

BUY

TP: Rs 1,230 | ▲ 20%

HCL TECHNOLOGIES

| IT Services

| 08 August 2019

Organic growth trending up; upgrade to BUY on cheap valuations

A strong revenue beat (+4.2% QoQ CC vs. +1.8% est.) but below-expected margins rounded off an in-line operating performance from HCL Tech (HCLT) for the Jun'19 quarter. Management's robust FY20 outlook is intact at 14-16% CC growth, albeit now baking in stronger organic revenues. In our view, valuations at 13.7x/12.1x FY20E/FY21E P/E are attractive, carrying 20% upside at our revised Jun'20 TP of Rs 1,230 (vs. Rs 1,260). Upgrade from ADD to BUY.

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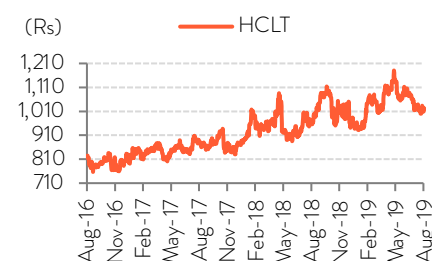
Strong revenue beat: HCLT's Q1FY20 revenues at US\$ 2.4bn increased by 3.8% QoQ or 4.2% QoQ CC vs. our/consensus estimates of ~1.8% QoQ CC growth. We note that HCLT is the only name amongst tier-I IT services peers to report a revenue beat in Q1. EBIT margins at 17.1% contracted 190bps QoQ vs. our estimate of a 130bps QoQ decline, impacted by currency headwinds, visa costs, transition costs and lower profitability in the ERS (engineering and R&D services) business.

Ticker/Price	HCLT IN/Rs 1,023
Market cap	US\$ 19.6bn
Shares o/s	1,357mn
3M ADV	US\$ 25.3mn
52wk high/low	Rs 1,188/Rs 920
Promoter/FPI/DII	60%/27%/13%

Source: NSE

Organic growth trending higher: HCLT posted 3.8% QoQ CC (14% YoY CC) organic growth, ahead of our/consensus estimates of ~1.3% QoQ CC growth. The improved organic revenue traction will make up for loss of inorganic revenue in FY20 due to a one-month delay in IBM product deal consummation (negative impact of 60-80bps YoY). Thus, the unchanged FY20 revenue guidance of 14-16% CC growth now implies higher organic growth compared to the earlier guided 9-11% CC range.

STOCK PERFORMANCE



Source: NSE

Upgrade to BUY: We trim our FY20/FY21 EPS estimates by 5%/6% on account of higher tax rate assumptions and a lower currency reset. Rolling valuations forward, we move to a revised Jun'20 TP of Rs 1,230 (vs. Rs 1,260 earlier) and upgrade the stock to BUY on attractive valuations.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	87,820	1,01,450	1,01,348	1,14,864	1,30,038
Adj. EPS (Rs)	63.0	74.6	74.7	84.7	95.8
Adj. EPS growth (%)	5.4	18.3	0.2	13.3	13.2
Adj. ROAE (%)	25.0	25.8	22.8	23.0	23.1
Adj. P/E (x)	16.2	13.7	13.7	12.1	10.7
EV/EBITDA (x)	12.1	9.8	8.2	6.8	5.9

Source: Company, BOBCAPS Research

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Other earnings highlights

- A below-expected drag from three clients (two in BFSI and one in manufacturing) and ramp-up of a large deal won in the Mar'19 quarter led to the revenue beat in Q1FY20, as per management.
- One of the two BFSI accounts facing growth challenges turned a corner in Q1, while continued softness is expected in the second BFSI account and one manufacturing account.
- HCLT won 12 transformational deals in the Jun'19 quarter compared to 17 in the Mar'19 quarter. Management attributed the lower count to the company's selective approach (driven by profitability), while asserting the absence of any impact from global macro concerns and stating that the deal pipeline was stable on a sequential basis.
- Management shared details on the accounting impact of IBM product consolidation, including amortisation and depreciation charge. Based on these new disclosures, the recently acquired IBM products are guided to have EBIT margins of ~30%.

