

HCL TECHNOLOGIES LTD

IT

12 FEB 2019

Company Update

BUY

Target Price : Rs 1,235

CMP : Rs 1,076
 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 1,124/ Rs 880
 Avg. Daily vol. (6mth) : 12,61,913 shares
 Bloomberg Code : HCLT IN
 Reuters Code : HCLT NS
 BSE Code : 532281
 NSE Code : HCL TECH

Q3 FY19: Ability Unleashed

HCL Technologies Ltd. (HCL Tech) reported strong organic growth of 5.7% QoQ and 22.6% YoY in Q3 FY19. HCL Tech's robust growth in Mode-2 Services fueled by all the components that include Digital & Analytics, Security, IoT and Cloud Native services. HCL Tech continues its strong deal win momentum, signing 17 transformational deals this quarter, which are a mix of Mode 1 and Mode 2 services across all service lines. These deals were led by verticals such as Financial Services, Technology & Services and Manufacturing. HCL Tech reported strong growth at 13% YoY in constant currency was broad based across verticals led by Telecommunications, Media, Publishing & Entertainment (up 40.3% YoY), Technology & Services (up 24.4% YoY), Life Science and Healthcare (up 23.4% YoY, Retail and CPG (up 21.5% YoY).

Healthy deal wins, higher growth in key business verticals will put HCL Tech on 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 across verticals

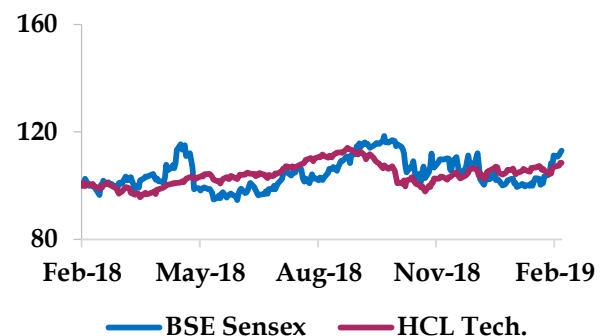
HCL Tech reported strong Q3FY19 results in terms of revenue and deal pipeline; HCL tech reported revenue growth of 5.6% QoQ and 13% on YoY on constant currency basis. HCL Tech's growth was broad based across Verticals led by Telecommunications, Media, Publishing & Entertainment (up 40.3% YoY), Technology & Services (up 24.4% YoY), Life Science and Healthcare (up 23.4% YoY), Retail and CPG (up 21.5% YoY). However financial services vertical posted marginal growth of 0.1% on YoY basis, impacted by 2 large European clients as they ramp downs the automation. Manufacturing segment reported steady growth of 3.9% on QoQ and 1.5% YoY.

FINANCIAL SUMMARY (Consolidated)

Y/E	Sales	EBITDA	PAT	EPS	P/E	RoE	RoCE
March	(Rs Cr)	(Rs Cr)	(Rs Cr)	(Rs)	(x)	(%)	(%)
FY18	47,568	11,458	8,606	64.7	15.2	29%	31%
FY19E	50,569	11,246	8,721	74.8	14.5	25%	26%
FY20E	60,385	14,062	10,134	83.4	13.3	26%	27%
FY21E	67,831	15,808	10,970	89.5	12.2	25%	26%

