

Industry	TECHNOLOGY
Bloomberg	HCLT IN
BSE CODE	532281

Strong margin execution in 2Q

RATING ACCUMULATE

CMP	1119
Price Target	1227
Potential Upside	10%

Rating Change 

Estimate Change 

Target Change 

Stock Info

52wk Range H/L	1190/920
Mkt Capital (Rs Cr)	151741
Free float (%)	40%
Avg. Vol 1M (000)	112
No. of Shares (Crs)	136
Promoters Pledged (Crs)	0

Fig in Rs cr

FINANCIAL	FY19	FY20E	FY21E
Net Sales	60,427	71,879	79,385
EBITDA	13,926	16,458	18,315
EBIT	11,853	13,394	14,995
PAT	10,120	10,318	11,883
EPS (Rs)	75	76	88
EPS	19%	2%	15%
ROE (%)	34	30	31
ROCE (%)	29	27	25
BV	305	372	450
P/B (X)	4	3	2
P/E (x)	15	15	13

Research Analyst

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2QFY20 Result update

- HCLTECH reported a healthy revenue and Pat growth. Revenue for the quarter grew 6%QoQ in cc terms to USD2486 million which is in line with our estimates of USD2483million. Growth in revenue was mainly driven by ramp up of new deal across verticals and also aided by consolidation of the IBM product acquisition which brought USD107million during the quarter.
- EBIT during the quarter posted a strong growth of 23.9%QoQ. EBIT margin touched 20% range which is expansion of 278bps (above our estimates of 150bps). Higher margins were driven by benefit from absence of one-time investments in 1QFY20 (210bps positive impact), SG&A efficiency (70bps positive), lower visa cost and lower amortization (combined 50bps impact).
- PAT for the quarter came in at Rs 2651 crore, a growth of 18.9%QoQ. Higher pat growth was mainly owing to higher operating income

Broad based growth across segments

The company reported a broad based growth across its segments with strong revenue coming from Products & Platforms business which grew 57%QoQ in USD terms (as expected) mainly due to IBM product consolidation. On the other hand, Engineering and R&D (ERD) clocked a healthy growth of 5.2% QoQ growth while IT and Business Services saw 0.2% QoQ USD revenue decline mainly reflecting pressure in traditional services. Even vertical wise, Financial Services grew 16%QoQ in USD terms, Telecom, MP&E was up by 10.4% in USD and Retail & CPG increased 10.7% QoQ in USD terms.

Margin to contract in 2H

The company posted solid margin execution during the quarter. Margin for the quarter expanded 278bps to 20% largely driven by integration of higher-margin IBM IP products and lower amortization recognized by the company in its Products and Platforms business. However as the amortization rate is expected to increase in 2H, EBIT margin will likely to contract in 2H. Thus management has also maintained its margin guidance (18.5% to 19.5%) seeing the margin pressure. Even for FY21, the increase in R&D spend will hold the margins in 18% range.

Raised revenue guidance

The company has raised its FY20E revenue growth guidance to 15-17% from 14-16% earlier, with 10-11% being organic and 5-6% being inorganic growth. EBIT margin guidance is maintained at 18.5- 19.5%.

View and valuation

HCLTECH has reported a healthy growth in both its revenue and margins in 2QFY20. Organic revenue grew 14%YoY mainly led by ramp up of new deal wins (Nokia, Broadcom and Xerox) while margin reached 20% range largely driven by integration of higher margin business (IBM products). Going forwards, we believe the HCLTECH will manage to clock industry leading growth among peers driven by strong organic growth with continued deals ramp up. Also inorganic growth is expected to inch up in 2H as focus on renewals will support growth.

However, on margin front, we expect higher amortization and R&D spend will drag the margins in 2H, thus overall FY20 margins is expected to land in lower end of the guidance (18.5% to 19.5%).

Factoring in near term margins pressure we have largely kept our estimates unchanged for FY20 and increased PAT by 3% for FY21. Thus we largely maintain our Accumulate stance on the stock with the target price of Rs1227.