FIG 1 – JUN'19 QUARTER PERFORMANCE

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	YoY (%)	QoQ (%)
Revenues (US\$ mn)	2,055	2,099	2,202	2,278	2,364	15.0	3.8
Revenue	1,38,780	1,48,610	1,56,990	1,59,900	1,64,250	18.4	2.7
Operating Expenditure	1,06,520	1,13,620	1,20,520	1,23,930	1,30,250	22.3	5.1
Cost of revenues	91,060	95,890	1,01,520	1,04,210	1,09,200	19.9	4.8
as % of sales	65.6	64.5	64.7	65.2	66.5	-	-
SG&A expenses	15,460	17,730	19,000	19,720	21,050	36.2	6.7
as % of sales	11.1	11.9	12.1	12.3	12.8	-	-
EBITDA	32,260	34,990	36,470	35,970	34,000	5.4	(5.5)
Depreciation	4,960	5,330	5,610	5,580	5,950	-	-
EBIT	27,300	29,660	30,860	30,390	28,050	2.7	(7.7)
Other Income	2,960	2,520	1,050	1,520	1,280	-	-
PBT	30,260	32,180	31,910	31,910	29,330	(3.1)	(8.1)
Total Tax	6,220	6,780	5,660	6,150	7,050	-	-
Adjusted PAT	24,040	25,400	26,250	25,760	22,280	(7.3)	(13.5)
(Profit)/loss from JVs/Assoc/MI	0	0	(140)	0	(80)	-	-
APAT after MI	24,040	25,400	26,110	25,760	22,200	(7.7)	(13.8)
Extraordinary items	0	0	0	0	0	-	-
Reported PAT	24,040	25,400	26,110	25,760	22,200	(7.7)	(13.8)
Reported EPS	17.3	18.2	19.2	19.0	16.4	(5.2)	(13.8)
Margins (%)						(bps)	(bps)
EBITDA	23.2	23.5	23.2	22.5	20.7	(255)	(180)
EBIT	19.7	20.0	19.7	19.0	17.1	(259)	(193)
EBT	21.8	21.7	20.3	20.0	17.9	(395)	(210)
PAT	17.3	17.1	16.6	16.1	13.5	(381)	(259)
Effective tax rate	20.6	21.1	17.7	19.3	24.0	348	476

Source: Company, BOBCAPS Research

FIG 2 – JUN'19 QUARTER OPERATING METRICS

Particulars	Q1FY20 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Business Segment			
Mode 1	70.3	3.5	10.3
Mode 2	18.8	3.2	38.6
Mode 3	10.9	6.7	14.0
Revenue by Geography			
US	67.7	11.7	20.8
Europe	25.9	(9.5)	6.0
Asia Pacific	6.3	(11.7)	(3.4)
Revenues by Industry			
BFSI	20.3	(0.2)	(1.9)
Retail	9.5	(1.4)	20.1
Media, Publishing & Entertainment	8	(3.5)	26.1
Life Sciences	12.8	2.2	15.0
Energy Utilities - Public Sector	10.5	(1.8)	15.0
Manufacturing	19.9	18.0	25.1
Technology Services	18.9	4.9	19.5
Client Contribution to Revenues			
Top 5	17	3.8	15.0
Top 10	24.1	3.8	12.7
Top 20	33.4	3.8	12.4
	Q1FY20	Q4FY19	Q1FY19
Quarterly Annualised Attrition (%)	29.5	25.5	27.9
Total Employees	1,43,900	1,37,965	1,24,121
Gross Addition	16,332	14,249	12,558
Net Addition	5,935	5,637	4,040
Revenues by Contract Type (%)			
Time & Material	36.5	37.3	38
Fixed Price	63.5	62.7	62

Source: Company, BOBCAPS Research

Valuation methodology

We trim our FY20/FY21 EPS estimates by 5%/6% on account of higher tax rate assumptions and a lower currency reset. We also introduce FY22 EPS of Rs 95.8 based on dollar revenue growth and EBIT margins assumption of 9.8% and 18.8% respectively.

