

HCL TECHNOLOGIES LTD.

Industry	IT
Bloomberg	HCLT IN
BSE CODE	532281

Strong order book to accelerate growth in FY20

RATING	BUY
CMP	988
Price Target	1252
Potential Upside	27%

Rating Change	↔
Estimate Change	↑
Target Change	↔

Stock Info

52wk Range H/L	880/1125
Mkt Capital (Rs Cr)	134012
Free float (%)	40%
Avg. Vol 1M (,000)	1730
No. of Shares (Cr)	136
Promoters Pledged (Cr)	0

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3QFY19 Result Update

- Company's 3QFY19 performance reported a mixed set of numbers where revenue grew 4.9%QoQ in USD terms (above our estimates of 2.1%QoQ) whereas PAT stood at Rs2605 crore (mainly in line with our estimate of 2622 crore) primarily led by lower tax.
- EBIT during the quarter stood at Rs 3091, a growth of 4.7%QoQ. Margin slightly missed the estimates and declined 30bps to 19.7% mainly impacted by wage hike (55bps) which completely offset the operational efficiency and currency tailwind of 15 bps.
- Core services like IMS posted a strong growth of 10.4%QoQ in cc terms after been weak for last few quarters. Engineering and R&D Services also grew 5.1%QoQ in CC terms, Application services showed a steady growth of 2.3%QoQ in CC whereas BPO service decline 3.7%QoQ in cc terms.
- From a Mode 1-2-3 perspective, Mode 1 growth 3.9%QoQ, Mode 2 grew by whopping 13.1%QoQ and Mode 3 grew 6.2% during the quarter. Mode 2 business crossed the milestone of USD 1.5 billion run rate.
- The company continued its strong deal momentum and signed 17 new transformational deals this quarter (Financial Services, Technology and Manufacturing).

View and Valuation

Company's 3QFY19 was encouraging quarter where revenue grew by 5.6%QoQ CC beating the estimates; however margin reported a slight miss but remained under guided range of 19.5% to 20.5%. The core business continued to post growth mainly on account of strong uptick in IMS business (grew 10.4% in cc) and continued growth in ER&D Services(grew 5.1%QoQ CC). Going forward we expect HCLTECH to deliver strong performance in FY20 on the back of continued deal momentum(won 17 new deals during the quarter), robust performance in ER&D(where the company is seeing core engineering to improve as structure reduction due to large wins in 2015 &2016 are slowing down and growth are seen in IP deals), Improvement in IMS business(clocked double digit growth in 3QFY19) and strong outlook for digital, products & platforms businesses mainly consisting of Mode 2 and 3(contributes ~29% of the revenue).Even order booking in YTD which now stands at 40%more than the last year, is giving a clear strong revenue visibility going ahead.Also the management after seeing strong booking and robust pipeline has revised its guidance and now expect to end the year achieving the higher end of guidance(9.2% to 11.5% cc). The management expects the order booking to ramp up and accelerate growth in FY20.On margin front we expect the margin to be within the guided range of 19.5% to 20.5% for FY20 as the management is aggressively investing in both in training workforce on emerging technology and injecting fresh talent. **Thus we expect HCLTECH to post revenue growth of 19.6% CAGR over FY18 to FY20E. We maintain our target price at Rs 1252 and recommend BUY.**

Key Risks to our rating and target

- Slow growth in order book and weakness in IMS.

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
Net Sales	30781	47568	50569	60680	72333
EBITDA	6540	10385	11246	14052	17588
EBIT	6148	9556	9863	11994	14466
PAT	5661	8606	8722	10158	11797
EPS (Rs)	40	60	63	75	87
EPS growth (%)	-24%	52%	4%	20%	16%
ROE (%)	22	32	32	34	34
ROCE (%)	24	31	28	30	29
BV	194	231	261	304	381
P/B (X)	4.2	3.8	3.7	3.3	2.6
P/E (x)	16.0	11.2	11.7	9.4	7.3

