

Industry	TECHNOLOGY
Bloomberg	HCLT IN
BSE CODE	532281

Strong organic growth to continue, margin to hold with guided range(18.5% to 19.5%)

RATING	ACCUMULATE
CMP	1086
Price Target	1202
Potential Upside	11%

Rating Change	↓
Estimate Change	↓
Target Change	↔

Stock Info

52wk Range H/L	1190/920
Mkt Capital (Rs Cr)	147567
Free float (%)	40%
Avg. Vol 1M (,000)	1368
No. of Shares (Crs)	136
Promoters Pledged %	0%

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1QFY20 Result update

- ❑ HCLTECH reported mix set of numbers in its 1QFY20 result. Revenue stood at USD 2364million(in line with our estimates), a growth of 4.2%QoQ in cc terms while PAT misses our estimates by 8% and declined 12.5%QoQ to Rs2230crore mainly owing to higher tax rate and lower operating income.
- ❑ EBIT for the quarter stood at Rs 2835 crore, a de-growth of 7%QoQ. EBIT Margin shrank 180bps to 17.1% (vs our expectation of 100 bps decline) primarily led by multiple factors like visa cost, higher SG&A and Forex headwind. However major drag came from lower profitability in Engineering Services where the company had one write-off, investments and also onsite centric deal ramp ups.
- ❑ Segments wise , IT and Business services grew 3.6% QoQ in cc terms , while Engineering and R&D Services and Products & Platforms grew by 5.6% and 7.0% QoQ in cc terms during the quarter.
- ❑ For FY20, the company has maintained its revenue guidance of 14.0% to 16.0% in Constant Currency seeing the client specific issue and macro challenges that are playing out around the world. However, it now expects organic growth to be 8-10% (1% higher), offset by lower inorganic contribution due to one month's delay in the integration of IBM IP purchases.

View and Valuation

HCLTECH started the year which solid revenue growth of 4.2%QoQ While Margin dropped 180bps owing to lower profitability in engineering services business. Going forwards, we believe HCLTECH will manage to clock revenue growth of 14% to 16%YoY as guided by the management .Organic revenue is expected to post industry leading growth in FY20 owing to continued ramp up of large deal wins .Also improvement in inorganic growth is expect to be seen during the course of the year as revenue from recent acquired IBM IP will start to flow in (some portion in 2QFY20 and will see full impact from 2HFY20) thus implying further improvement in overall revenue going ahead.

On margin front we expect the company to meet midpoint of margin guidance (18.5% to 19.5%) as continued investments to build up digital capabilities and SG&A pertaining to IBM IP will hold back margin expansion in FY20.

Post result, we have slightly reduced our PAT estimate for FY20 by 2% considering higher tax rate. Thus We largely maintain our target price of Rs 1202 and recommend Accumulate.

Key Risks to our rating and target

- ❑ Slow growth in order book and weakness in IMS.
- ❑ Continued drag on organic growth.

Fig in Rs cr

KEY FINANCIAL/VALUATIONS	FY17	FY18	FY19	FY20E	FY21E
Net Sales	47568	50569	60427	70195	82157
EBITDA	10385	11246	13926	15875	19289
EBIT	9556	9863	11853	13352	15836
PAT	8606	8722	10120	10683	12232
EPS (Rs)	60	63	75	79	90
EPS growth (%)	52%	4%	19%	6%	15%
ROE (%)	32	32	34	31	31
ROCE (%)	31	28	29	27	26
BV	231	261	305	374	455
P/B (X)	3.8	3.7	3.6	2.9	2.4
P/E (x)	14.5	15.5	14.6	13.8	12.0

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1QFY20 Results**Mixed quarter**

Financials	Fig in Rs cr									
	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales	13,878	14,860	15,699	15,990	16,427	18.4%	2.7%	50,569	60,427	19.5%
Other Income	325	284	134	200	183	-43.7%	-8.5%	1,217	943	415.3%
Employee Exp	6,707	7,258	7,605	7,713	8,398	25.2%	8.9%	24,729	29,283	18.4%
Other Expenses	3,561	3,784	3,979	4,198	4,183	17.5%	-0.4%	4,619	5,761	24.7%
EBITDA	3,237	3,463	3,632	3,594	3,570	10.3%	-0.7%	11,246	13,926	23.8%
Depreciation	476	511	541	545	735	54.4%	34.9%	1,383	2,073	49.9%
EBIT	2,761	2,952	3,091	3,049	2,835	2.7%	-7.0%	9,863	11,853	20.2%
Interest	20	30	55	69	87	335.0%	26.1%	69	174	152.2%
PBT	3,066	3,206	3,170	3,180	2,931	-4.4%	-7.8%	11,011	12,622	14.6%
Tax	635	672	565	630	701	10.4%	11.3%	2,302	2,502	8.7%
PAT	2,431	2,534	2,605	2,550	2,230	-8.3%	-12.5%	8,722	10,120	16.0%