Source: Company, Axis Securities, Consensus Estimates, CMP as on 11th FEB, 2019

PRICE PERFORMANCE

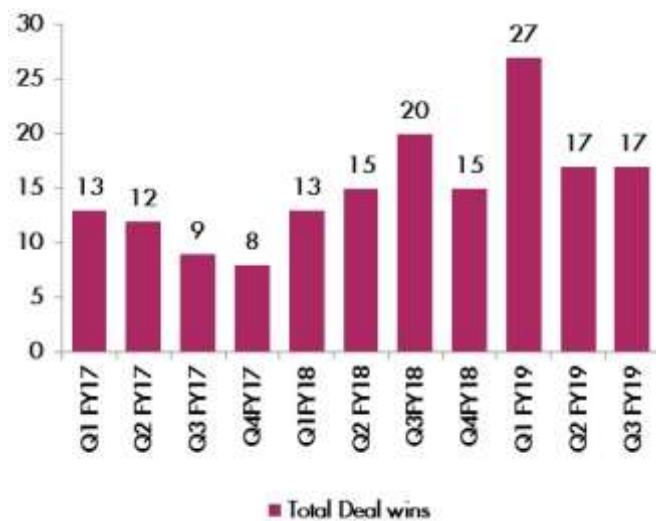


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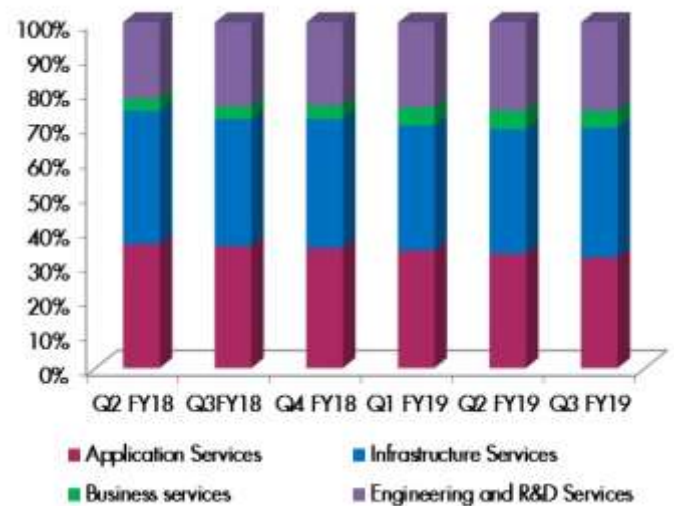
Robust growth across Business lines

In Q3 FY19, HCL tech posted healthy growth across all the business lines. Mode-2 services grew 13.1% on YoY basis, Mode-3 grew 6.2% on YoY basis and Mode-1 grew by 3.9% on YoY basis. Mode 2 has crossed \$1.5 bn run rate. The robust growth in Mode-2 Services was fueled by all the components including Digital & Analytics, Security, IoT and Cloud Native services contributed about 17.2% to the revenue. Mode-1 growth was driven by IMS, ERS and Applications, all of them demonstrating strong traction contributed about 71% to the revenue. During Q3 FY19 HCL Tech added 17 transformational deals these deals are across sectors and different business lines. For the period of Q3 FY19, IMS vertical posted strong growth of 10.4% growth on QoQ while ER&D services posted highest growth among all verticals at 17.4% QoQ. Application services posted marginal growth of 2.5% on QoQ basis.

Deal Wins



Services contribution



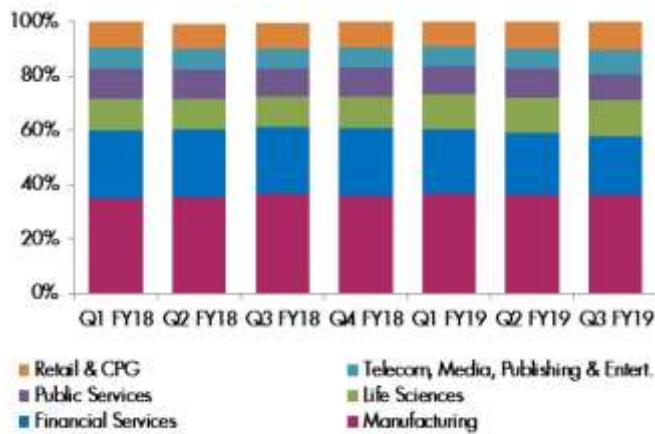
Source: Company, Axis Securities

Key business verticals gaining momentum

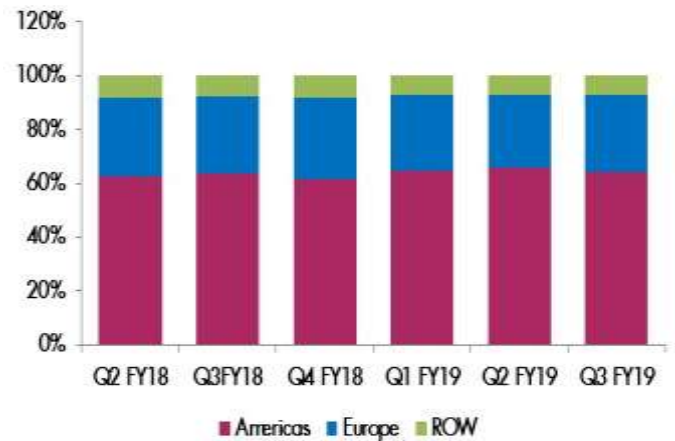
HCL Tech’s strong growth at 13% YoY in CC terms. The reported growth was broad based across verticals led by Telecommunications, Media, Publishing & Entertainment 40.3%, Technology & Services 24.4%, Life Science and Healthcare 23.4%, Retail and CPG 21.5%. (On YoY Constant Currency basis). However financial services vertical posted marginal growth of 0.1% on YoY basis, impacted by 2 large European clients as they ramp downs the automation. Manufacturing segment reported steady growth of 3.9% on QoQ and 1.5% YoY.