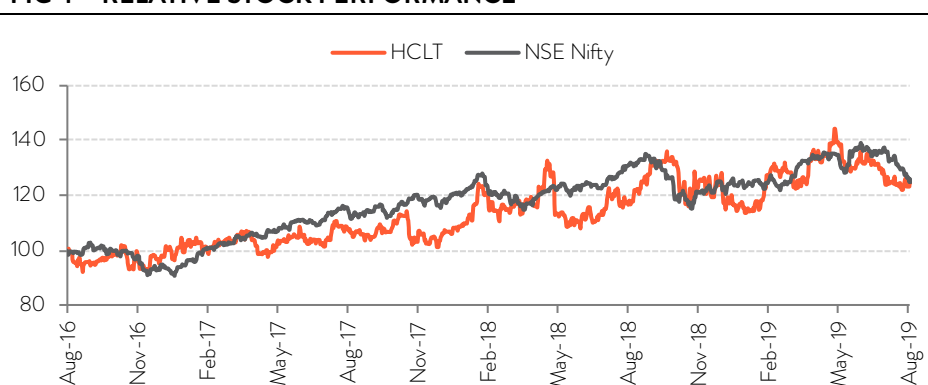
In our view, valuations at 13.7x/12.1x FY20E/FY21E P/E are attractive and factor in IP business concerns. We thus upgrade the stock from ADD to BUY, while rolling over to a revised Jun'20 target price of Rs 1,230 (vs. Rs 1,260 earlier), based on an unchanged target P/E multiple of 14x.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	9,951	9,961	0.1	11,072	10,861	(1.9)	11,926
YoY growth (%)	15.3	15.4	-	11.3	9.0	-	9.8
Revenues	6,96,583	6,88,455	(1.2)	7,75,040	7,60,248	(1.9)	8,34,795
EBITDA	1,50,644	1,65,916	10.1	1,69,140	1,88,189	11.3	2,05,620
EBITDA margins (%)	21.6	24.1	-	21.8	24.8	-	24.6
EBIT margins (%)	18.6	18.4	-	18.9	18.6	-	18.8
Net profits	1,07,073	1,01,348	(5.3)	1,22,534	1,14,864	(6.3)	1,30,038
EPS (Rs)	78.9	74.7	(5.3)	90.3	84.7	(6.3)	95.8

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- above-expected revenue contraction in IMS due to automation,
- an inability to renew existing contracts,
- a sharp decline in IT demand, and
- adverse currency movement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	5,05,700	6,04,280	6,88,455	7,60,248	8,34,795
EBITDA	1,14,400	1,39,690	1,65,916	1,88,189	2,05,620
EBIT	99,880	1,18,210	1,26,785	1,41,087	1,57,118
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	11,110	8,050	6,581	10,050	13,985
Exceptional items	0	0	0	0	0
EBT	1,10,990	1,26,260	1,33,366	1,51,137	1,71,103
Income taxes	23,170	24,810	32,019	36,273	41,065
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	87,820	1,01,450	1,01,348	1,14,864	1,30,038
Adjustments	0	0	0	0	0
Adjusted net profit	87,820	1,01,450	1,01,348	1,14,864	1,30,038

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	1,06,460	1,26,860	1,44,576	1,59,652	1,75,307
Provisions	5,300	0	13,769	15,205	16,696
Debt funds	4,370	39,860	39,860	39,860	39,860
Other liabilities	0	0	0	0	0
Equity capital	2,812	2,812	2,812	2,812	2,812
Reserves & surplus	3,65,348	4,14,888	4,67,467	5,27,059	5,94,523
Shareholders' fund	3,68,160	4,17,700	4,70,279	5,29,871	5,97,335
Total liabilities and equities	4,84,290	5,84,420	6,68,484	7,44,588	8,29,197
Cash and cash eq.	16,930	59,290	1,42,471	2,21,175	3,08,749
Accounts receivables	1,22,570	1,46,100	1,65,984	1,83,293	2,01,266
Inventories	0	0	0	0	0
Other current assets	25,190	37,160	44,750	49,416	54,262
Investments	86,040	58,520	58,520	58,520	58,520
Net fixed assets	1,18,646	1,32,396	1,10,544	80,943	49,942
CWIP	0	0	0	0	0
Intangible assets	77,244	1,02,564	1,02,564	1,02,564	1,02,564
Deferred tax assets, net	0	0	0	0	0
Other assets	37,670	52,930	48,192	53,217	58,436
Total assets	4,84,290	5,88,960	6,73,024	7,49,127	8,33,737

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	1,00,510	1,20,740	1,40,479	1,61,965	1,78,540
Interest expenses	(4,450)	(4,480)	(6,581)	(10,050)	(13,985)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,340)	(24,660)	8,750	(10,489)	(10,891)
Other operating cash flows	(486)	(1,936)	0	0	0
Cash flow from operations	83,234	89,664	1,42,647	1,41,427	1,53,664
Capital expenditures	(53,210)	(34,340)	(17,279)	(17,500)	(17,500)
Change in investments	(13,180)	5,200	0	0	0
Other investing cash flows	44,016	(3,604)	6,581	10,050	13,985
Cash flow from investing	(22,374)	(32,744)	(10,698)	(7,450)	(3,515)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(1,480)	36,230	0	0	0
Interest expenses	(38,750)	(39,860)	0	0	0
Dividends paid	(16,910)	(10,990)	(48,768)	(55,273)	(62,574)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(57,140)	(14,620)	(48,768)	(55,273)	(62,574)
Changes in cash and cash eq.	3,720	42,300	83,181	78,704	87,574
Closing cash and cash eq.	16,930	59,290	1,42,471	2,21,175	3,08,749