1QFY20 performance: Solid revenue growth

- Company 1QFY20 revenue stood at USD2364 million , a growth of 4.2%QoQ in cc terms mainly led by faster-than-expected ramp up of a deal win in the manufacturing vertical. Also some portion was driven by Strong Bridge Envision LLC acquisition (incremental revenue of USD 11mn).
- In USD terms, revenue grew by 3.8% QoQ in line with our estimates and in rupee terms , revenue stood at RS 16427 crore , a growth of 2.7%QoQ during the quarter.
- Mode1 which is core business and contributes 70.3% of the revenue, grew 4.1%QoQ during the quarter. Mode 2 posted a moderate growth of 3.6% QoQ cc growth during the quarter. Mode 3 saw a strong growth of 6.5%QoQ after declining in last quarter.
- Segments wise , IT and Business services grew 3.6% QoQ in cc terms , while Engineering and R&D Services and Products & Platforms grew by 5.6% and 7.0% QoQ in cc terms during the quarter.

Manufacturing, Technology led growth for the quarter

Verticals (USD Mn)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ%	QoQ cc
Financial Services	489	509	489	483	476	481	480	-0.2%	0.5%
Manufacturing	726	733	750	760	802	825	917	11.2%	18.4%
Retail & CPG	233	234	263	271	286	228	225	-1.4%	-1.4%
Telecommunication	203	216	216	225	214	196	189	-3.5%	-2.7%
Lifesciences & Healthcare	191	196	187	210	225	296	303	2.2%	2.4%
Public Services	147	151	150	151	203	253	248	-1.9%	-0.2%

- The Company saw strong growth across verticals. Manufacturing and technology led the growth by growing 18%QoQcc followed by Life sciences & Healthcare which grew 2.4%QoQ cc . Financial Services posted a muted growth of 0.5%QoQ due to one client issue which resulted in downward impact on the financial services vertical while Retail & CPG and Telecommunication declined 1.4%/2.7%QoQ cc during the quarter

Growth seen in US geography with ramp up of large deals

Business unit(USD mn)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ%	QoQ cc
Americas	1,263	1,255	1,326	1,381	1,418	1,433	1,600	12%	11.7%
Europe	571	611	578	562	621	677	612	-10%	-8.1%
RoW	157	173	154	155	161	169	149	-12%	-10.6%

- Geography wise, Americas led the growth by growing 11.7%QoQ in cc terms mainly on the back of large deal that the company won in last quarter resulted on big uptick in US. Europe was soft and declined 8%QoQ. However grew double digit in YoY as large deal went into steady state and that's what is reflected in these numbers. ROW has some contribution from India. But overall, ROW's performance has been soft (declined 10.6%QoQ in cc terms). But the management expects it to pick up in the coming quarters.

Investments impacted the overall margins

- ❑ EBIT for the quarter stood at Rs 2835 crore, a drop of 7%QoQ.
- ❑ EBIT Margin shrank 180bps to 17.1% (vs. our expectation of 100 bps decline) primarily led by multiple factors like visa cost, higher SG&A and Forex headwind. However major drag came from lower profitability in Engineering Services where the company had one write-off, investments and also onsite centric deal ramp ups.
- ❑ PAT during the quarter was at Rs2230crore, declined 12.5%QoQ mainly owing to higher tax rate and lower operating income.