All geographies reported double-digit growth with Europe being leader. Europe grew by 14.5% on YoY basis, America grew by 12.9% on YoY basis and RoW (ex-India) 12.1% on YoY basis. Broad based growth across geographies denotes growing robustness of the business.

Revenues by Business segments



Revenues by client geography



Source: Company, Axis Securities

Another quarter of Strong client addition

HCL Tech has strong client distribution across segments which reduces dependency over particular clients and makes business structure more robust. This also helps to maintain steady operating margins over longer period of time. Client addition during the recent quarters remained high which denotes rising demand for automation among different verticals. During Q3 FY19 HCL Tech added 17 transformational deals these deals are across sectors and different business lines. For Q3 FY19 HCL Tech added 22 clients in \$1mn+ bucket, 7 clients in \$5mn+ bucket and 5 clients in \$20mn+ bucket. A new client was added in the \$100mn+ client bracket. There was decline of 1/2 clients in the \$10mn+ and \$50mn+ client buckets, respectively.

Client Matrix

Client Matrix	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19
\$1-5 mn	277	291	297	304	306	321
\$10-20 mn	73	71	73	75	75	69
\$50-100 mn	16	16	20	23	22	19
\$100 mn +	9	9	8	9	9	10

Client contribution Revenue

Client contribution Revenue	Q3 FY19	Q2 FY19	Q3 FY18
Top 5 Clients	17.4%	17.3%	15.8%
Top 10 Clients	24.8%	24.8%	23.5%
Top 20 Clients	34.1%	34.2%	33.5%

Client Business

Client contribution Revenue	Q3 FY19	Q2 FY19	Q3 FY18
New Clients	3.8%	3.1%	3.1%
Existing Clients	96.2%	96.9%	96.9%
Days Sales Outstanding	66	64	66

Higher employee addition denotes rising demand

In Q3FY19, HCL Tech has reported strong employee addition thereby promising timely delivery of projects undertaken and also rising demand for automation. The company has added 4,453 employees during Q3FY19 taking the total headcount at 1,32,328. The attrition rate for IT services during the quarter has increased to 17.8% as compared to 16.3% in Q2FY19.

