

# HCL TECHNOLOGIES LTD

IT SERVICES

21 AUG 2019

Company Update

**BUY**

Target Price : Rs 1,235

CMP : Rs 1,072  
Potential Upside : 15%  
Relative to Sector : Positive

## MARKET DATA

No. of Shares : 135.62 Cr  
FV (Rs) : 2  
Market Cap (Rs Cr.) : 144,482  
52-week High / Low : Rs 1,190/ Rs 920  
Avg. Daily vol. (6mth) : 45,28,033 shares  
Bloomberg Code : HCLT IN  
Reuters Code : HCLT NS  
BSE Code : 532281  
NSE Code : HCL TECH

## Q1 FY20:- Healthy growth momentum to continue

HCL Tech reported strong Q1FY20 numbers. The numbers are much in line with expectations. The revenue in constant currency grew 2.7% QoQ and 18.4% on YoY basis at Rs. 16,425 crs. However Net income was down by 13.6% QoQ at Rs. 2,220 crs. The mode 1 business vertical grew by 4.1% QoQ, Mode 2 business vertical grew by 3.6% QoQ. Mode 3 business grew by 6.5% QoQ. However operating margins have decline by 193 bps at 17.1% due to higher visa cost, investment in ERS business, and forex loss. The company has given strong revenue growth guidance 14%-16% for FY20 backed by strong deal wins. It maintained FY20 operating margin guidance of 18.5-19.5% citing investments in the digital business. Management commentary on deal wins was positive with 12 transformational deals linked during the quarter. During the quarter the company added 2 clients in 100mn+ vertical, 6 clients in 10mn+ vertical, 10 clients under 5mn + bucket, 10 clients under 1mn + bucket.

Healthy deal wins, higher growth in key business verticals will put HCL Tech on high growth trajectory. **We assign 13.8x P/E multiple to its FY21E earnings of Rs. 89.5 per share which gives a target price of Rs. 1,235 per share, an upside of 15%.**

## Key Highlights

### Strong broad based growth, IMS business seen strong revival

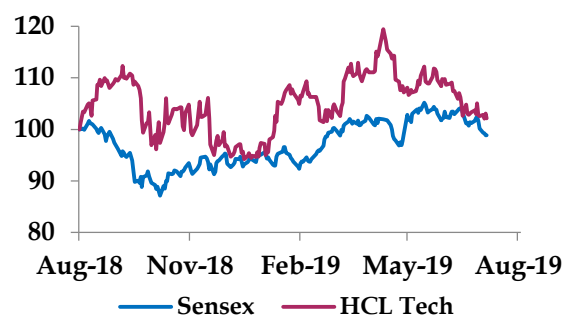
IMS vertical has seen strong revival during two previous consecutive quarters. Its strong integrated offering with DRYICE (automation platform) is driving strong wins. Management expects 30% of deals to move to public cloud and next generation services will adopt a hybrid cloud model. Business services, Engineering and R&D services grew by 6.0% QoQ. On Vertical front financial services grew marginally by 0.5% QoQ, Manufacturing sector showed a strong growth 18.4% QoQ, Healthcare sector grew by 2.4%QoQ, Technology and services sector grew 5% QoQ, Retail and CPG remained tepid at -1.4% QoQ growth. Telecommunication Sector degrew by 2.7%. On Geographical front, Americas grew by 11.7%QoQ, Europe degrew by 8.4%, RoW degrew by 8.1% QoQ.