Concall Highlights

- **Geography performance:** Americas grew 21% year-on-year. Europe grew 11.3% and rest of the world was more or less flat. The growth in US came on the back of large deal that the company won in last quarter resulted on big uptick in US. Europe was soft and declined 8%QoQ. However grew double digit in YoY as large deal went into steady state and that's what is reflected in these numbers. ROW has some contribution from India. But overall, ROW's performance has been soft. But the management expects it to pick up in the coming quarters.
- **Vertical performance:** The Company saw strong growth across verticals. Manufacturing and technology led the growth by growing 28%YoY followed by Retail and CPG grew 22%, Life Sciences 16%, energy utility, about 18%. Financial Services while the growth is broad based however due one client issue it has a resulted in downward impact on the financial services vertical. The management expects FS and manufacturing to continue to see the client specific issue in 2QFY20 however expects H2 or from 4QFY20 to see some growth coming from Financial service.
- **Margin performance in 1QFY20:** EBIT margins were flat on a YoY basis and dropped 180 bps QoQ. The margins were largely in line with what the company had expected for various reasons in this quarter. The drop in margins were mainly attributable to four factor;1)forex headwind impacting 15bps;2)higher visa cost(15 to 20 bps impact);3) 50 bps impact in the SG&A which is largely investment made for the HCL software revenues to start flowing and taking charge of the front end of the market in that business;4)additional 110bps impact in ERS business. Good momentum in Mode 2 and Mode 3 ,as 20 bps increased in the mix. It's now 29.7%, which is again a 300 bps growth from the previous quarter last year
- **Rise in ETR:** The effective tax rate has gone up this fiscal to 24%, which is largely driven by the consummation of the seven software products acquired from IBM and its related accounting. ETR is expected to remain in 24% range.
- **New launch:** the company launched HCL software. This is the new business unit for software products, which is really starting up of all the IBM IP partnerships and the acquisition which got consummated on the 1st of July. The company has also increased focus and footprint on the cyber security business by launching a cyber security fusion center, which is already off to some a very good start with clients, including government client in the state of Texas.
- **Deal wins:** 12 transformational deals won during the quarter. Financial services were a good contribution here. Of course manufacturing and retail, other segments, which were the top three in terms of contribution to the transformational deal
- **IBM deal payment:** The consideration f IBM deal is kind of fixed consideration of 1.6 billion for which half of that has already been paid out and the balance USD812 out of that fixed consideration will be paid on the June 30th next year. The second component there is the USD150 million, which is earn outs, which are payable in next three installments.
- **Demand environment:** Over the demand trend remain mixed .In terms of vertical there is some slowness seen in decision making but they are more project type of work where there could be some delays. However the company sees enough opportunities in traditional business.
- **Outlook for FY20:** The Company remained conservative seeing the client specific issue that persists and macro challenges that are playing out around the world. Thus the company maintained its revenue guidance of 14.0% to 16.0% in Constant Currency. Organic business to grow 7% to 9% as previously stated however due to delay in deal execution , inorganic expected to grow 6%mark(earlier 7% mark) .Composition of Organic growth to be higher than inorganic part. The management remains cautiously optimistic and expects to deliver an industry leading organic growth in FY20.Operating Margin (EBIT) for FY20 expected in the range of 18.5% to 19.5%.

Exhibit: Revenue trend

Faster than expected large deal ramp up resulted in solid 4.2% QoQ during the quarter.