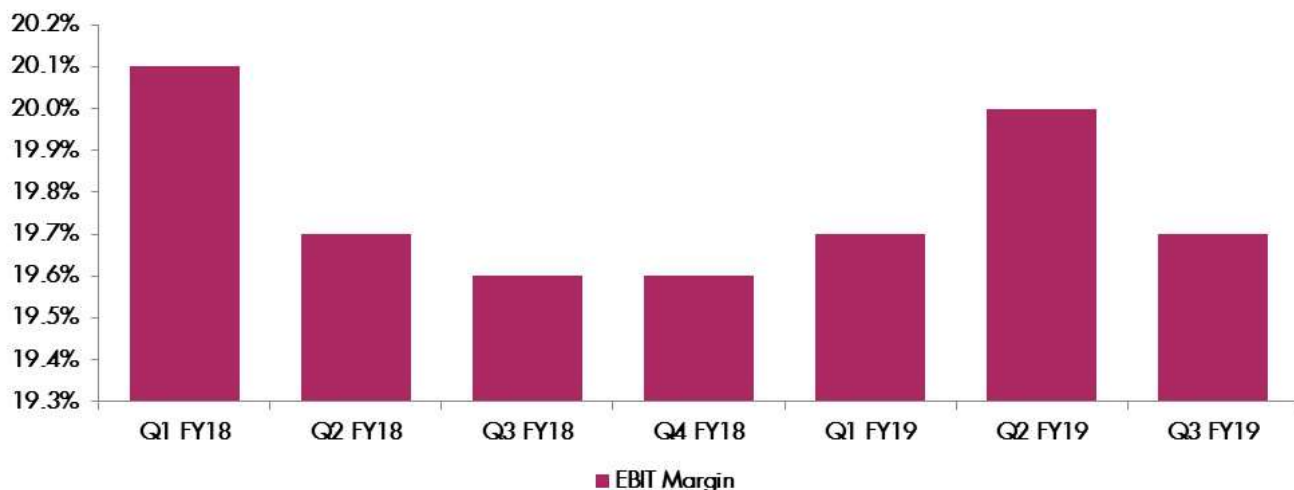
Employee Matrix

Headcount & Attrition Rate	Q2 FY18	Q3FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19
Total Employee	119,040	119,291	120,081	124,121	127,875	132,328
Utilization (%)	86%	86%	86%	86%	87%	87%
Attrition Rate (%)	16%	15%	16%	16%	17%	18%

Margin Analysis

For Q3 FY19, Gross margins have improved slightly by 101 bps on YoY at 35%. EBIT margin declined 30 bps sequentially to 19.7% due to headwinds arising from higher onsite expenses and employee expenses. The higher operating expenses were partly recovered by tailwinds like higher utilization and currency translation. The company retained EBIT margin band of 19.5% - 20.5% for Q4 FY19. We believe operating margin will be under stress in upcoming quarters on account of rising onsite expenses. Tax rate was lower at 17.7% than previous quarter of 20.9%.

Operating Margins



Source: Company, Axis Securities

Margin Analysis

In (%)	Q3 FY19	Q3 FY18	Q2 FY18	YoY	QoQ
Direct cost (As % of Revenue)	65%	66%	65%	(101)	14
Gross profit margin (%)	35%	34%	36%	101	(14)
SG&A Expenses (As % of Revenue)	12%	11%	12%	92	17
EBITDA Margin	23%	23%	24%	9	(31)
EBIT Margin	20%	20%	20%	7	(30)
Effective Tax Rate (ETR %)	18%	21%	21%	(314)	(333)
Net Profit Margin	17%	17%	17%	(50)	(46)

