HCL Technologies

2QFY19 Result Update

Maintains Guidance; re-iterate Buy

Sector: Technology

CMP: ` 953

Recommendation: Buy

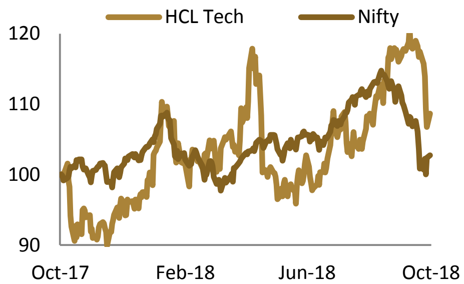
Market statistics

Current stock price (`)	953
Shares O/S (cr.)	139.2
Mcap (` cr)	132,673
52W H/L (`)	1125/825
6m avg. volume	2,428,094
Bloomberg	HCLT IN

Shareholding pattern

Promoters	60.17
Domestic Institution	8.16
Foreign Institution	28.02
Non-institution	3.65
of which more than 1%	

HCL Tech vs Nifty



Capital efficiency & valuations

Particulars	FY18	FY19E	FY20E
RoE (%)	23.9	22.4	20.5
EPS (`)	63.1	73.4	81.5
CEPS (`)	73.5	88.5	98.2
P/E (x)	15.4	13.0	11.7
P/BV (x)	3.7	2.9	2.4
EV/EBITDA (x)	11.1	8.8	7.2
Income growth (%)	8.2	18.0	11.0
EBITDA growth (%)	11.0	23.1	11.5
PAT growth (%)	3.8	16.4	11.0

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HCL Technologies reported a stable quarter. HCLT reported revenues of US$2,099mn, up 2.1% (in USD terms, up 3% in cc terms), during Q2FY19. Margin was helped by INR depreciation and higher utilisation. For FY19, HCLT has maintained it's guided - revenue growth of 9.5%-11.5% growth in cc terms and EBIT margin guidance of 19.5-20.5%. We maintain our Buy rating on HCL Tech given the deal wins (17 transformational deals), strong bookings, better execution and strategy of augmenting offerings by acquiring IPs.

Quarter details: HCL Technologies' EBITDA was as per our expectations with 2.1% QoQ growth in US$ revenue (3% QoQ in cc terms) led by healthy growth in IMS services (2.5% QoQ) and ERD business (6.3% QoQ) while EBITDA margin stood at 23.5% driven by rupee tailwind (90 bps) and operational efficiencies (30 bps), partially offset by wage revision (70 bps) and higher SG&A expenses. EBITDA margin was up 30bps QoQ and EBIT margin was up 29bps QoQ. Net profit increased 16.1% YoY to `25.4bn. Regionally, North America reported cc revenue growth of 4.4% QoQ. The revenues of Europe and RoW declined/increased by 0.9% and 4.9% QoQ on cc terms respectively. The company secured 17 transformational deals reflecting a mix of Mode 1 and Mode 2 services led by Digital & Analytics, Cloud Native, IoT Works, Cybersecurity, along with Infrastructure Services, Engineering and R&D Services and Business Services.

Guidance maintained at 9.5-11.5% revenue growth in cc terms: FY19 includes the full integration of several acquisitions to revenue growth. Management had provided FY19 revenue growth guidance of 9.5-11.5% YoY on cc basis, Revenue from Mode 2 (digital services) and Mode 3 (product & platform) grew at 9.6% QoQ, taking combined revenue contribution to total revenues to 26.6% (vs. 23.4% in FY18). **Deal wins.** HCL Tech signed 17 transformational deals during the quarter.

Remains optimistic for higher organic growth in FY19: The management cited that the organic contribution to overall growth would be better as compared to inorganic growth contribution for FY19, though HCLT had mentioned at the start of FY19 - growth would be evenly distributed between organic and inorganic. During Q2FY19, the organic growth was slightly lower than 2%, while the remaining growth (~1%) was derived from Actian. Ramp-up of deal wins in recent quarters and healthy growth momentum in ERD business would drive the organic growth in FY19E. Management highlighted that Q3FY19 is expected to be a strong quarter on account of strong seasonality in IP product business. The management believes that the margins would remain under guided range in FY19 despite higher revenues from IP products in 2HFY19, owing to continued investments on building up digital competencies and sales resources and higher subcontractor expenses.