## FINANCIAL SUMMARY (Consolidated)

Y/E	Sales	EBITDA	PAT	EPS	P/E	RoE	RoCE	DPS
March	(Rs Cr)	(Rs Cr)	(Rs Cr)	(Rs)	(x)	(%)	(%)	(Rs)
FY18	47,568	11,458	8,606	64.7	15.8	25%	25%	12
FY19	60,427	13,968	10,127	74.6	13.7	26%	24%	10
FY20E	67,385	15,548	10,134	81.4	13.3	23%	21%	32
FY21E	70,831	17,808	11,470	89.5	12.2	24%	22%	34

Source: Company, Axis Securities, Consensus Estimates, CMP as on 20<sup>th</sup> Aug, 2019

## PRICE PERFORMANCE



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## IBM partnership – driving growth and earnings momentum

HCL Tech has completed the acquisition of 7 products from IBM out of which 5 products were earlier under IP partnership and 2 products are new. Company has already paid \$ 81 crs on June 30, 2019, and will likely pay \$ 81.25 Crs after one year. The deal also has an earnout component of \$ 15 crs to be paid in three installments. This partnership will lead to goodwill of \$ 92 crs and intangible asset of \$ 125 crs adding to amortization. IBM product portfolio has EBITDA margin of 50%+ with amortization of ~20%, yielding EBIT margin of ~30%. The business has Q3 as the strongest quarter and Q2 as the weakest. We believe that IBM product business will help regain the operating margins over the longer run.

## Key Highlights

- Financial services vertical reported muted growth for yet another quarter, the financial services vertical posted 0.5% QoQ growth due to client specific issues in two key accounts. However management indicated that 1 account is stabilizing and will likely see revival in H2 FY20 or in Q4 FY20.
- HCL launched new division viz HCL software which will be a part of products and platform and will house the IBM products along with several other software and IP assets.
- Management is expecting tax rate to be at 24%-26% for FY20.
- HCLT highlighted the selective approach it is adopting to sign deals in order to protect margin due to margin headwinds from deal transition costs and ER&D business

## Mode 1-2-3 Highlights

	Revenue (In \$ mn)	Revenue Mix	EBIT Margin	QoQ Growth
Mode 1	1662	70%	18%	4%
Mode 2	444	19%	13%	4%
Mode 3	258	11%	19%	7%
<b>Total</b>	<b>2364</b>	<b>100%</b>	<b>17%</b>	<b>4%</b>

### Geographical Mix

	Q1 FY20	Q4 FY19	Q1 FY19	QoQ	YOY
America	68%	63%	64%	480	370
Europe	26%	30%	28%	(380)	(220)
RoW	6%	7%	8%	(110)	(120)

### Service Mix

	Q1 FY20	Q4 FY19	Q1 FY19	QoQ	YOY
Application Services	33%	32%	35%	60	(210)
Infrastructure Services	39%	38%	37%	140	160
Business Services	5%	5%	4%	(50)	60
Engineering and R&D Services	24%	26%	24%	(160)	(20)

### Vertical Mix

In (%)	Q1 FY20	Q4 FY19	Q1 FY19	QoQ	YOY
Financial Services	20%	21%	24%	(80)	(350)
Manufacturing	20%	18%	18%	240	160
Technology & Services	19%	19%	18%	20	70
Retail & CPG	10%	10%	9%	(50)	40
Telecommunication, Media	8%	9%	7%	(40)	90
Lifesciences & Healthcare	11%	13%	13%	(250)	(230)
Public Services	11%	11%	11%	-	60

### Number of Clients

In (%)	Q1 FY20	Q4 FY19	Q1 FY19	QoQ	YOY
100 Mn +	12	10	9	20%	33%
50 Mn +	29	29	32	0%	-9%
20 Mn +	93	95	87	-2%	7%
10 Mn +	172	166	162	4%	6%
5 Mn +	293	283	267	4%	10%
1 Mn +	633	623	571	2%	11%

## Clinet Contribution

	Q1 FY20	Q4 FY19	Q1 FY19
Top 5 Clients	17%	17%	17%
Top 10 Clients	24%	24%	25%
Top 20 Clients	34%	33%	34%