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3QFY19 Results

Mixed performance

Financials	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY %	QoQ%	FY17	FY18	YoY %
Net Sales /	12,809	13,178	13,878	14,860	15,699	22.6%	5.6%	47,568	50,569	6.3%
Other Income	270	302	325	284	134	-50%	-53%	1,073	1,217	13.4%
Employee	6,297	6,338	6,707	7,258	7,605	20.8%	4.8%	22,866	24,729	8.1%
Other Expenses	3,336	3,401	3,561	3,784	3,979	19.3%	5.2%	4,836	4,619	-4.5%
EBITDA	2,789	3,022	3,237	3,463	3,632	30.2%	4.9%	10,385	11,246	8.3%
Dep and	431	429	476	511	541	25.5%	5.9%	828	1,383	67.0%
EBIT	2,358	2,593	2,761	2,952	3,091	31.1%	4.7%	9,556	9,863	3.2%
Interest	21	19	20	30	55	161.9%	83.3%	89	69	
PROFIT BEFORE	2,607	2,876	3,066	3,206	3,170	21.6%	-1.1%	10,541	11,011	4.5%
Tax	532	646	635	672	565	6.2%	-15.9%	1,936	2,302	18.9%
Exceptional	-	-	-	-	-			-	-	
PROFIT AFTER	2,075	2,230	2,431	2,534	2,605	25.5%	2.8%	8,606	8,722	1.3%

Strong growth led by core service engines

HCLTECH's 3QFY19 revenue stood at USD 2201 million, a growth of 4.9% in USD term and 5.6%QoQ in constant currency (CC). In rupee term, revenue stood at Rs15699 crore and grew 5.6%QoQ (above our estimate of 15420 crore).IMS led the growth by growing 10.4% in CC terms and 16.Even Application service business posted a steady growth and grew 2.3%QoQ in CC terms and 2.5%YoY. However BPO business decline 3.7%QoQ CC.

Marginal miss in margins

- EBIT during the quarter stood at Rs 3091crore vs. our estimated of 3088 crore (growth of 4.7%QoQ) . Margin saw a marginal decline of 30bps due to wage hike which completely offset the operational and currency benefit. Gross margin largely remain flat in 3QFY19 (35.3% as compared to 35.4% last quarter).
- Margins have expanded in Mode 2 where it now stands at 12.30% as compared to 10.8% last quarter. However, Mode 1 and Mode 3 have shown a deterioration in margins in Mode 1 (20.70% in 3QFY19 v/s 21.20%% in 2QFY19) and Mode 3 (23.0% in 3QFY19 v/s 24.40% last quarter).
- PAT for the quarter stood at Rs2605 crore a growth of 2.8%QoQ (in line with our estimates of 2622crore) primarily impacted by lower other income.

Revised guidance: Revenue to clock at higher end of guidance

The company after delivering strong growth in 3QFY19, expects to achieve higher end of the guidance (9.5% to 11.5% in cc term) for FY19 mainly coming from organic growth. Even seeing the strong order booking and robust pipeline the management is optimistic of continued acceleration in organic growth in FY20.

Strong uptick in IMS business

SERVICE(USD Mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	YoY %
Application Services	684	692	702	707	699	695	705	1.4%	0.4%
IMS	727	742	730	760	745	755	825	9.3%	13.0%
BPO	67	70	74	78	107	114	110	-3.6%	48.7%
Engg and R&D Services	405	424	481	491	504	535	562	4.9%	16.7%

Application posted a steady growth of 2.3%QoQ in CC terms and 1.4% in USD term. IMS reported a strong growth of 10.4%QoQ CC and9.3% in USD, ER&D grew 5.1% QoQ and 4.9% in USD while BPO business decline 3.7% QoQ in cc terms and 3.6% in USD terms.

QoQ CC) drove growth.

Barring financial & public services, other verticals posted strong growth

Verticals (USD Mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	CC QOQ
Financial Services	469	482	489	509	489	483	476	-1.5%	-0.6%
Manufacturing	657	682	726	733	750	760	802	5.5%	3.9%
Life Sciences	222	226	233	234	263	271	286	5.7%	7.5%
Public Services	209	204	203	216	216	225	214	-4.9%	-4.4%
Retail & CPG	179	179	191	196	187	210	225	7.0%	8.4%
Telecom MP&E	149	152	147	151	150	151	203	34.1%	35.4%

Amongst verticals, softness was seen in the Financial Services (declined 1.5% in USD and 0.6% QoQ CC) and Public Services (declined 4.9% in USD and 4.4% QoQ CC). Moderate growth was seen in Manufacturing (grew 5.5% in USD and 3.9% QoQ CC) whereas Telecom clocked double digit (grew 34.1% and 35.4% QoQ CC) and Retail (grew 7% and 8.4% QoQ CC) drove growth.