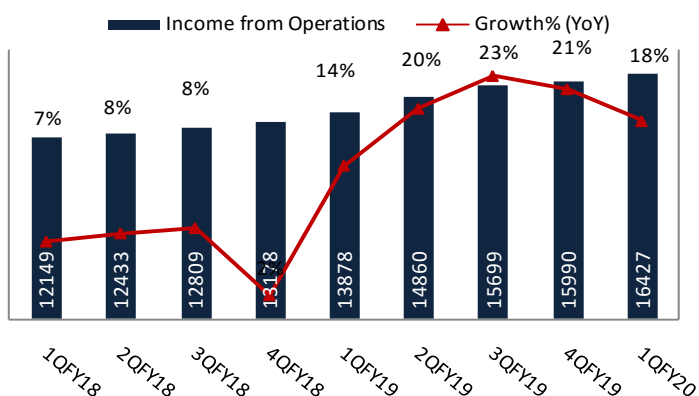


Exhibit: Services revenue

Higher focus towards Mode 2 and Mode 3

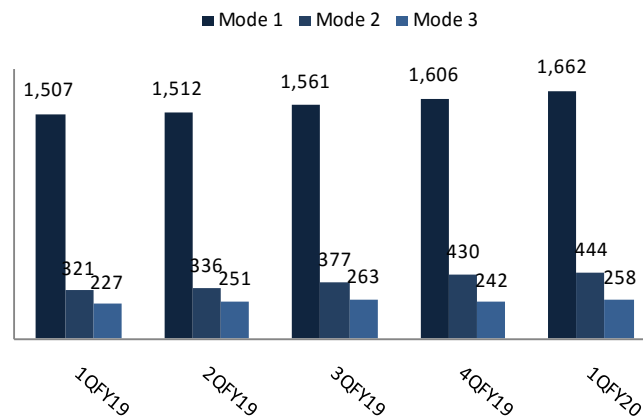


Exhibit: Margin Trend

EBIT margins declined due to investment, FY20 guidance at 18.5-19.5%

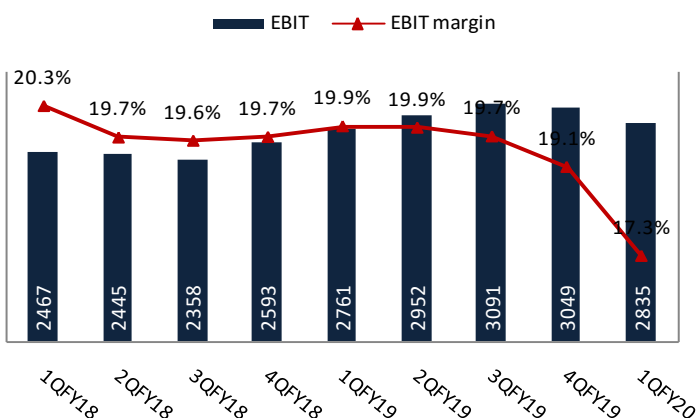


Exhibit: Attrition Trend

Attrition still remain under control.

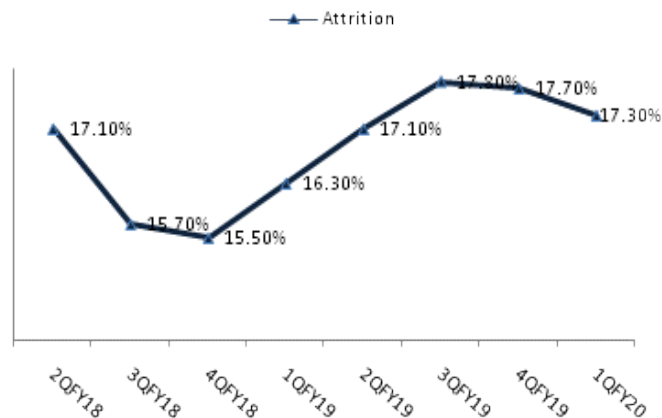
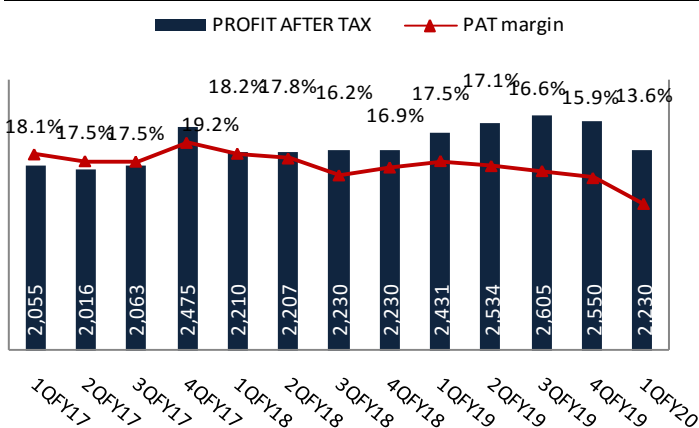


Exhibit: PAT growth

Higher-than-expected Tax rate impacted the PAT growth.