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	63.0	74.6	74.7	84.7	95.8
Adjusted EPS	63.0	74.6	74.7	84.7	95.8
Dividend per share	8.0	29.8	29.9	33.9	38.4
Book value per share	264.3	307.0	346.6	390.5	440.3

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.7	2.3	2.0	1.7	1.4
EV/EBITDA	12.1	9.8	8.2	6.8	5.9
Adjusted P/E	16.2	13.7	13.7	12.1	10.7
P/BV	3.9	3.3	3.0	2.6	2.3

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	79.1	80.4	76.0	76.0	76.0
Interest burden (PBT/EBIT)	111.1	106.8	105.2	107.1	108.9
EBIT margin (EBIT/Revenue)	19.8	19.6	18.4	18.6	18.8
Asset turnover (Revenue/Avg TA)	106.6	112.6	109.1	106.9	105.5
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.4	1.4
Adjusted ROAE	25.0	25.8	22.8	23.0	23.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	8.2	19.5	13.9	10.4	9.8
EBITDA	11.0	22.1	18.8	13.4	9.3
Adjusted EPS	5.4	18.3	0.2	13.3	13.2
Profitability & Return ratios (%)					
EBITDA margin	22.6	23.1	24.1	24.8	24.6
EBIT margin	19.8	19.6	18.4	18.6	18.8
Adjusted profit margin	17.4	16.8	14.7	15.1	15.6
Adjusted ROAE	25.0	25.8	22.8	23.0	23.1
ROCE	23.2	25.2	25.2	29.9	35.3
Working capital days (days)					
Receivables	83	81	83	84	84
Inventory	0	0	0	0	0
Payables	102	92	95	97	97
Ratios (x)					
Gross asset turnover	5.3	4.8	5.7	7.9	12.8
Current ratio	1.8	2.3	2.5	2.9	3.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.2)	(0.3)	(0.5)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

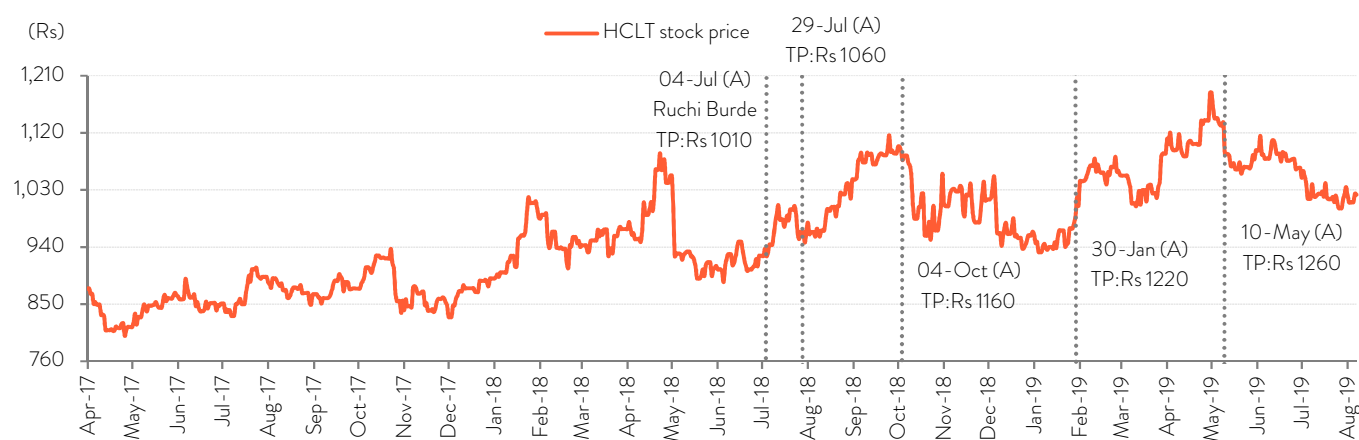
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: HCL TECHNOLOGIES (HCLT IN)



B – Buy, A – Add, R – Reduce, S – Sell

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