

BUY

TP: Rs 1,260 | ▲ 15%

HCL TECHNOLOGIES

IT Services

24 October 2019

Organic growth trending higher

HCL Tech (HCLT) reported an above-expected operating performance in Q2FY20 supported by a margin beat (EBIT margin up 290bps QoQ to 20%). Large deal wins improved sequentially, numbering at 15 transformational deals vs. 12 in the Jun'19 quarter. Completion of IBM IP asset acquisition in Q2 added momentum to the company's Products and Platforms revenues. Revenue guidance has been upped on rising organic growth while margin guidance is intact. We roll over to a Sep'20 TP of Rs 1,260 (vs. Rs 1,230) and retain BUY.

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Operating performance ahead of estimates: HCLT reported 6% QoQ CC revenue growth with 20% EBIT margins (+290bps QoQ) in Q2, translating into better than estimated operating performance. Margin expansion was broad-based across mode 1, mode 2 and mode 3 services.

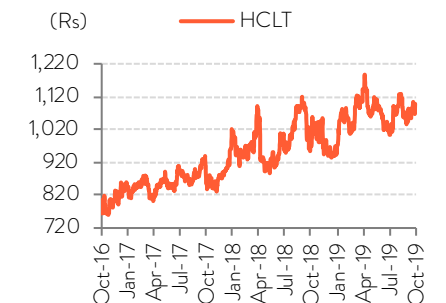
FY20 revenue guidance upped: Management raised FY20 revenue guidance to 15-17% YoY CC growth from 14-16% earlier on the back of an uptrend in organic growth (guided at 10-11% YoY CC vs. 9-11% earlier) and healthy deal wins. The revised revenue guidance implies -0.4% and +1.8% CQGR at the lower and upper ends respectively over the next two quarters. Management, however, is confident of sequential revenue growth in the organic business. Guided EBIT margins remain unchanged at 18.5-19.5%.

Retain BUY: We maintain BUY and roll over to a revised Sep'20 TP of Rs 1,260 (vs. Rs 1,230 earlier). In our view, valuations at 13.1x/11.6x FY21E/FY22E P/E are inexpensive and factor in IP product concerns. Moreover, HCLT offers strong near-term growth visibility and margin stability.

Ticker/Price	HCLT IN/Rs 1,095
Market cap	US\$ 21.0bn
Shares o/s	1,357mn
3M ADV	US\$ 29.4mn
52wk high/low	Rs 1,188/Rs 920
Promoter/FPI/DII	60%/27%/13%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	5,05,700	6,04,280	6,87,705	7,53,687	8,27,591
EBITDA (Rs mn)	1,14,400	1,39,690	1,62,931	1,86,565	2,03,845
Adj. net profit (Rs mn)	87,820	1,01,450	1,01,727	1,13,411	1,28,475
Adj. EPS (Rs)	63.0	74.6	75.0	83.6	94.7
Adj. EPS growth (%)	5.4	18.3	0.6	11.5	13.3
Adj. ROAE (%)	25.0	25.8	22.9	22.7	22.8
Adj. P/E (x)	17.4	14.7	14.6	13.1	11.6
EV/EBITDA (x)	12.9	10.5	9.0	7.4	6.4

Source: Company, BOBCAPS Research

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FIG 1 – SEP'19 QUARTER PERFORMANCE