Concall highlights

- **Macro concern persists:** The management stated that some customer are talking of some impact in their business due to slowdown in China however the management is confident of no cut down in the digital transformation spend, as it is no longer a discretionary spend for the client. Thus the management is not concerned about the macro issues as they strongly believe digital is critical for the client to evolve their business and thus client are not going to cut down on digital spend in spite of some pressure in their business.
- **Highest deal booking:** The company consecutively for the second time within the current the fiscal year saw a record high order book primarily driven by financial services, technology & services vertical and manufacturing vertical. YTD booking for FY19 is 40% more as compared to similar period last year. 17 new transformational deals were won during the quarter which is reflecting a broad base growth across verticals, services and geographies. The Management expects these deals to ramp up and contribute to organic growth in future. Also the booking is expected to continue to be good in 4QFY19.
- **Continued growth in Mode 1, 2&3:** From a Mode 1-2-3 perspective, Mode 1 growth 3.9%, Mode 2 grew by whopping 13.1% and Mode 3 grew 6.2% during the quarter. Mode 2 business crossed the milestone of \$1.5 billion run rate (started from \$890 million). Combined Mode 2 and Mode 3 revenues now constitute 29% of our revenue.
- **Strong acceleration in Mode 2 business:** In digital and analytics business, the company continues to see strong acceleration which resulted in double digit growth during the quarter. The company is seeing strong demand in scale digital led RFPs, demand for ASM and ADDs. The company has signed deal in IoT, cloud and cyber security, thus expecting the growth to continue going ahead.
- **IP deal on track:** Organic IPs is continuing to move in the right direction as the company continues to incubate ideas across technology and vertical domain opportunities. On the deal acquired by IBM for 1.8 billion, the transaction is on track and is expected to close by mid 2019.
- **Vertical performance:** Manufacturing had a muted performance on a YoY basis, however the management expects to reverse course and improve in FY20. Financial service which witnessed a decline in last few quarter due to a couple of client-specific issues in Europe, is now expected to deliver growth as ramp down of accounts is behind and growth is pickup in digital space.

Exhibit: Revenue trend

Strong revenue growth of 6.5% QoQ CC on back pickup in IMS and continued growth in ER&D services .

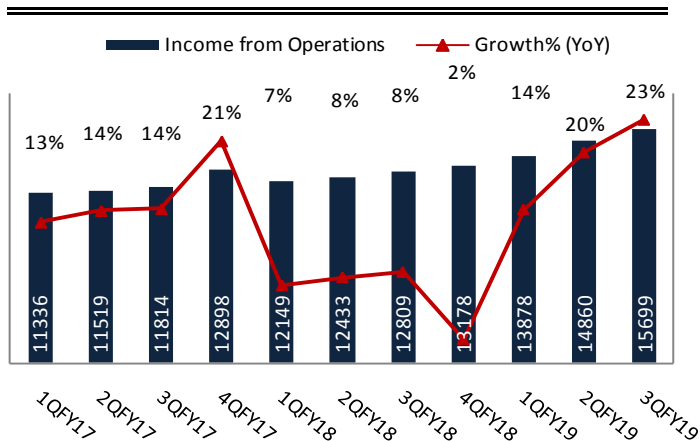


Exhibit: IMS revenue

Pickup in IMS(key driver) after subdued growth in last few quarters .

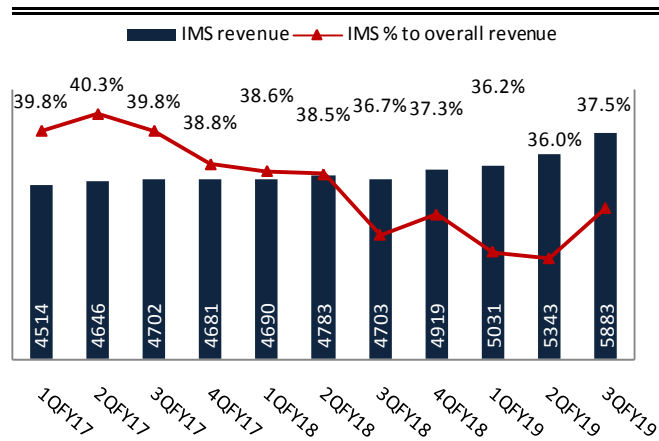


Exhibit: EBITDA margins

Aggressive investment plan to hold margin in guided range of 19.5 to 20.5% in FY19.