IMS still remains strong, HCLT better placed. While competitive intensity in IMS has increased, it remains a large and underpenetrated market and gives us comfort that HCLT's competitive advantages are intact. Compared to peers, HCLT has a better portfolio mix (higher exposure to cost-focused service-lines such as infrastructure management services), stable senior management team, efficient use of capital and a track record of recovering margins in large deals.

Valuation: We maintain our Buy rating on HCL Tech on account of its continuous large deal wins; market share wins in its large clients, beneficiary in vendor consolidation. Though organic revenue growth guidance in FY19E would be impacted owing to the decline in India SI business and headwinds in renewals, we see positive setups for organic revenue growth in FY20E on account of a ramp-up of infra related deals, incremental deal pipelines and traction in engineering services. Further, we believe that successful inorganic strategy will keep the company in the top quadrant of growth among peers.

Exhibit 1: Quarterly details

` mn	2QFY18	1QFY19	2QFY19	QoQ (%)	YoY (%)	Comments
Revenues (in US$mn)	**1,928**	**2,055**	**2,099**	**2.1**	**8.8**	
Revenues	**124,340**	**138,780**	**148,610**	**7.1**	**19.5**	Revenues were up 3% in cc terms.
- Operating costs	96,750	106,520	113,620	6.7	17.4	
EBITDA	**27,590**	**32,260**	**34,990**	**8.5**	**26.8**	
EBITDA margin (%)	**22.2**	**23.2**	**23.5**	**30bps**	**136bps**	Margin were helped by INR depreciation, higher utilization
- Interest expense	-	-	-	-	-	
- Depreciation	3,080	4,960	5,330	7.5	73.1	
+ Other income, net (incl forex)	2,980	2,960	2,520	(14.9)	(15.4)	Includes a forex gain of `690mn, compared to a of `1430mn
PBT	**27,490**	**30,260**	**32,180**	**6.3**	**17.1**	
- Taxes	5,610	6,220	6,780	9.0	20.9	
Effective tax rate (%)	20.4	20.6	21.1	51bps	66bps	Tax rate to remain in the range of 22-23%
PAT	**21,880**	**24,040**	**25,400**	**5.7**	**16.1**	
Net margin (%)	17.6	17.3	17.1	(23)bps	(51)bps	
Reported profits	**21,880**	**24,040**	**25,400**	**5.7**	**16.1**	

Source: Company

Exhibit 2: Change in estimates

` mn	FY19E			FY20E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US$ mn)	8,653	8,575	(0.9)	9,461	9,461	-
Revenue	580,284	596,773	2.8	633,920	662,284	4.5
EBITDA margin (%)	22.9	23.6	70bps	23.1	23.7	60bps
EPS (`)	69.9	73.4	5.0	76.0	81.5	7.2

Source: Trust Research

Geography wise Revenues: Regionally, North America reported cc revenue growth of 4.4% QoQ. The revenues of Europe and RoW declined/increased by 0.9% and 4.9% QoQ on cc terms respectively. India is expected to remain weak for 2-3 quarters.

Exhibit 3: Geographical wise Performance

Geographical mix	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
US	61.9	61.9	62.6	62.8	62.4	63.5	61.6	64.5	65.8
Europe	29.3	29.6	27.7	27.4	29.1	28.7	30.0	28.1	26.8
RoW	8.8	8.5	9.7	9.8	8.5	7.8	8.4	7.4	7.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company

Exhibit 4: Vertical mix

Offerings	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Financial Services	24.1	24.3	24.2	24.9	25.0	24.6	25.0	23.8	23.0
Manufacturing	32.2	33.9	34.6	34.9	35.4	36.5	36.0	36.5	36.2
Life sciences & Healthcare	9.4	8.9	8.4	7.9	7.9	7.4	7.4	7.3	7.2
Public Services	10.4	9.4	9.2	9.5	9.3	9.6	9.6	9.1	10.0
Retail & CPG	12.6	12.0	11.5	11.8	11.7	11.7	11.5	12.8	12.9
Telecommunications, Media, Publishing & Entertainment	10.9	11.2	11.7	11.0	10.7	10.2	10.5	10.5	10.7
Others	0.4	0.3	0.4	-	-	-	-	-	-
Total revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Trust Research

Exhibit 5: Services Mix

Offerings	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Application services	37.8	37.5	36.8	36.3	35.9	35.3	34.7	34.0	33.1
Engineering and R&D services	17.8	18.6	20.5	21.5	22.0	24.2	24.1	24.5	25.5
Infrastructure services	40.3	39.8	38.8	38.6	38.5	36.7	37.3	36.2	36.0
BPO services	4.1	4.1	3.9	3.6	3.6	3.8	3.9	5.3	5.4
Total revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Trust Research

Human Resources: Headcount saw a net of 3,754 employees join (gross 11,683 employees joined) to take the total base to 127,875.