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	YoY (%)	QoQ (%)	H1FY20	H1FY19	YoY (%)
Revenues (US\$ mn)	2,055	2,099	2,202	2,278	2,364	2,486	18.4	5.2	4,849	4,153	16.8
Revenue	1,38,780	1,48,610	1,56,990	1,59,900	1,64,250	1,75,280	17.9	6.7	3,39,530	2,87,390	18.1
Operating Expenditure	1,06,520	1,13,620	1,20,520	1,23,930	1,30,250	1,34,250	18.2	3.1	2,64,500	2,20,140	20.2
Cost of revenues	91,060	95,890	1,01,520	1,04,210	1,09,200	1,10,610	15.4	1.3	2,19,810	1,86,950	17.6
as % of sales	65.6	64.5	64.7	65.2	66.5	63.1	-	-	64.7	65.1	-
SG&A expenses	15,460	17,730	19,000	19,720	21,050	23,640	33.3	12.3	44,690	33,190	34.6
as % of sales	11.1	11.9	12.1	12.3	12.8	13.5	-	-	13.2	11.5	-
EBITDA	32,260	34,990	36,470	35,970	34,000	41,030	17.3	20.7	75,030	67,250	11.6
Depreciation	4,960	5,330	5,610	5,580	5,950	6,060	-	-	12,010	10,290	16.7
EBIT	27,300	29,660	30,860	30,390	28,050	34,970	17.9	24.7	63,020	56,960	10.6
Other Income	2,960	2,520	1,050	1,520	1,280	(30)	-	-	1,250	5,480	(77.2)
PBT	30,260	32,180	31,910	31,910	29,330	34,940	8.6	19.1	64,270	62,440	2.9
Total Tax	6,220	6,780	5,660	6,150	7,050	8,350	-	-	15,400	13,000	18.5
Adjusted PAT	24,040	25,400	26,250	25,760	22,280	26,590	4.7	19.3	48,870	49,440	(1.2)
(Profit)/loss from JV's/Ass/MI	0	0	(140)	0	(80)	(80)	-	-	(160)	0	-
APAT after MI	24,040	25,400	26,110	25,760	22,200	26,510	4.4	19.4	48,710	49,440	(1.5)
Extraordinary items	0	0	0	0	0	0	-	-	0	0	-
Reported PAT	24,040	25,400	26,110	25,760	22,200	26,510	4.4	19.4	48,710	49,440	(1.5)
Reported EPS	17.3	18.2	19.2	19.0	16.4	19.5	7.4	19.4	36	35	1.3
Margins (%)							(bps)	(bps)			(bps)
EBITDA	23.2	23.5	23.2	22.5	20.7	23.4	(10)	270	22.1	23.4	(130)
EBIT	19.7	20.0	19.7	19.0	17.1	20.0	-	290	18.6	19.8	(130)
EBT	21.8	21.7	20.3	20.0	17.9	19.9	(170)	210	18.9	21.7	(280)
PAT	17.3	17.1	16.6	16.1	13.5	15.1	(200)	160	14.3	17.2	(290)
Effective Tax rate	20.6	21.1	17.7	19.3	24.0	23.9	280	(10)	24.0	20.8	310

Source: Company, BOBCAPS Research

FIG 2 – SEP'19 QUARTER OPERATING METRICS

Particulars	Q2FY20	Growth	
	(% Contr. to Revenue)	QoQ (%)	YoY (%)
Revenue by Business Segment			
Mode 1	67.0	0.2	10.2
Mode 2	18.3	2.4	35.5
Mode 3	14.7	41.8	46.3
Revenue by Geography			
US	67.9	5.5	22.2
Europe	25.7	4.3	13.6
Asia Pacific	6.4	6.8	2.4
Revenue by Vertical			
BFSI	20.4	5.7	5.1
Retail	9.1	0.7	7.8
Media, Publishing & Entertainment	8	5.2	31.6
Life Sciences	12.6	3.5	15.7
Energy Utilities - Public Sector	9.5	(4.9)	5.2
Manufacturing	18.7	(1.2)	23.0
Technology Services	21.7	20.7	41.2

Particulars	Q2FY20 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Contract Type			
Time & Material	33.5	36.5	38.2
Fixed Price	66.5	63.5	61.8
Client Concentration			
Top 5	16.5	2.1	13.0
Top 10	24	4.7	14.6
Top 20	34.6	8.9	19.8
	Sep'19	Jun'19	Sep'18
Quarterly Annualised Attrition (%)	28.1	29.5	25.2
Total Employees (nos)	1,47,123	1,43,900	1,27,875
Gross Addition (nos)	13,430	16,332	11,683
Net Addition (nos)	3,223	5,935	3,754