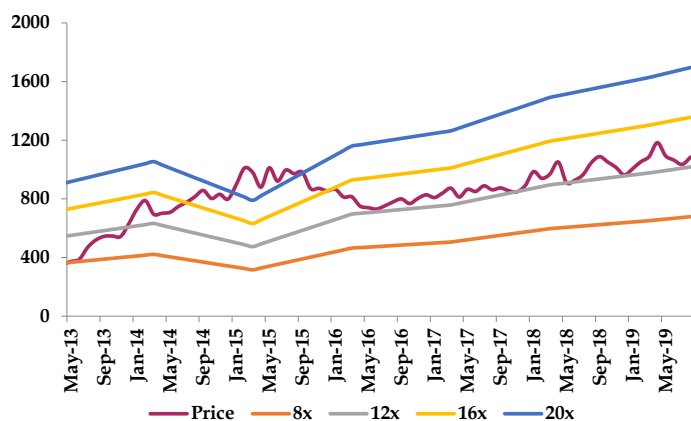
## Employee Data

In (%)	Q1 FY20	Q4 FY19	Q1 FY19	QoQ	YOY
<b>Total Employee Count</b>	<b>143,900</b>	<b>137,965</b>	<b>124,121</b>	<b>4%</b>	<b>16%</b>
Technical	132,384	126,717	113,404	4%	17%
Support	11,516	11,248	10,717	2%	7%
Gross Addition	16,332	14,249	12,558	15%	30%
Attrition	17.3%	18.0%	16.3%		
Blended Utilization	85.4%	86.6%	85.9%		

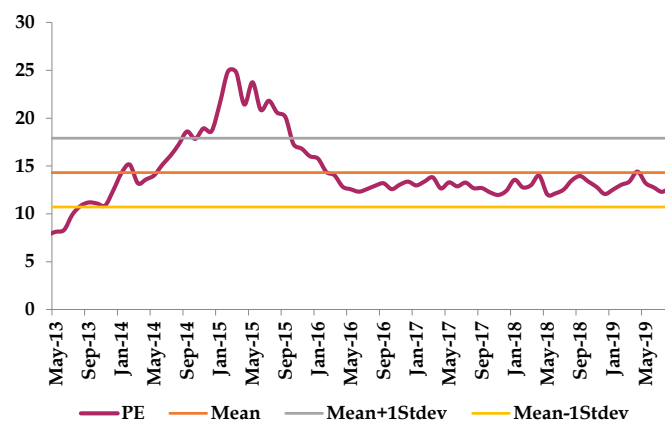
## Valuations

Robust business structure, healthy deal pipeline and revitalization of key business segment make HCL Tech a safer bet to invest in. Rising demand across geographies and across different verticals helps HCL Tech to attain higher growth momentum. We assign 13.8x P/E multiple to its FY21E earnings of Rs. 89.5 per share which gives a target price of Rs. 1,235 per share, an upside of 15%.