Exhibit 6: Employee strength

Employees	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Total employee count	**109,795**	**111,092**	**115,973**	**117,781**	**119,040**	**119,291**	**120,081**	**124,121**	**127,875**
Technical	99,897	101,154	105,537	107,029	108,351	108,831	109,565	113,404	116,910
Support	9,898	9,938	10,426	10,752	10,689	10,460	10,516	10,717	10,965
Gross Addition	9,083	8,467	10,605	9,462	8,645	7,113	8,476	12,558	11,683

Source: Company

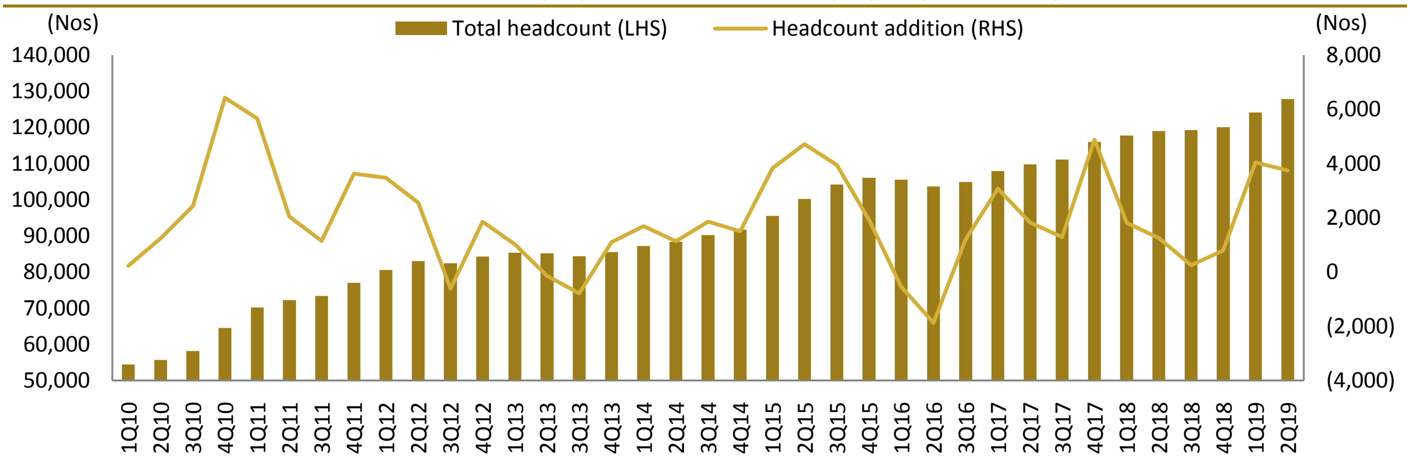
Client Concentration: The Company lost 1 client QoQ in the US$50mn+, and added 3 clients each in the US$20mn+ and US$10mn+ bracket to take the list to 31, 90 and 165 respectively.

Exhibit 7: Client details

Client metrics	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
100 million dollar +	8	8	8	8	9	9	8	9	9
50 million dollar +	20	24	25	25	25	25	28	32	31
20 million dollar +	82	87	85	86	84	85	87	87	90
10 million dollar +	146	148	153	154	157	156	160	162	165
5 million dollar +	235	241	246	249	259	261	264	267	269
1 million dollar +	494	496	506	508	536	552	561	571	575
Top 5 clients (LTM)	13.8	14.2	14.7	14.4	15.1	15.8	16.3	17.0	17.3
Top 10 clients (LTM)	21.6	21.7	22.1	22.4	22.9	23.5	23.8	24.6	24.8
Top 20 clients (LTM)	31.8	31.9	32.9	33.0	33.2	33.5	33.7	34.2	34.2