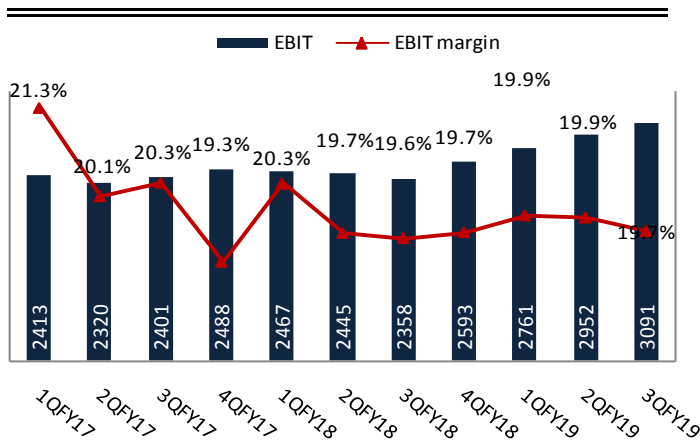


Exhibit: Utilization Rate

Utilization in one of its highs, limited room for further expansion.

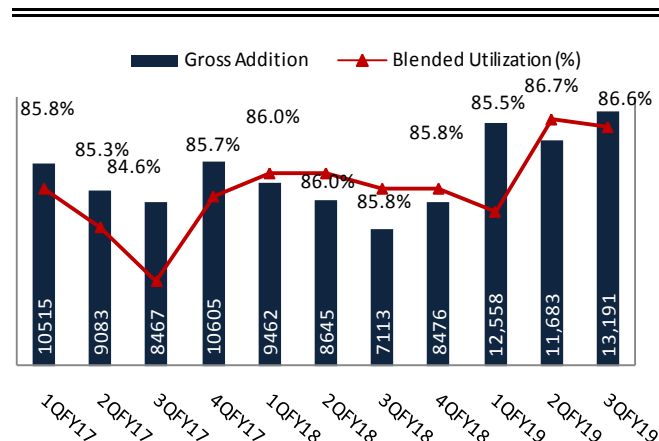
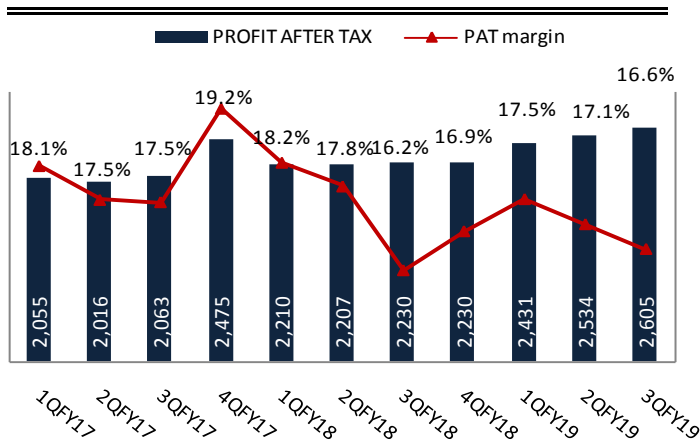


Exhibit: PAT and PAT margin

Lower tax and revenue beat led to PAT growth.



Operational Details

By Project Type (%)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Americas	61.9%	62.6%	62.8%	62.4%	63.5%	61.6%	64.5%	65.8%	64.4%
Europe	29.6%	27.7%	27.4%	29.1%	28.7%	30.0%	28.1%	26.8%	28.2%
RoW	8.5%	9.7%	9.8%	8.5%	7.9%	8.5%	7.5%	7.4%	7.3%

REVENUE BY VERTICAL	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Financial Services	24.3%	24.2%	24.9%	25.0%	24.6%	25.0%	23.8%	23.0%	21.6%
Manufacturing	33.9%	34.6%	34.9%	35.4%	36.5%	36.0%	36.5%	36.2%	36.4%
Lifesciences & Healthcare	12.0%	11.5%	11.8%	11.7%	11.7%	11.5%	12.8%	12.9%	13.0%
Public Services	11.2%	11.7%	11.1%	10.6%	10.2%	10.6%	10.5%	10.7%	9.7%
Retail & CPG	9.4%	9.2%	9.5%	9.3%	9.6%	9.6%	9.1%	10.0%	10.2%
Telecommunications	8.9%	8.4%	7.9%	7.9%	7.4%	7.4%	7.3%	7.2%	9.2%
Others	0.4%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