### HCL Tech- 12M Fwd PE Band

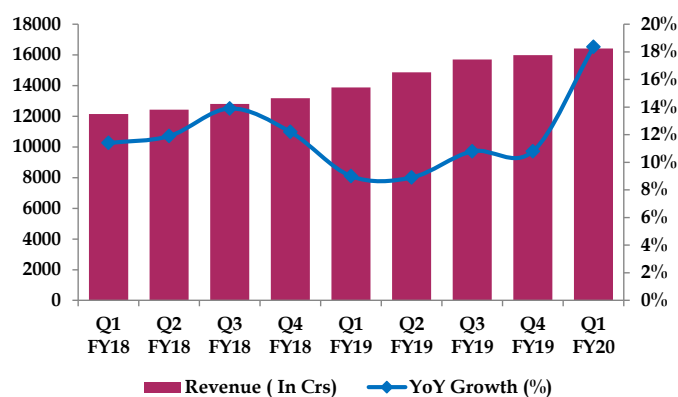


### HCL Tech 12M Fwd PE Chart

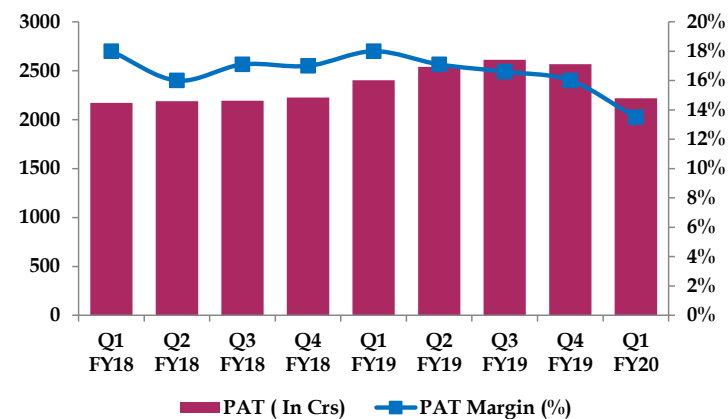


Source: Company, Axis Securities

## Revenue growth

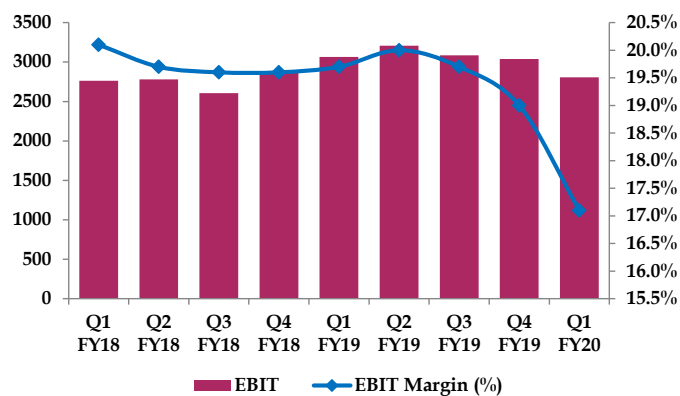


## Net Profit growth

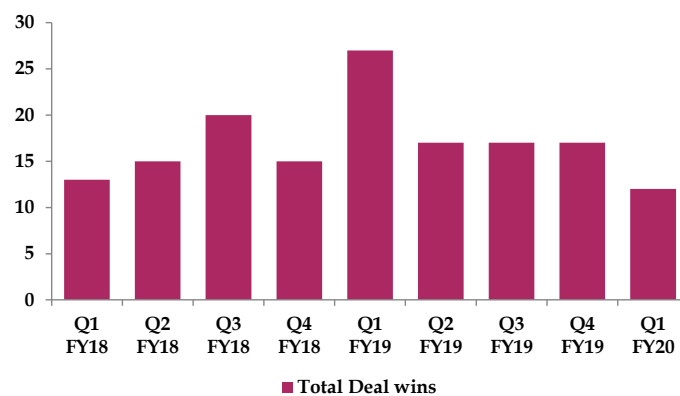


Source: Company, Axis Securities

## Operating Margin



## Total Deal wins (In Numbers)



Source: Company, Axis Securities

## Results Update

	Quarterly Performance				
(Rs.Cr.)	Q1FY20	Q4FY19	Q1FY19	% Change (QoQ)	% Change (YoY)
Revenues	16425	15,990	13,878	3%	18%
Direct Costs	10920	10,421	9,106	5%	20%
Gross Profits	5505	5,568	4,771	-1%	15%
SG&A	2105	1,972	1,546	7%	36%
<b>EBITDA</b>	<b>3401</b>	<b>3,596</b>	<b>3,225</b>	-5%	5%
EBITDA Margin	21%	22%	23%		
Depreciation	595	558	496	7%	20%
<b>EBIT</b>	<b>2806</b>	<b>3,039</b>	<b>2,729</b>	-8%	3%
EBIT Margin	17%	19%	20%		
Forex Gains	19	23	143	-17%	
Other Income	109	129	153	-16%	
<b>EBT</b>	<b>2934</b>	<b>2,568</b>	<b>3025</b>	14%	-3%
Provision For Tax	705	615	622	15%	13%
<b>ETR</b>	<b>24%</b>	<b>24%</b>	<b>21%</b>		
<b>Net Profit</b>	<b>2220</b>	<b>2,568</b>	<b>2,403</b>	-14%	-8%
Net Profit Margin	14%	16%	17%		
<b>EPS Diluted</b>	<b>65.5</b>	<b>75.7</b>	<b>69</b>		

Source: Company, Axis Securities

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