

RETAIL EQUITY RESEARCH

HCL Technologies Ltd

IT Consulting & Software

BSE CODE: 532281

NSE CODE: HCLTECH

Bloomberg CODE: HCLT:IN SENSEX: 27,850

BUY

Rating as per Large cap

12months investment period

CMP Rs840 TARGET Rs947 RETURN 13%

30th Jan, 2017

Margin outperformance

HCL Technologies, India's fourth largest IT services company, is engaged in providing software, business process outsourcing and IT infrastructure services. The company has a wide geographical presence across 32 countries.

- HCL Tech reported a sturdy 3% YoY revenue growth in CC terms and 1.3% in USD terms led by broad-based growth across service lines.
- EBIT margin rose to 20.4% driven by lower SG&A expenses and better operational efficiency.
- Management has retained revenue growth guidance of 12%-14% (CC terms) and EBIT margin guidance of 19.5%-20.5% for FY17.
- The company signed nine transformational deals and added 19 new clients in Q3FY17. The contribution of Top 5 clients increased to 14.2% from 13.6% YoY.
- At CMP, the stock trades at a PE of 14.5x/13.3x/12X for FY17E/FY18E/19E. We maintain Buy rating with a revised target price of Rs947 based on 13.5x FY19E PE.

Broad based growth

HCL Tech has reported good set of numbers with INR revenue growing by 2.6% QoQ. While, revenue in constant currency grew 3% QoQ, dollar revenue rose 1.3% sequentially. While steady growth was witnessed across services, engineering and R&D services grew by a robust 7.1% in CC terms. Among verticals, growth was led by manufacturing (8.3%), public services (5.6%) and financial services (4.5%). However, Lifesciences & Healthcare (-2.9%) was soft and Retail & CPG degrew 6.9% impacted by seasonality. The impact of cross-currency movement on revenue growth was 170bps. Geographically, Europe grew by 6.8% while US reported moderate growth of 1.7%.

Solid EBIT margin performance

EBIT rose 3.5% QoQ with margin expanding to 20.4% predominantly due to lower SG&A expenses. Further, better operational efficiency led by automation also supported the growth. Net profit reported growth of ~2% aided by higher forex gain.

Guidance maintained

Management has retained FY17 revenue growth guidance of 12-14% in CC terms, translating into dollar revenue guidance of 10-12%. It further expects the acquisitions and IP led partnerships to contribute 0.6% to 1.0% in revenue growth depending upon the completion of the Geometric deal. The management has also maintained EBIT margin guidance of 19.5-20.5% for FY17 (post integration of acquisitions).

Betting big on products business

HCL Tech has further extended its IP partnership with IBM with the acquisition of IP assets in areas of application security, B2B data transformation, testing automation and mainframe management tools. It has committed USD155mn for this and is expected to generate additional revenue of USD45-50mn in the first year itself. The new CEO is committed to invest further in products & platforms to build a steady revenue steam from products business. We expect these IP deals to be margin accretive.

Outlook & Valuation: Given steady Q3 performance and aggressive focus on its high margin products business, we maintain positive stance on the stock. We expect revenue/PAT to grow at a CAGR of ~24%/21% over FY16-FY19E. Maintain BUY rating on the stock with a revised TP of Rs947.

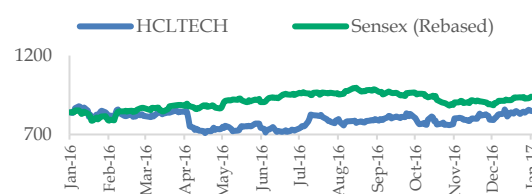
Company Data

Market Cap (Rs cr)	118,516
Enterprise Value (Rs cr)	106,074
Outstanding Shares (cr)	141.0
Free Float	39.0%
Dividend Yield	0.0%
52 week high	Rs890
52 week low	Rs707
6m average volume (lakh)	24.8
Beta	0.7
Face value	Rs2