Source: Company, BOBCAPS Research

Valuation methodology

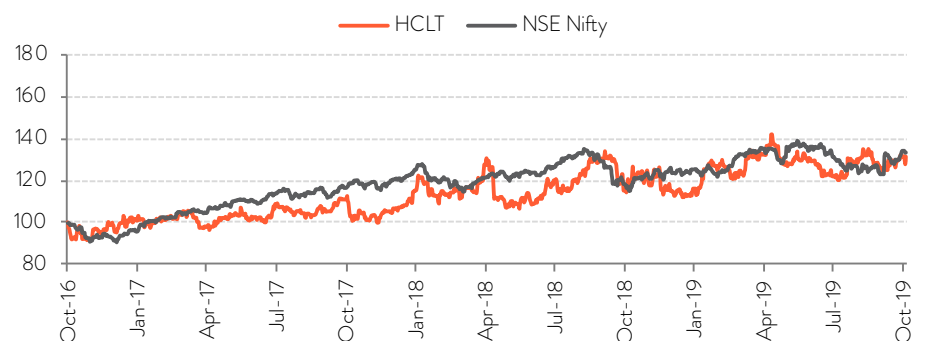
We marginally adjust earnings estimates and reiterate BUY, rolling forward to a revised Sep'20 target price of Rs 1,260 (vs. Rs 1,230 earlier). Valuations at 13.1x/11.6x FY21E/FY22E P/E appear inexpensive and factor in IP product concerns. Moreover, we believe HCLT offers strong near-term growth visibility and margin stability.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	9,961	9,895	(0.7)	10,861	10,767	(0.9)	11,926	11,823	(0.9)
YoY growth (%)	15.4	14.6	-	9.0	8.8	-	9.8	9.8	-
Revenues	6,88,455	6,87,705	(0.1)	7,60,248	7,53,687	(0.9)	8,34,795	8,27,591	(0.9)
EBITDA	1,65,916	1,62,931	(1.8)	1,88,189	1,86,565	(0.9)	2,05,620	2,03,845	(0.9)
EBITDA margins (%)	24.1	23.7	-	24.8	24.8	-	24.6	24.6	-
EBIT margins (%)	18.4	18.8	-	18.6	18.5	-	18.8	18.8	-
Net profits	1,01,348	1,01,727	0.4	1,14,864	1,13,411	(1.3)	1,30,038	1,28,475	(1.2)
EPS (R)	74.7	75.0	0.4	84.7	83.6	(1.3)	95.8	94.7	(1.2)

Source: 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	6,87,705	7,53,687	8,27,591
EBITDA	1,14,400	1,39,690	1,62,931	1,86,565	2,03,845
Depreciation	14,520	21,480	33,308	47,109	48,509
EBIT	99,880	1,18,210	1,29,623	1,39,456	1,55,336
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	11,110	8,050	4,195	9,769	13,709
Exceptional items	0	0	0	0	0
EBT	1,10,990	1,26,260	1,33,819	1,49,225	1,69,046
Income taxes	23,170	24,810	32,092	35,814	40,571
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	1,01,727	1,13,411	1,28,475
Adjustments	0	0	0	0	0
Adjusted net profit	87,820	1,01,450	1,01,727	1,13,411	1,28,475

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	1,44,418	1,58,274	1,73,794
Provisions	5,300	0	13,754	15,074	16,552
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	4,67,664	5,26,501	5,93,154
Shareholders' fund	3,68,160	4,17,700	4,70,476	5,29,313	5,95,966
Total liabilities and equities	4,84,290	5,84,420	6,68,508	7,42,521	8,26,172
Cash and cash eq.	16,930	59,290	1,36,858	2,15,665	3,02,529
Accounts receivables	1,22,570	1,46,100	1,65,803	1,81,711	1,99,529
Inventories	0	0	0	0	0
Other current assets	25,190	37,160	44,701	48,990	53,793
Investments	86,040	58,520	58,520	58,520	58,520
Net fixed assets	1,18,646	1,32,396	1,16,463	86,854	55,845
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	48,139	52,758	57,931
Total assets	4,84,290	5,88,960	6,73,048	7,47,061	8,30,712