CONTRACT TYPE	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Fixed Price Projects	63.20%	61.60%	59.80%	60.40%	60.80%	61.60%	62.00%	61.80%	63.30%
Time & Material	36.80%	38.40%	40.20%	39.60%	39.20%	38.40%	38.00%	38.20%	36.70%

AVERAGE RATES	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
USD - INR	67.8	66.3	64.5	64.5	64.4	64.7	67.5	70.8	71.48
GBP - USD	1.23	1.24	1.29	1.31	1.33	1.4	1.34	1.3	1.28
EUR - USD	1.07	1.07	1.12	1.18	1.18	1.23	1.18	1.16	1.14
SEK - USD	0.11	0.11	0.12	0.11	0.12	0.12	0.11	0.11	0.11
AUD - USD	0.74	0.76	0.76	0.79	0.77	0.78	0.75	0.73	0.72

CLIENTS (LTM)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
100 Million dollar +	8	8	8	9	9	8	9	9	10
50 Million dollar+	24	25	25	25	25	28	32	31	29
40 Million dollar +	35	34	35	37	40	40	40	N/A	N/A
30 Million dollar +	48	49	52	52	56	58	56	N/A	N/A
20 Million dollar +	87	85	86	84	85	87	87	90	95
10 Million dollar +	148	153	154	157	156	160	162	165	164
5 Million dollar +	241	246	249	259	261	264	267	269	276
1 Million dollar +	496	506	508	536	552	561	571	575	597

CLIENT CONTRIBUTION	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Top 5 Clients	14.2%	14.7%	14.4%	15.1%	15.8%	16.3%	17.0%	17.3%	17.4%
Top 10 Clients	21.7%	22.1%	22.4%	22.9%	23.5%	23.8%	24.6%	24.8%	24.8%
Top 20 Clients	31.9%	32.9%	33.0%	33.2%	33.5%	33.7%	34.2%	34.2%	34.1%

SERVICE MIX	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Application Services	37.5%	36.8%	36.3%	35.9%	35.3%	34.7%	34.0%	33.1%	32.0%
Infrastructure Services	39.8%	38.8%	38.6%	38.5%	36.7%	37.3%	36.2%	36.0%	37.5%
Business Services	4.0%	3.9%	3.6%	3.6%	3.7%	3.9%	5.2%	5.4%	5.0%
Eng and R&D Services	18.6%	20.5%	21.5%	22.0%	24.2%	24.1%	24.5%	25.5%	25.5%

Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	139	140	281	282	285	278	271	271
Reserves	13020	19402	23943	27012	32664	36108	40937	51433
Networth	13159	19542	24224	27294	32950	36386	41209	51704
Debt	925	406	523	952	445	380	2917	2917
Other Non Cur Liab	920	930	825	841	923	1192	1866	1866
Total Capital Employed	14084	19949	24748	28246	33395	36766	44126	54621
Net Fixed Assets (incl CWIP)	7246	7975	8827	10561	9180	12274	15134	18234
Non Cur Investments	0	0	107	321	34	303	303	303
Other Non Cur Asst	2519	2675	3264	3602	10086	10888	13366	13366
Non Curr Assets	2519	2675	3371	3922	10120	11191	13669	13669
Inventory	232	122	158	264	276	172	206	246
Debtors	4497	5683	6539	7682	8301	9639	11566	13787
Cash & Bank	627	606	763	535	1146	2357	2357	2357
Other Curr Assets	1572	1590	2189	3340	2528	3410	4092	4878
Current investments	3577	8807	9786	9285	9044	4018	4324	8965
current tax asset	2129	2521	3613	5075	5175	4962	5263	5610
Short-term loans and advances	12634	19330	23047	24860	26470	24558	27808	35843
Curr Assets	401	468	625	700	801	918	1102	1313
Creditors	1723	1462	1734	1804	473	530	636	758
Provisions	5221	7105	7231	7442	1722	1325	1590	1895
Other Curr Liab	0	0	0	0	7545	6606	6606	6606
Other financial liability	0	0	0	0	739	686	686	686
Curr Liabilities	7345	9036	9590	9945	11280	10065	10619	11258
Net Curr Assets	5288	10294	13457	14915	15190	14493	17189	24585
Total Assets	22399	29980	35245	39344	45769	48023	56611	67745