Shareholding %	Q1 FY17	Q2FY17	Q3FY17
Promoters	60.4	60.4	60.3
FII's	25.7	25.7	24.3
MFs/Insti	6.6	6.7	8.0
Public& Others	7.4	7.2	7.4
Total	100	100	100

Price Performance	3mth	6mth	1 Year
Absolute Return	10%	12%	(3%)
Absolute Sensex	0%	-1%	12%
Relative Return*	10%	13%	(15%)

*over or under performance to benchmark index



Y.E Mar (Rscr)	FY17E	FY18E	FY19E
Sales	46,962	52,790	59,342
Growth (%)	52.6%	12.4%	12.4%
EBITDA	10,266	11,329	12,557
EBITDA Margin (%)	21.9	21.5	21.2
PAT Adj	8,160	8,930	9,897
Growth (%)	44.6%	9.4%	10.8%
Adj.EPS	57.8	63.3	70.2
Growth (%)	44.5%	9.4%	10.8%
P/E	14.5	13.3	12.0
P/B	3.6	3.1	2.6
EV/EBITDA	10.6	9.4	8.2
RoE (%)	27.3	25.1	23.5
Adj. D/E	0.0	0.0	0.0



Quarterly Financials (Consolidated)

Profit & Loss Account

(Rs Cr)	Q3FY17	Q3FY16	YoY Growth %	Q2FY16	QoQ Growth %	9MFY17	9MFY16	YoY Growth %
Total Revenue	11,814	10,341	14.3	11,519	2.6	34,670	20,437	69.6
EBITDA	2,610	2,216	17.8	2,503	4.3	7,637	4,311	77.2
EBITDA Margin (%)	22.1	21.4	67bps	21.7	37bps	22.0	21.1	94bps
Depreciation	210	141	48.6	183	14.8	569	264	115.1
EBIT	2,401	2,075	15.7	2,320	3.5	7,068	4,046	74.7
Interest	22	23	(3.2)	11	108.8	61	49	25.2
Other Income	207	364	(43.0)	217	(4.4)	648	610	6.1
Exceptional Items	43	12	261.5	31	39.7	140	33	332.0
PBT	2,629	2,427	8.3	2,558	2.8	7,795	4,640	68.0
Tax	572	508	12.5	540	5.8	1,662	981	69.4
PAT	2,058	1,920	7.2	2,017	2.0	6,133	3,659	67.6
Minority Interest/P&L of Associates	(4)	(5)	(15.9)	2	(361.3)	1	(5)	(110.2)
Reported PAT	2,062	1,925	7.1	2,016	2.3	6,133	3,664	67.4
Adjustment	(43)	(12)	261.5	(31)	39.7	(140)	(33)	332.0
Adj PAT	2,019	1,913	5.5	1,985	1.7	5,992	3,632	65.0
No. of shares (cr)	141.12	140.93	0.1	141.09	0.0	141.12	140.93	0.1
EPS (Rs.)	14.30	13.57	5.4	14.07	1.7	42.46	25.77	64.8

Segment Performance

(Rs Cr)	Q3FY17	Q3FY16	YoY Growth %	Q2FY16	QoQ Growth %	9MFY17	9MFY16	YoY Growth %
Software Services	6,636	6,101	8.8	6,405	3.6	19,395	12,120	60.0
Business Process Outsourcing Services	477	573	(16.8)	468	1.8	1,413	1,104	28.0
IT Infrastructure Services	4,702	3,667	28.2	4,646	1.2	13,862	7,214	92.2
Total	11,814	10,341	14.3	11,519	2.6	34,670	20,437	69.6
Less: Inter-segment revenue	-	-	-	-	-	-	-	-
Net Revenue	11,814	10,341	14.3	11,519	2.6	34,670	20,437	69.6

Change in estimates

Year / Rscr	Old estimates		New estimates		Change %	
	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Revenue	46,962	53,022	46,962	52,790	0.0	(0.4)
EBITDA	9,871	10,880	10,266	11,329	4.0	4.1
Margin (%)	21.0	20.5	21.9	21.5	90 bps	100 bps
PAT	7,772	8,591	8,160	8,930	5.0	3.9
EPS	55.1	60.9	57.8	63.3	4.9	3.9