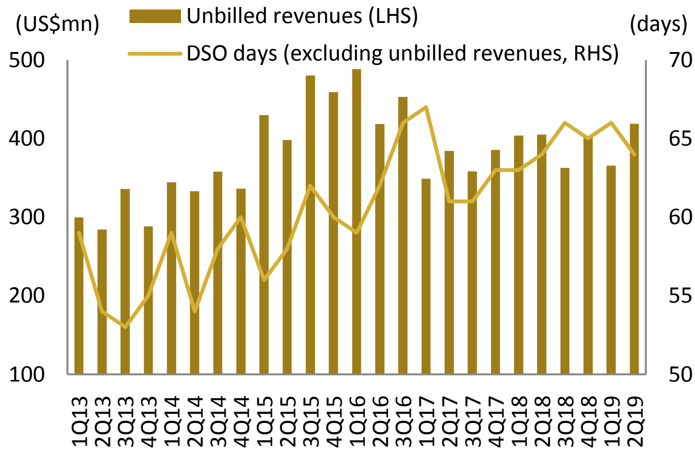
Source: Company

Exhibit 8: Utilization can be used as a lever, Employee addition: 3,754 employees joined this quarter



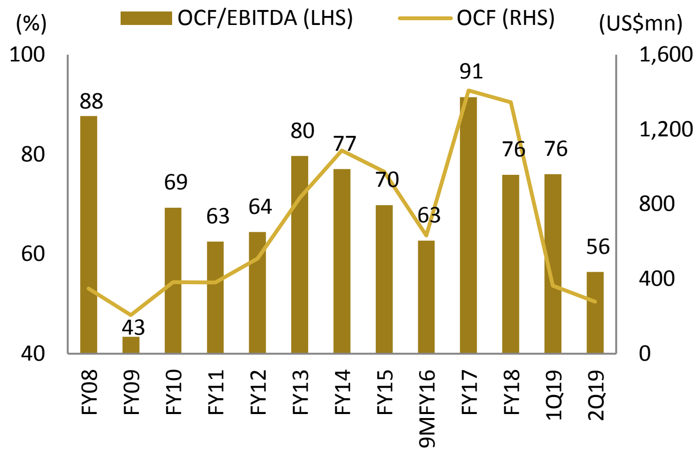
Source: Company, Trust

Exhibit 9: DSO decreased to 64 days, Unbilled rev. increased



Source: Company, Trust

Exhibit 10: OCF/EBITDA was weak this quarter



Source: Company, Trust

FY19 Guidance

FY19 includes the full integration of several acquisitions to revenue growth. Management had provided FY19 revenue growth guidance of 9.5-11.5% YoY on cc basis, Revenue from Mode 2 (digital services) and Mode 3 (product & platform) grew at 9.6% QoQ, taking combined revenue contribution to total revenues to 26.6% (vs. 23.4% in FY18). **Deal wins.** HCL Tech signed 27 transformational deals during the quarter, and the management indicated that HCLT had signed highest amount of bookings ever signed in this quarter.

Financials

Income Statement (` mn)

Year End-March	FY16*	FY17	FY18	FY19E	FY20E
Revenues	**311,360**	**467,220**	**505,700**	**596,773**	**662,284**
Op. Expenses	243,210	364,130	391,300	455,923	505,244
EBITDA	**68,150**	**103,090**	**114,400**	**140,851**	**157,040**
Other Income	7,960	9,340	11,110	10,220	12,590
Depreciation	4,450	8,340	14,520	21,013	23,263
EBIT	71,660	104,090	110,990	130,058	146,366
Interest	-	-	-	-	-
PBT	**71,660**	**104,090**	**110,990**	**130,058**	**146,366**
Tax	14,990	19,520	23,170	27,876	32,932
PAT	**56,670**	**84,570**	**87,820**	**102,182**	**113,434**
Minority + Extra Ord. Item	970	-	-	-	-
Adj Pat	**55,700**	**84,570**	**87,820**	**102,182**	**113,434**