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	25,581	32,144	36,701	30,781	47,568	50,569	60,680	72,333
Change (%)	23%	26%	14%	-16%	55%	6%	20%	19%
	-	-	-	-	-	-	-	-
EBITDA	5,661	8,035	8,473	6,540	10,385	11,246	14,052	17,588
Change (%)	53%	42%	5%	-23%	59%	8%	25%	25%
Margin (%)	22%	25%	23%	21%	22%	22%	23%	24%
Depr & Amor.	637	681	404	393	828	1,383	2,058	3,122
EBIT	5,024	7,354	8,069	6,148	9,556	9,863	11,994	14,466
Int. & other fin. Cost	106	115	91	74	89	69	160	220
Other Income	351	677	1,139	895	1,073	1,217	905	673
EBT	5,270	7,917	9,117	6,969	10,541	11,011	12,739	14,919
Exp Item	-	-	-	-	-	-	-	-
Tax	1,225	1,410	1,815	1,364	1,936	2,302	2,581	3,123
Minority Int & P/L share of Ass.	(4)	2	40	56	2	13	-	-
Reported PAT	4,040	6,510	7,342	5,661	8,606	8,722	10,158	11,797
Adjusted PAT	4,040	6,510	7,342	5,661	8,606	8,722	10,158	11,797
Change (%)	66%	61%	13%	-23%	52%	1%	16%	16%
Margin(%)	16%	20%	20%	18%	18%	17%	17%	16%

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
ROE	35	40	34	22	32	32	34	34
ROCE	36	43	36	24	31	28	30	29
Asset Turnover	3	3	2	1	2	2	2	2
Current Ratio	2	2	2	3	2	2	3	3
Debtor Days	64	65	65	91	64	70	70	70
Book Value Per Share	189	279	172	194	231	261	304	381
Payable Days	6	5	6	8	6	7	7	7
Earnings Per Share	58	93	52	40	60	63	75	87
P/E	14	15	19	20	14	15	13	11
Price / Book Value	4	5	6	4	4	4	3	3
EV/EBITDA	9	11	15	16	11	12	9	7
EV/Sales	2	3	4	3	2	3	2	2
Div Payout%	10%	9%	57%	40%	40%	13%	11%	9%

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	5270	7917	9117	6969	10543	11024	12739	14193
(inc)/Dec in Working Capital	-149	-244	-1188	-1456	321	-635	-1282	-1282
Non Cash Op Exp	635	228	-615	-317	139	1430	2151	2151
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	-1264	-1445	-1774	-1400	-2007	-2356	-2581	-3123
others	0	0	0	0	0	0	0	0
CF from Op. Activities	4492	6457	5539	3796	8995	8328	8022	10544
(inc)/Dec in FA & CWIP	-619	-720	-1208	-917	-1278	-5344	-4918	-5328
Free Cashflow	3873	5737	4331	2879	7717	2984	3104	5217
(Pur)/Sale of Inv	-4771	-7852	-8205	-6869	-11666	-20027	0	0
others	-7744	-13412	-11427	-9940	-16761	-27654	-9836	-10656
CF from Inv. Activities	-2354	-4840	-2014	-2154	-3817	-2283	-4918	-5328
inc/(dec) in NW	34	34	10	1	0	0	0	0
inc/(dec) in Debt	48	73	582	52	197	0	-36	0
Int. Paid	-114	-184	-24	0	-8	-19	-14	0
Div Paid (inc tax)	-769	-1173	-2824	-2697	-4068	-2031	-1301	-1301
others	-344	73	151	-151	-143	-234	-49	-36
CF from Fin. Activities	-2086	-1308	-3140	-2237	-4533	-5714	-2799	-1301
Inc(Dec) in Cash	52	309	385	-595	645	331	305	3915
Add: Opening Balance	669	719	953	1319	676	1368	1699	2004
Closing Balance	721	1027	1339	724	1321	1699	2004	5920

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Disclosure of Interest Statement-

Analyst's ownership of the stocks mentioned in the Report	NIL
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