Key Risks to our rating and target

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

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2QFY20 Results

Mixed performance

Financials	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	YoY %	QoQ%	FY18	FY19	Fig in Rs cr
										YoY %
Net Sales	14,860	15,699	15,990	16,427	17,527	17.9%	6.7%	50569	60427	19.5%
Other Income	284	134	200	183	102	-64.1%	-44.3%	1,217	943	-22.5%
Employee Exp	7,258	7,605	7,713	8,398	8,647	19.1%	3.0%	24,729	29,283	18.4%
Other Expenses	3,784	3,979	4,198	4,183	4,294	13.5%	2.7%	4,619	5,761	24.7%
EBITDA	3,463	3,632	3,594	3,570	4,259	23.0%	19.3%	11246	13926	23.8%
Depreciation	511	541	545	735	747	46.2%	1.6%	1,383	2,073	49.9%
EBIT	2,952	3,091	3,049	2,835	3,512	19.0%	23.9%	9,863	11,853	20.2%
Interest	30	55	69	87	136	353.3%	56.3%	69	174	152.2%
PBT	3,206	3,170	3,180	2,931	3,478	8.5%	18.7%	11,011	12,622	14.6%
Tax	672	565	630	701	827	23.1%	18.0%	2,302	2,502	8.7%
PAT	2,534	2,605	2,550	2,230	2,651	4.6%	18.9%	8,722	10,120	16.0%

Concall Highlights

- **Mode-wise performance:** IT and business services, which is Infrastructure Application and business services grew 0.9% during the quarter. Engineering and R&D Services delivered a stellar performance on the back of a very good revenue performance last quarter. Products & Platform grew 57%QoQ mainly supported from the contribution from the HCL Software business (\$100 million came from that business). Mode 2 and mode3 continued its growth momentum and grew 3% and 6%QoQ respectively. The mix now stands at 33%
- **Margin performance :**
 - The margin came at 20%, 210bps expansion during the quarter. Products & Platforms (benefited 115bps), Engineering and R&D Services and ITes support the growth. In ERS, productivity was one lever which helped. Also some revenue which couldn't come in last quarter came in 2QFY20.
 - Also, 290 bps improvement in margin came from Forex which benefitted 23bps, absence of Visa expenses further gave 9bps, Amortization added 15bps and One off in the previous quarter benefitted 70bp. However 45 bps increments given by the company offset some margins.
- **Broad based across geographies and verticals:** Geography wise, Americas grew by 5.5%QoQ; Europe was up by 7% and ROW, a little over 7%QoQ. Segments wise, the company posted a double digit in four of the seven verticals. The highlights of the quarter were the financial services which grew on a robust 7.4%QoQ on the back of number of ramp-ups in some of the existing clients and the project work. Technology vertical saw significant growth mainly contributed by the uptick in revenue due to the HCL Software business. Other verticals also grew quite well. Public services (part of other segment) has seen a big uptick during the quarter because a lot of government clients have been using the products that the company acquired from IBM.
- **Update on HCL Software:**
 - Total value of IBM acquisition deal have gone up marginally by USD 7 million to USD1743m due to increase in earn out estimates.
 - Amortization for 2QFY20 was USD38m mainly due to lower revenue recognition from direct billing and more from deferred revenues. Amortization is expected to increase as revenue recognition increases from direct billing in following quarters. Amortization for FY20 is expected to be USD 145m (USD 49m below 1Q guidance).
 - Seasonality of software business is expected to come down going forward as earlier it was largely driven by IBM's sales cycle.
- **Continued uptick in deal wins:** 15 transformational deals were signed in 2QFY20. Also order booking which was lower in 1QFY20, saw a good order booking in this quarter.
- **Tax rate:** Standalone tax rate for India is quite lower than 25%, hence the company will not go to newer tax regime for some years given lot of MAT credit has been accumulated as well.
- **Bonus:** Company has proposed 1:1 bonus share subject to appropriate approvals. Board has approved a dividend of Rs2 per share.
- **Retail outlook:** 1H booking was strong. In Q3FY20, as few projects will be getting completed and it is expected to be soft.
- **Guidance and outlook:** The company has increased the guidance for FY20 revenue growth to 15-17% YoY CC from earlier 14-16% YoY CC. Management has retained its margin guidance of 18.5%-19.5%. Organic growth is expected to be 10 to 11% YoY CC while rest 5% to 7% will come from inorganic growth.