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	1,35,035	1,60,520	1,76,984
Interest expenses	(4,450)	(4,480)	(4,195)	(9,769)	(13,709)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,340)	(24,660)	8,859	(9,640)	(10,797)
Other operating cash flows	(486)	(1,936)	0	0	0
Cash flow from operations	83,234	89,664	1,39,699	1,41,111	1,52,477
Capital expenditures	(53,210)	(34,340)	(17,375)	(17,500)	(17,500)
Change in investments	(13,180)	5,200	0	0	0
Other investing cash flows	44,016	(3,604)	4,195	9,769	13,709
Cash flow from investing	(22,374)	(32,744)	(13,179)	(7,731)	(3,791)
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)	(48,951)	(54,573)	(61,822)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(57,140)	(14,620)	(48,951)	(54,573)	(61,822)
Changes in cash and cash eq.	3,720	42,300	77,568	78,807	86,864
Closing cash and cash eq.	16,930	59,290	1,36,858	2,15,665	3,02,529

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	63.0	74.6	75.0	83.6	94.7
Adjusted EPS	63.0	74.6	75.0	83.6	94.7
Dividend per share	8.0	29.8	30.0	33.4	37.9
Book value per share	264.3	307.0	346.8	390.1	439.3

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.9	2.4	2.1	1.8	1.6
EV/EBITDA	12.9	10.5	9.0	7.4	6.4
Adjusted P/E	17.4	14.7	14.6	13.1	11.6
P/BV	4.1	3.6	3.2	2.8	2.5

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	103.2	107.0	108.8
EBIT margin (EBIT/Revenue)	19.8	19.6	18.8	18.5	18.8
Asset turnover (Revenue/Avg TA)	106.6	112.6	109.0	106.1	104.9
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.4	1.4
Adjusted ROAE	25.0	25.8	22.9	22.7	22.8

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	13.8	9.6	9.8
EBITDA	11.0	22.1	16.6	14.5	9.3
Adjusted EPS	5.4	18.3	0.6	11.5	13.3
Profitability & Return ratios (%)					
EBITDA margin	22.6	23.1	23.7	24.8	24.6
EBIT margin	19.8	19.6	18.8	18.5	18.8
Adjusted profit margin	17.4	16.8	14.8	15.0	15.5
Adjusted ROAE	25.0	25.8	22.9	22.7	22.8
ROCE	23.2	25.2	25.5	29.2	34.4
Working capital days (days)					
Receivables	83	81	83	84	84
Inventory	0	0	0	0	0
Payables	102	92	94	97	97
Ratios (x)					
Gross asset turnover	5.3	4.8	5.5	7.4	11.6
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)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

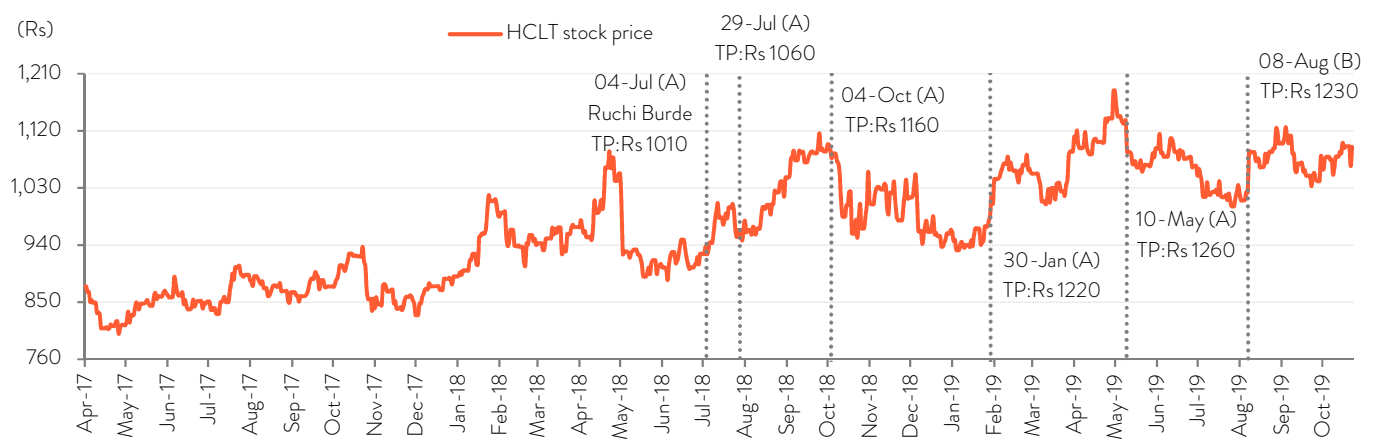
ADD – Expected return from >+5% to +15%

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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