	-85.7	-142.6
Other income	129.0	119.0	159.0	8.4	-18.9
PBT	**3,191.0**	**2,863.0**	**3,191.0**	**11.5**	**0.0**
Tax provision	615.0	634.0	566.0	-3.0	8.7
Net profit	**2,568.0**	**2,227.0**	**2,611.0**	**15.3**	**-1.7**
EPS (Rs.)	18.9	16.4	19.2	15.3	-1.7
Margin (%)				**BPS**	**BPS**
EBITDA	22.4	23.0	23.1	-54	-74
EBIT	18.9	19.6	19.6	-59	-65
NPM	16.0	16.9	16.5	-84	-57

Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenue ($ mn)	Contribution (%)	$ Growth (%)		CC growth (%)	
			q-o-q	y-o-y	q-o-q	y-o-y
Revenue ($ mn)	2,278	100	3.5	11.8	3.3	15.3
Geographic mix						
Americas	1,433	62.9	1.1	14.1	1.1	15.1
Europe	677	29.7	9.0	10.6	8.4	18.7
RoW	169	7.4	4.9	-2.7	3.6	4.7
Industry verticals						
Financial services	481	21.1	1.1	-5.7	0.9	-1.4
Manufacturing	399	17.5	2.3	1.9	2.5	6.7
Technology and services	426	18.7	3.5	24.4	3.9	25.9
Retail and CPG	228	10.0	1.4	16.4	1.4	20.9
Telecommunications, media	196	8.6	-3.3	29.9	-3.8	33.4
Lifesciences and healthcare	296	13.0	3.5	26.3	3.5	28.2
Public services	253	11.1	18.4	17.0	17.7	21.8
Service line						
Application services	743	32.6	5.4	5.0	5.2	8.4
Infrastructure Services	886	38.9	7.3	16.6	7.3	21.9
ERD services	544	23.9	-3.0	10.8	-3.0	12.1
BPO	103	4.5	-6.9	29.0	-5.8	33.5
Clients Contribution						
Top 5	387	17.0	1.1	16.6	-	-
Top 10	549	24.1	0.5	13.2	-	-
Top 20	761	33.4	1.3	10.8	-	-

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;