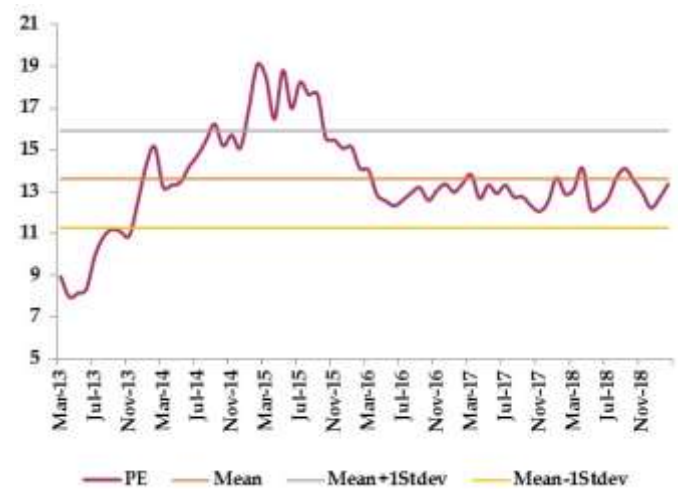
Valuations

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

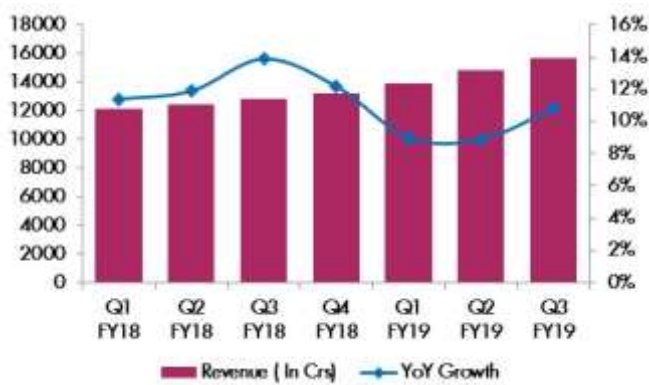


HCL Tech 12M Fwd PE Band

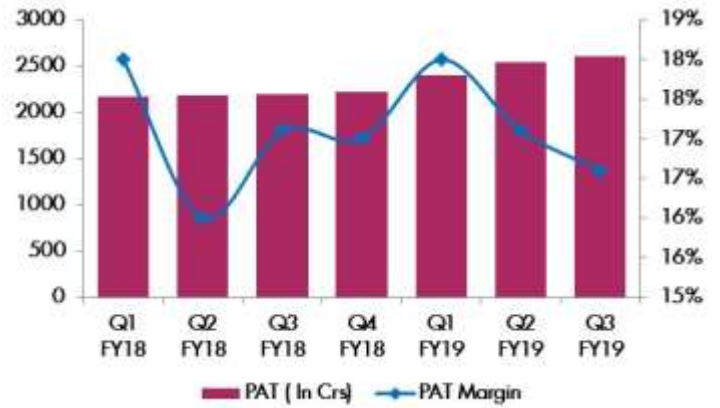


Source: Company, Axis Securities

Revenue growth

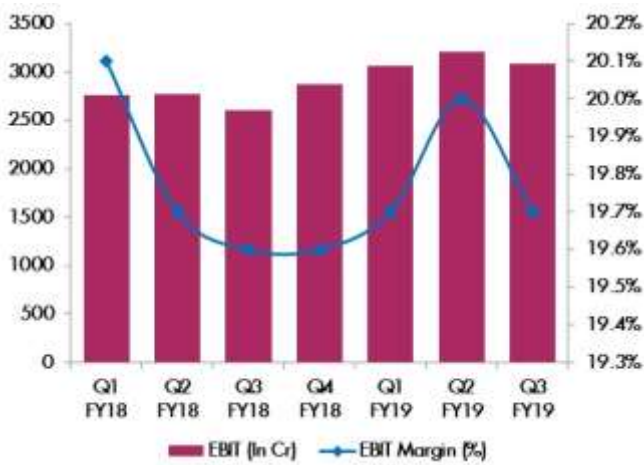


Net Profit growth

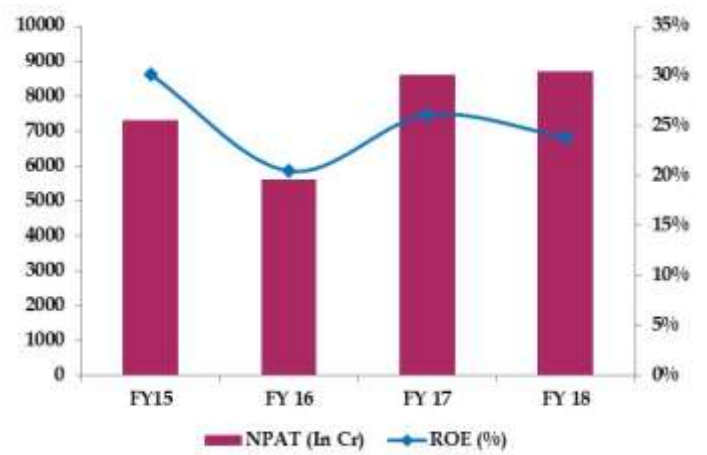


Source: Company, Axis Securities

Operating Margin



Net Profit & ROE



Source: Company, Axis Securities

Results Update

(Rs.Cr.)	Quarterly Performance				
	Q3FY19	Q2FY19	Q3FY18	% Change (QoQ)	% Change (YoY)
Net Sales	15,699	14,861	12,808	23%	6%
Direct cost	10,152	9,589	8,412	21%	6%
As % of sale	65%	65%	66%	(101) bps	14 bps
Gross Profit	5,547	5,272	4,396	26%	5%
Gross Profit Margin	35%	35%	34%	101 bps	(14) bps
SG &A	1,900	1,773	1,432	33%	7%
EBITDA	3,647	3,499	2,964	23%	4%
EBITDA Margin	23%	24%	23%	9 bps	(31) bps
Depreciation & Amortization	561	533	455	23%	5%
Operating Profit (EBIT)	3,086	2,966	2,510	23%	4%
EBIT Margin	20%	20%	20%	6 bps	(30) bps
Forex gain/ Loss	(54)	69	129		
Other Income	159	183	135	18%	(13)%
PBT	3,191	3,218	2,774	15%	(1)%
PBT Margin	20%	22%	22%	(133) bps	(133) bps
Tax	566	678	579	-2%	-17%
Effective Tax rate (ETR)	18%	21%	21%	(314) bps	(333) bps
Non-controlling interest	-	-	14		
Net Income	2,611	2,540	2,194	19%	3%
NPAT Margin	17%	17%	17%	(50) bps	(46) bps
Earnings per share					
Basic	76.8	73.0	63.0		
Diluted	76.8	72.8	63.0		

Source: Company, Axis Securities

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