Revenue Mix

Strong growth across segments

VERTICAL (USD mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	QoQ%	YoY%
Financial Services	509	489	483	476	481	480	507	5.7%	5.1%
Manufacturing	733	750	760	802	825	917	1004	9.5%	32.2%
Retail & CPG	234	263	271	286	228	225	226	0.7%	-16.4%
Telecommunication	216	216	225	214	196	189	199	5.2%	-11.4%
Lifesciences & Healthcare	196	187	210	225	296	303	313	3.5%	49.2%
Public Services	151	150	151	203	253	248	236	-4.8%	56.3%

Revenue by Geography

Strong growth in US

GEOGRAPHY (USD mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	QoQ%	YoY%
US	1255	1326	1381	1418	1433	1600	1688	5.5%	22.22%
Europe	611	578	562	621	677	612	639	4.4%	13.58%
RoW	173	154	155	161	169	149	159	6.8%	2.44%

Revenue by Geography

Mode 2 and mode remained robust

Business Lines	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	QoQ%	YoY%
Mode 1		1507	1512	1561	1606	1662	1665	0.2%	10.12%
Mode 2		321	336	377	430	444	455	2%	35.42%
Mode 3		227	251	263	242	258	365	41%	45.42%

Exhibit: Revenue trend

Large deal ramp ups and consolidation of IP aided to revenues

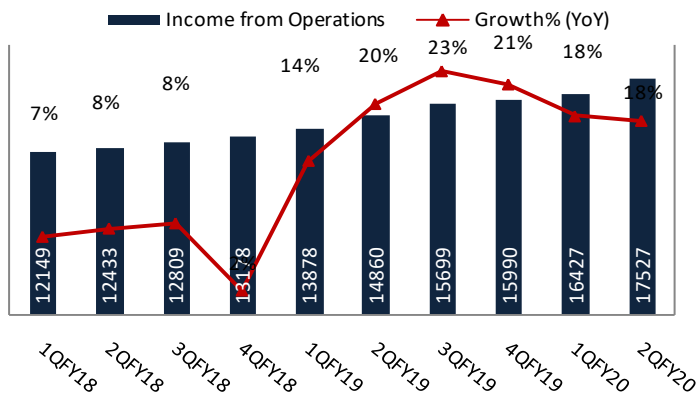


Exhibit: Services revenue

Higher focus towards Mode 2 and Mode 3

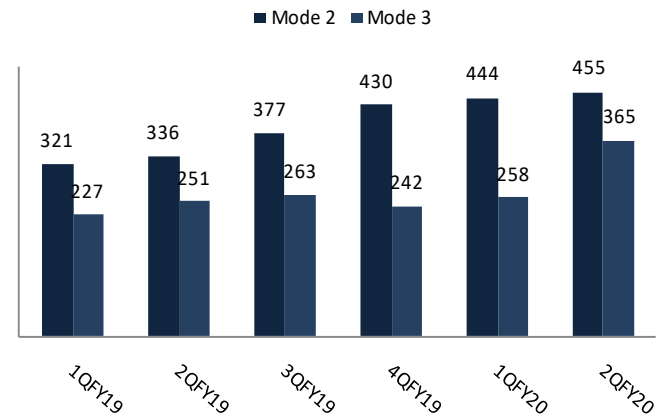


Exhibit: Margin Trend

Strong margin execution in 2Q, FY20 guidance at 18.5-19.5%

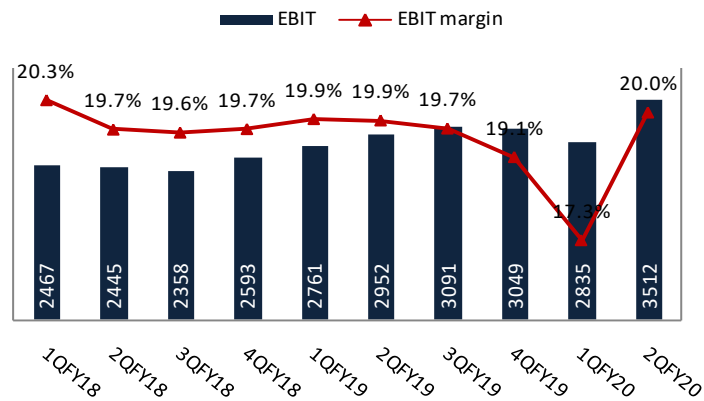


Exhibit: Attrition trend

Attrition inched up during the quarter however still remain under control.