Valuations Summary

Year End-March	FY16*	FY17	FY18	FY19E	FY20E
Per share (`)					
EPS	40.2	60.0	63.1	73.4	81.5
CEPS	43.3	65.9	73.5	88.5	98.2
BVPS	198.7	237.5	264.5	332.6	402.4
DPS	17.0	24.0	8.0	9.0	10.0
Payout (%)	49.4	46.8	14.9	14.3	14.4
Valuation (x)					
P/E	20.5	14.6	15.4	13.0	11.7
P/BV	4.1	3.7	3.7	2.9	2.4
EV/EBITDA	15.6	10.8	11.1	8.8	7.2
Dividend Yield (%)	2.1	2.7	0.8	0.9	1.0
Return ratio (%)					
EBIDTA Margin	21.9	22.1	22.6	23.6	23.7
PAT Margin	18.2	18.1	17.4	17.1	17.1
ROAE	20.2	25.3	23.9	22.4	20.5
ROACE	24.7	30.6	29.8	28.4	26.4
Leverage Ratios (x)					
Total D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.0)	(0.4)	(0.3)	(0.3)	(0.4)
Current ratio	1.3	2.1	2.2	2.6	3.0
Growth Ratios (%)					
Income growth	(16.0)	50.1	8.2	18.0	11.0
EBITDA growth	(21.7)	51.3	11.0	23.1	11.5
PAT growth	(21.9)	49.2	3.8	16.4	11.0
Turnover Ratios					
F.A. Turnover (x)	7.2	5.3	9.8	10.3	11.0
Debtors Days	23	22	21	21	21
Payable days	98	97	96	96	95

** FY16 is a 9-month period from Jul-15 to Mar-16*

Balance Sheet (` mn)

Year End-March	FY16*	FY17	FY18	FY19E	FY20E
Sources of Funds					
Equity Share Capital	2,821	2,821	2,784	2,784	2,784
Reserves & Surplus	277,400	332,082	365,384	452,908	550,056
Total Shareholders Fund	**280,221**	**334,903**	**368,168**	**455,692**	**552,840**
Non- current liabilities	9,732	5,417	4,371	2,371	2,371
Long term Borrowings	9,732	5,417	4,371	2,371	2,371
Total Current Liabilities	**107,720**	**124,002**	**111,812**	**126,159**	**139,807**
Current Liabilities	95,085	111,477	99,143	112,419	124,581
Other cur liabilities & Prov	12,635	12,525	12,669	13,740	15,227
Total Liabilities	**397,673**	**464,322**	**484,351**	**584,222**	**695,018**
Assets					
Non- current Assets	**253,684**	**199,646**	**238,801**	**261,307**	**278,428**
Fixed assets	43,230	87,479	51,847	58,200	59,937
Non-current investments	171,666	73,583	144,057	154,057	164,057
Other non-current assets	38,788	38,584	42,897	49,050	54,434
Current assets	**143,989**	**264,676**	**245,550**	**322,916**	**416,590**
Current investments	5,365	113,653	80,838	90,838	100,838
Accounts Receivables, net	77,213	83,014	96,394	114,450	127,013
Unbilled Receivables	30,015	25,012	26,181	32,700	36,290
Cash & bank balances	7,293	13,165	16,939	47,323	110,716
Other current assets	24,103	29,832	25,198	37,605	41,733
Total Assets	**397,673**	**464,322**	**484,351**	**584,222**	**695,018**

Cash flow Statement

Year End-March	FY16*	FY17	FY18	FY19E	FY20E
PBT	71,660	104,090	110,990	130,058	146,366
Depreciation	4,450	8,340	14,520	21,013	23,263
Others	(970)	-	-	-	-
CF before W.cap	**75,140**	**112,430**	**125,510**	**151,071**	**169,630**
Inc/dec in W.cap	18,411	(9,959)	26,426	28,787	12,018
Op CF after W.cap	**56,729**	**122,389**	**99,084**	122,284	157,612
Less Taxes	14,990	19,520	23,170	27,876	32,932
Net CF From Operations	**41,739**	**102,869**	**75,914**	**94,408**	**124,679**
Inc/(dec) in F.A + CWIP	9,483	52,589	19,557	27,366	25,000
(Pur)/sale of Investments	20,540	10,205	(3,018)	20,000	20,000
CF from Invst Activities	**(30,023)**	**(62,794)**	**(16,539)**	**(47,366)**	**(45,000)**
Loan Raised/(repaid)	5,046	(4,315)	(1,046)	(2,000)	-
Equity Raised	5,036	9,716	(41,444)	0	(0)
Dividend	28,021	39,604	13,111	14,658	16,286
CF from Fin Activities	**(17,939)**	**(34,203)**	**(55,601)**	**(16,658)**	**(16,286)**
Net inc /(dec) in cash	(6,223)	5,872	3,774	30,384	63,393
Op. bal of cash	**13,516**	**7,293**	**13,165**	**16,939**	**47,323**
Cl. balance of cash	**7,293**	**13,165**	**16,939**	**47,323**	**110,716**

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