Source: Company, Geojit Research



Consolidated Financials

Profit & Loss Account

Y.E March (Rscr)	FY15	FY16#	FY17E	FY18E	FY19E
Sales	36,701	30,781	46,962	52,790	59,342
% change	14.2%	-16.1%	52.6%	12.4%	12.4%
EBITDA	8,546	6,606	10,266	11,329	12,557
% change	6.4%	-22.7%	55.4%	10.4%	10.8%
Depreciation	404	393	779	899	1,019
EBIT	8,142	6,213	9,487	10,430	11,538
Interest	91	74	80	85	85
Other Income	1,066	830	946	985	1,105
PBT	9,117	6,969	10,353	11,330	12,559
% change	15.2%	-23.6%	48.6%	9.4%	10.8%
Tax	1,815	1,364	2,205	2,413	2,675
Tax Rate (%)	19.9%	19.6%	21.3%	21.3%	21.3%
Reported PAT	7,317	5,643	8,160	8,930	9,897
Adj*	-	-	-	-	-
Adj PAT	7,317	5,643	8,160	8,930	9,897
% change	16.4%	-22.9%	44.6%	9.4%	10.8%
No. of shares (cr)	140.6	141.0	141.1	141.1	141.1
Adj EPS (Rs)	52.0	40.0	57.8	63.3	70.2
% change	-42.1%	-23.1%	44.5%	9.4%	10.8%
DPS (Rs)	17.0	17.0	17.0	17.0	17.0

Cash flow

Y.E March (Rscr)	FY15	FY16#	FY17E	FY18E	FY19E
Pre-tax profit	9,117	7,025	10,363	11,341	12,571
Depreciation	404	393	779	899	1,019
Changes in W.C	(1,188)	(2,384)	801	(346)	(321)
Others	(1,019)	(756)	(866)	(900)	(1,020)
Tax paid	(1,774)	(1,364)	(2,205)	(2,413)	(2,675)
C.F.O	5,539	2,914	8,872	8,581	9,573
Capital exp.	(1,208)	(2,044)	(3,500)	(2,000)	(2,000)
Change in inv.	(70)	14	(2,000)	(2,000)	(2,000)
Other invest.CF	(809)	830	946	985	1,105
C.F - investing	(2,088)	(1,200)	(4,554)	(3,015)	(2,895)
Issue of equity	10	1	0	-	-
Issue/repay debt	(301)	304	(362)	-	-
Dividends paid	(2,385)	(2,877)	(2,878)	(2,878)	(2,878)
Other finance.CF	(464)	(74)	(80)	(85)	(85)
C.F - Financing	(3,140)	(2,646)	(3,320)	(2,963)	(2,963)
Chg. in cash	311	(932)	999	2,603	3,715
Closing cash	9,786	9,285	10,284	12,887	16,602

Balance Sheet

Y.E March (Rscr)	FY15	FY16#	FY17E	FY18E	FY19E
Cash	9,786	9,285	10,284	12,887	16,602
Accounts Receivable	6,539	7,682	8,539	9,598	10,789
Inventories	158	264	113	127	142
Other Cur. Assets	5,802	7,094	6,947	7,585	8,288
Investments	869	855	2,855	4,855	6,855
Gross Fixed Assets	7,388	9,484	12,984	14,984	16,984
Net Fixed Assets	3,482	5,185	7,906	9,007	9,988
CWIP	552	500	500	500	500
Intangible Assets	4,793	4,877	4,877	4,877	4,877
Def. Tax (Net)	790	826	826	826	826
Other Assets	2,475	2,776	3,053	3,267	3,496
Total Assets	35,245	39,344	45,899	53,529	62,363
Current Liabilities	9,465	9,945	11,540	13,076	14,847
Provisions	-	-	-	-	-
Debt Funds	648	952	590	590	590
Other Liabilities	825	841	883	927	973
Equity Capital	281	282	282	282	282
Reserves and Surplus	23,943	27,012	32,293	38,345	45,364
Shareholder's Fund	24,224	27,294	32,576	38,627	45,646
Minority Interest	82	312	310	308	306
Total Liabilities	35,245	39,344	45,899	53,529	62,363
BVPS (Rs)	172.3	193.5	230.9	273.8	323.5