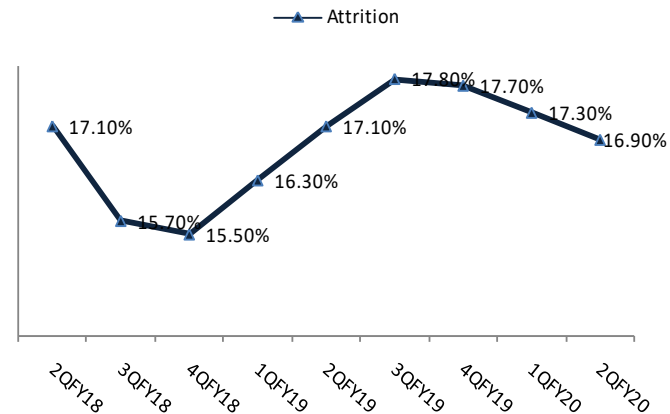
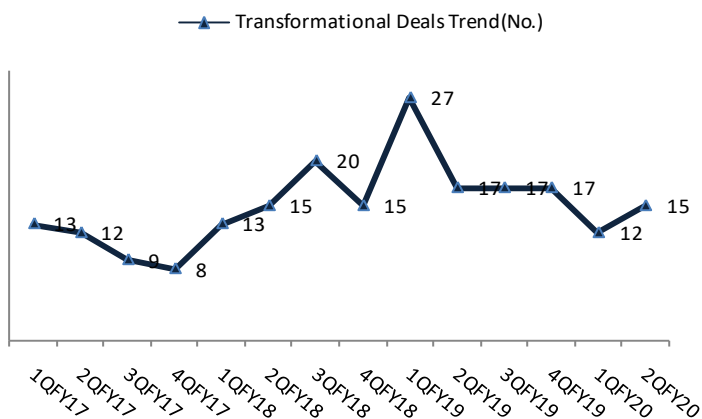


Exhibit: Transformational Deals Trend

Deal wins remained strong



Operational Details

Industry Revenue	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
IT and Business services						75.8%	75.3%	71.4%
Engineering and R&D services						16.6%	16.9%	16.9%
Products & Platforms						7.6%	7.8%	11.7%
Geography (%)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Americas	63.5%	61.6%	64.5%	65.8%	64.4%	62.9%	67.7%	67.9%
Europe	28.7%	30.0%	28.1%	26.8%	28.2%	29.7%	25.9%	25.7%
RoW	7.9%	8.5%	7.5%	7.4%	7.3%	7.4%	6.3%	6.4%
REVENUE BY VERTICAL	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Financial Services	24.6%	25.0%	23.8%	23.0%	21.6%	21.1%	20.3%	20.4%
Manufacturing	36.5%	36.0%	36.5%	36.2%	36.4%	36.2%	38.8%	40.4%
Lifesciences & Healthcare	11.7%	11.5%	12.8%	12.9%	13.0%	10.0%	9.5%	9.1%
Public Services	10.2%	10.6%	10.5%	10.7%	9.7%	8.6%	8.0%	8.0%
Retail & CPG	9.6%	9.6%	9.1%	10.0%	10.2%	13.0%	12.8%	12.6%
Telecommunications, Media, P	7.4%	7.4%	7.3%	7.2%	9.2%	11.1%	10.5%	9.5%
CONTRACT TYPE	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Fixed Price Projects	60.8%	61.6%	62.0%	61.8%	63.3%	63.7%	63.5%	66.5%
Time & Materia	39.2%	38.4%	38.0%	38.2%	36.7%	36.3%	36.5%	33.5%
AVERAGE RATES	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
USD - INR	64.4	64.7	67.5	70.8	71.48	70.19	70.19	70.52
GBP - USD	1.33	1.4	1.34	1.3	1.28	1.31	1.31	1.23
EUR - USD	1.18	1.23	1.18	1.16	1.14	1.13	1.13	1.1
SEK - USD	0.12	0.12	0.11	0.11	0.11	0.11	9.2	9.66
AUD - USD	0.77	0.78	0.75	0.73	0.72	0.71	0.71	0.68
CLIENTS (LTM)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
100 Million dollar +	9	8	9	9	10	10	12	13
50 Million dollar+	25	28	32	31	29	29	29	30
40 Million dollar +	40	40	40	N/A	N/A	N/A	N/A	N/A
30 Million dollar +	56	58	56	N/A	N/A	N/A	N/A	N/A
20 Million dollar +	85	87	87	90	95	95	93	93
10 Million dollar +	156	160	162	165	164	166	172	171
5 Million dollar +	261	264	267	269	276	283	293	299
1 Million dollar +	552	561	571	575	597	623	633	667
CLIENT CONTRIBUTION	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Top 5 Clients	15.8%	16.3%	17.0%	17.3%	17.4%	17.0%	16.6%	16.5%
Top 10 Clients	23.5%	23.8%	24.6%	24.8%	24.8%	24.1%	23.9%	24.0%
Top 20 Clients	33.5%	33.7%	34.2%	34.2%	34.1%	33.4%	34.2%	34.6%
People metrics	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Total Employee Count	119040	120081	124121	127875	132328	137965	143900	147123
Technical	108351	109565	113404	116910	121273	126717	132384	135957
Support	10689	10516	10717	10965	11055	11248	11516	11166
Gross Addition	11683	8476	12558	11683	13191	14249	16332	13430
Attrition - IT Services (LTM)	15.7%	15.5%	16.3%	17.1%	17.8%	17.7%	17.3%	16.9%