Operational Details

Industry Revenue (%)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
IT and Business services	0%	0%	0%	75%	0%	0%	76%	75%
Engineering and R&D services	0%	0%	0%	17%	0%	0%	17%	17%
Products & Platforms	0%	0%	0%	8%	0%	0%	8%	8%

Geography (%)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Americas	62%	64%	62%	65%	66%	64%	63%	68%
Europe	29%	29%	30%	28%	27%	28%	30%	26%
RoW	9%	8%	9%	8%	7%	7%	7%	6%

REVENUE BY VERTICAL	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Financial Services	25%	25%	25%	24%	23%	22%	21%	20%
Manufacturing	35%	37%	36%	37%	36%	36%	36%	39%
Lifesciences & Healthcare	12%	12%	12%	13%	13%	13%	10%	10%
Public Services	11%	10%	11%	11%	11%	10%	9%	8%
Retail & CPG	9%	10%	10%	9%	10%	10%	13%	13%
Telecommunication,Media, Publishing & Entertainment	8%	7%	7%	7%	7%	9%	11%	11%

CONTRACT TYPE	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Fixed Price Projects	60%	61%	62%	62%	62%	63%	64%	64%
Time & Materia	40%	39%	38%	38%	38%	37%	36%	37%

AVERAGE RATES	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
USD - INR	64.5	64.4	64.7	67.5	70.8	71.48	70.19	70.19
GBP - USD	1.31	1.33	1.4	1.34	1.3	1.28	1.31	1.31
EUR - USD	1.18	1.18	1.23	1.18	1.16	1.14	1.13	1.13
SEK - USD	0.11	0.12	0.12	0.11	0.11	0.11	0.11	9.2
AUD - USD	0.79	0.77	0.78	0.75	0.73	0.72	0.71	0.71

CLIENTS (LTM)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
100 Million dollar +	9	9	8	9	9	10	10	12
50 Million dollar+	25	25	28	32	31	29	29	29
40 Million dollar +	37	40	40	40	N/A	N/A	N/A	N/A
30 Million dollar +	52	56	58	56	N/A	N/A	N/A	N/A
20 Million dollar +	84	85	87	87	90	95	95	93
10 Million dollar +	157	156	160	162	165	164	166	172
5 Million dollar +	259	261	264	267	269	276	283	293
1 Million dollar +	536	552	561	571	575	597	623	633

CLIENT CONTRIBUTION	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Top 5 Clients	15%	16%	16%	17%	17%	17%	17%	17%
Top 10 Clients	23%	24%	24%	25%	25%	25%	24%	24%
Top 20 Clients	33%	34%	34%	34%	34%	34%	33%	34%

People metrics	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Total Employee Count	127875	119040	120081	124121	127875	132328	137965	143900
Technical	116910	108351	109565	113404	116910	121273	126717	132384
Support	10965	10689	10516	10717	10965	11055	11248	11516
Gross Addition	11683	11683	8476	12558	11683	13191	14249	16332
Attrition - IT Services (LTM)	17%	16%	16%	16%	17%	18%	18%	17%

Financial Details

Balance Sheet

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	140	281	282	285	278	271	271	271
Reserves	19,402	23,943	27,012	32,664	36,108	41,095	50,477	61,408
Networth	19,542	24,224	27,294	32,950	36,386	41,366	50,748	61,679
Debt	406	523	952	445	380	3,701	4,199	4,199
Other Non Current Liab	930	825	841	923	1,192	1,830	1,830	1,830
Total Capital Employed	19,949	24,748	28,246	33,395	36,766	45,067	54,947	65,878
Net Fixed Assets (incl CWIP)	7,975	8,827	10,561	9,180	12,274	14,062	17,816	19,195
Non Current Investments	-	107	321	34	303	85	85	85
Other Non Cur Asst	2,675	3,264	3,602	10,086	10,888	14,706	14,706	14,706
Non Current Assets	2,675	3,371	3,922	10,120	11,191	14,791	14,791	14,791
Inventory	122	158	264	276	172	91	106	124
Debtors	5,683	6,539	7,682	8,301	9,639	11,706	13,598	15,916
Current investments	606	763	535	1,146	2,357	2,220	2,220	2,220
Short-term loans and advances	1,590	2,189	3,340	2,528	3,410	1,312	1,524	1,784
Cash & Bank	8,807	9,786	9,285	9,044	4,018	7,872	12,161	19,465
Other Curr Assets	2,521	3,613	5,075	5,175	4,962	6,521	6,837	7,223
Current Assets	19,330	23,047	24,860	26,470	24,558	29,722	36,446	46,731
Creditors	468	625	700	801	918	1,305	1,516	1,774
Provisions	1,462	1,734	1,804	473	530	586	681	797
Other Curr Liab	7,105	7,231	7,442	1,722	1,325	1,810	2,103	2,461
Others Financial liabilities	-	-	-	7,545	6,606	6,950	6,950	6,950
Current tax liabilities (net)	-	-	-	739	686	924	924	924
Curr Liabilities	9,036	9,590	9,945	11,280	10,065	11,575	12,173	12,906
Net Current Assets	10,294	13,457	14,915	15,190	14,493	18,147	24,273	33,825
Total Assets	29,980	35,245	39,344	45,769	48,023	58,575	69,053	80,717