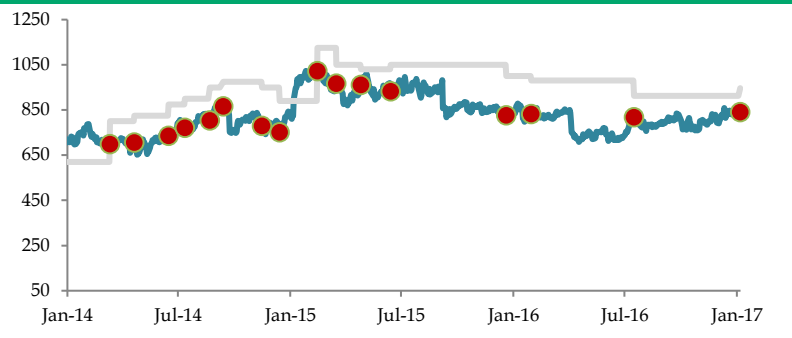
Ratios

Y.E March	FY15	FY16#	FY17E	FY18E	FY19E
Profitab. & Return					
EBITDA margin (%)	23.3	21.5	21.9	21.5	21.2
EBIT margin (%)	22.2	20.2	20.2	19.8	19.4
Net profit mgn.(%)	19.9	18.3	17.4	16.9	16.7
ROE (%)	33.4	21.9	27.3	25.1	23.5
ROCE (%)	40.4	26.3	33.6	31.3	29.4
W.C & Liquidity					
Receivables (days)	65.0	91.1	66.4	66.4	66.4
Inventory (days)	3.0	6.1	1.8	1.8	1.8
Payables (days)	8.1	12.3	7.5	7.5	7.5
Current ratio (x)	2.4	2.4	2.2	2.3	2.4
Quick ratio (x)	2.3	2.4	2.2	2.3	2.4
Turnover & Levq.					
Gross asset T.O (x)	0.0	0.0	0.0	0.0	0.0
Total asset T.O (x)	5.3	3.6	4.2	3.8	3.7
Adj. debt/equity (x)	1.1	0.8	1.1	1.1	1.0
Adj. debt/equity (x)	0.0	0.0	0.0	0.0	0.0
Valuation ratios					
EV/Net Sales (x)	3.0	3.6	2.3	2.0	1.7
EV/EBITDA (x)	12.8	16.7	10.6	9.4	8.2
P/E (x)	16.1	21.0	14.5	13.3	12.0
P/BV (x)	4.9	4.3	3.6	3.1	2.6

#FY16 is a 9 months period due to change in accounting year to March from June
Note: We have not factor in the Geometric acquisition in our estimates yet.



Recommendation Summary (last 3 years)



Source: Bloomberg, Geojit BNP Paribas Research

Dates	Rating	Target
22 October 2013	BUY	620
04 April 2014	BUY	800
14 May 2014	BUY	825
09 July 2014	BUY	875
05 August 2014	BUY	900
15 September 2014	BUY	950
07 October 2014	BUY	975
09 December 2014	BUY	950
07 January 2015	BUY	890
10 March 2015	BUY	1125
10 April 2015	BUY	1050
20 May 2015	BUY	1030
08 July 2015	BUY	1050
13 January 2016	BUY	1000
23 February 2016	BUY	980
9 August 2016	BUY	913
30 January 2017	BUY	947

Investment Rating Criteria

Large Cap Stocks;

Buy	-	Upside is 10% or more.
Hold	-	Upside or downside is less than 10%.
Reduce	-	Downside is 10% or more.

Mid Cap and Small Cap;

Buy	-	Upside is 15% or more.
Accumulate*	-	Upside between 10% - 15%.
Hold	-	Absolute returns between 0% - 10%.
Reduce/Sell	-	Absolute returns less than 0%.

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating.

* For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.

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