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	50,112	60,693
Networth	19,542	24,224	27,294	32,950	36,386	41,366	50,383	60,964
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	54,582	65,163
Net Fixed Assets (incl CWIP)	7,975	8,827	10,561	9,180	12,274	14,062	17,920	19,510
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	108	120
Debtors	5,683	6,539	7,682	8,301	9,639	11,706	13,924	15,379
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	1,561	1,724
Cash & Bank	8,807	9,786	9,285	9,044	4,018	7,872	11,376	18,956
Other Curr Assets	2,521	3,613	5,075	5,175	4,962	6,521	6,891	7,133
Current Assets	19,330	23,047	24,860	26,470	24,558	29,722	36,081	45,531
Creditors	468	625	700	801	918	1,305	1,552	1,714
Provisions	1,462	1,734	1,804	473	530	586	697	770
Other Curr Liab	7,105	7,231	7,442	1,722	1,325	1,810	2,153	2,378
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	12,276	12,736
Net Current Assets	10,294	13,457	14,915	15,190	14,493	18,147	23,804	32,795
Total Assets	29,980	35,245	39,344	45,769	48,023	58,575	68,791	79,832

Income Statement

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	32143.66	36701.22	30780.8	47567.53	50569	60427	71878.87	79384.87
Change (%)	26%	14%	-16%	55%	6%	19%	19%	10%
EBITDA	8,035	8,473	6,540	10,385	11,246	13,926	16,458	18,315
Change (%)	42%	5%	-23%	59%	8%	24%	18%	11%
Margin (%)	25%	23%	21%	22%	22%	23%	23%	23%
Depr & Amor.	681	404	393	828	1,383	2,073	3,064	3,321
EBIT	7,354	8,069	6,148	9,556	9,863	11,853	13,394	14,995
Int. & other fin. Cost	115	91	74	89	69	174	495	544
Other Income	677	1,139	895	1,073	1,217	943	664	1,393
EBT	7,917	9,117	6,969	10,541	11,011	12,622	13,563	15,844
Exp Item	-	-	-	-	-	-	-	-
Tax	1,410	1,815	1,364	1,936	2,302	2,502	3,245	3,961
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	10,318	11,883
Adjusted PAT	6,510	7,342	5,661	8,606	8,722	10,120	10,318	11,883
Change (%)	61%	13%	-23%	52%	1%	16%	2%	15%
Margin(%)	20%	20%	18%	18%	17%	17%	14%	15%

Financial Details

Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	40	34	22	32	32	34	30	31
ROCE	43	36	24	31	28	29	27	25
Asset Turnover	3	2	1	2	2	2	2	2
Current Ratio	2	2	2.6	2.3	2.4	2.6	2.9	3.6
Debtor Days	65	65	91	64	70	71	71	71
Book Value Per Share	279	172	194	231	261	305	372	450
Payable Days	5	6	8	6	7	8	8	8
Earnings Per Share	93	52	40	60	63	75	76	88
P/E	15	19	20	14	15	15	15	13
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	13563	15844
(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	-3245	-3961
others	0	0	0	0	0	0	0	0
CF from Op. Activities	6457	5539	3796	8995	8328	9974	11229	13792
(inc)/Dec in FA & CWIP	-720	-1208	-917	-1278	-5344	-3861	-6922	-4911
Free Cashflow	5737	4331	2879	7717	2984	6113	4308	8881
(Pur)/Sale of Inv	-7852	-8205	-6869	-11666	-20027	137	0	0
others	-13412	-11427	-9940	-16761	-27654	-7449	-13844	-9822
CF from Inv. Activities	-4840	-2014	-2154	-3817	-2283	-3724	-6922	-4911
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	3504	7580
Add: Opening Balance	719	953	1319	676	1368	1699	5934	9438
Closing Balance	1027	1339	724	1321	1699	5934	9438	17018

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