Income Statement

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	32,144	36,701	30,781	47,568	50,569	60,427	70,195	82,157
Change (%)	26%	14%	-16%	55%	6%	19%	16%	17%
	-	-	-	-	-	-	-	-
EBITDA	8,035	8,473	6,540	10,385	11,246	13,926	15,875	19,289
Change (%)	42%	5%	-23%	59%	8%	24%	14%	21%
Margin (%)	25%	23%	21%	22%	22%	23%	23%	23%
Depr & Amor.	681	404	393	828	1,383	2,073	2,523	3,452
EBIT	7,354	8,069	6,148	9,556	9,863	11,853	13,352	15,836
Int. & other fin. Cost	115	91	74	89	69	174	261	348
Other Income	677	1,139	895	1,073	1,217	943	703	822
EBT	7,917	9,117	6,969	10,541	11,011	12,622	13,794	16,310
Exp Item	-	-	-	-	-	-	-	-
Tax	1,410	1,815	1,364	1,936	2,302	2,502	3,111	4,077
Minority Int & P/L share of Ass.	2	40	56	2	13	-	-	-
Reported PAT	6,510	7,342	5,661	8,606	8,722	10,120	10,683	12,232
Adjusted PAT	6,510	7,342	5,661	8,606	8,722	10,120	10,683	12,232
Change (%)	61%	13%	-23%	52%	1%	16%	6%	15%
Margin(%)	20%	20%	18%	18%	17%	17%	15%	15%

Financial Details

Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	40	34	22	32	32	34	31	31
ROCE	43	36	24	31	28	29	27	26
Asset Turnover	3	2	1	2	2	2	2	2
Current Ratio	2	2	2.6	2.3	2.4	2.6	3.0	3.6
Debtor Days	65	65	91	64	70	71	71	71
Book Value Per Share	279	172	194	231	261	305	374	455
Payable Days	5	6	8	6	7	8	8	8
Earnings Per Share	93	52	40	60	63	75	79	90
P/E	15	19	20	14	15	15	14	12
Price / Book Value	5	6	4	4	4	4	3	2
EV/EBITDA	11	15	16	11	12	10	9	7
EV/Sales	3	4	3	2	3	2	2	2

Cash Flow Statement

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	7917	9117	6969	10543	11024	12622	13794	16310
(inc)/Dec in Working Capital	-244	-1188	-1456	321	-635	-1282	-1282	-1282
Non Cash Op Exp	228	-615	-317	139	1430	2151	2151	2151
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	-1445	-1774	-1400	-2007	-2356	-2502	-3111	-4077
others	0	0	0	0	0	0	0	0
CF from Op. Activities	6457	5539	3796	8995	8328	9974	11370	13436
(inc)/Dec in FA & CWIP	-720	-1208	-917	-1278	-5344	-3861	-6278	-4831
Free Cashflow	5737	4331	2879	7717	2984	6113	5092	8605
(Pur)/Sale of Inv	-7852	-8205	-6869	-11666	-20027	137	0	0
others	-13412	-11427	-9940	-16761	-27654	-7449	-12555	-9662
CF from Inv. Activities	-4840	-2014	-2154	-3817	-2283	-3724	-6278	-4831
inc/(dec) in NW	34	10	1	0	0	0	0	0
inc/(dec) in Debt	73	582	52	197	0	682	-724	0
Int. Paid	-184	-24	0	-8	-19	-14	0	0
Div Paid (inc tax)	-1173	-2824	-2697	-4068	-2031	-1301	-1301	-1301
others	73	151	-151	-143	-234	-49	682	-724
CF from Fin. Activities	-1308	-3140	-2237	-4533	-5714	-2015	-803	-1301
Inc(Dec) in Cash	309	385	-595	645	331	4235	4289	7303
Add: Opening Balance	719	953	1319	676	1368	1699	5934	10223
Closing Balance	1027	1339	724	1321	1699	5934	10223	17527

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Disclosure of Interest Statement-

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