

HCL Technologies

Performance Highlights

(₹ cr) – Consl.	4QFY17	3QFY17	% chg (qoq)	4QFY16	% chg (yoy)
Net revenue	12,053	11,814	2.0	10,698	12.7
EBIT	2,416	2,408	0.3	2,222	8.7
EBIT margin (%)	20.0	20.4	(34)bp	20.8	(73)ps
PAT	2,325	2,070	12.3	1,926	20.7

Source: Company, Angel Research

The company posted 4QFY2017 results better than expected. In US\$ terms, the revenues came in at US\$1,817mn (v/s US\$1,810mn expected) v/s US\$1,745mn in 3QFY2017, a qoq growth of 4.1%. On Constant Currency (CC) basis, company posted a 3.8% qoq growth. On the operating front, EBIT came in at 20.0% (v/s 20.1% expected) v/s 20.4% in 3QFY2017, a dip of 34bps qoq. Thus, PAT came in at 2,325cr (v/s `1,982cr expected) v/s `2,070cr in 3QFY2017, up 12.3% qoq. For FY'2018, revenues are expected to grow 10.5-12.5% in Constant Currency (CC) and EBIT Margin of 19.5-20.5%. **We maintain our buy.**

Quarterly highlights: In US\$ terms, the revenues came in at US\$1,817mn v/s US\$1,745mn in 3QFY2017, a qoq growth of 4.1%. On Constant Currency (CC) basis, company posted a 3.8% qoq growth. On the growth front, USA posted a CC qoq growth of 5.3%, Europe posted a dip of 3.0% CC and ROW posted a CC qoq growth of 15.8%. In terms of verticals, Financial Services posted a CC qoq growth of 3.0%, Manufacturing posted a CC qoq growth of 6.3%, Life sciences & Healthcare posted a CC qoq growth of 0.1%, Public Services posted a CC qoq growth of 8.1%, while Retail & CPG posted a CC qoq growth of 2.1%. On the operating front, EBIT came in at 20% (v/s 20.1% expected) v/s 20.4% in 3QFY2017, a dip of 34bps qoq. Thus, PAT came in at 2,325cr (v/s `1,982cr expected) v/s `2,070cr in 3QFY2017, up 12.3% qoq.

Outlook and valuation: We expect HCL Tech to post a USD and INR revenue CAGR of 10.7% and 10.7% respectively over FY2017–19E. On the back of strong order book and given the attractive valuations, we **recommend a Buy on the stock.**

Key financials (Consolidated, US GAAP)

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
Net sales	30,781	46,723	52,342	57,053
% chg	(16.9)	51.8	12.0	9.0
Net profit	5,643	8,457	8,860	9,536
% chg	(22.2)	49.9	4.8	7.6
EBITDA margin (%)	21.5	22.1	20.9	20.9
EPS (`)	40.0	60.0	62.8	67.6
P/E (x)	21.2	14.1	13.5	12.5
P/BV (x)	4.3	3.6	3.0	2.6
RoE (%)	20.1	25.3	22.4	20.6
RoCE (%)	15.6	20.4	18.3	17.3
EV/Sales (x)	3.6	2.3	2.0	1.7
EV/EBITDA (x)	16.6	10.5	9.5	8.2

Source: Company, Angel Research; Note: CMP as of May 12, 2017

Please refer to important disclosures at the end of this report

BUY

CMP	₹847
Target Price	₹1,014

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	1,20,898
Net Debt (₹ cr)	(12140)
Beta	0.4
52 Week High / Low	890/707
Avg. Daily Volume	37,534
Face Value (₹)	2
BSE Sensex	30,188
Nifty	9,401
Reuters Code	HCLT.BO
Bloomberg Code	HCLT@IN

Shareholding Pattern (%)

Promoters	59.7
MF / Banks / Indian Fls	11.8
FII / NRIs / OCBs	25.1
Indian Public / Others	3.5

Abs.(%)	3m	1yr	3yr
Sensex	6.5	17.1	28.2
HCL Tech	2.5	18.3	21.9

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 4QFY2017 performance (Consolidated, US GAAP)

Y/E March (' cr)	4QFY17	3QFY17	% chg (qoq)	4QFY16	% chg (yoy)	FY17	FY16	% chg(yoy)
Net revenue	12,053	11,814	2.0	10,698	12.7	46,723	40,913	14.2
Cost of revenue	7,987	7,809	2.3	6,961	14.7	30,890	26,901	14.8
Gross profit	4,066	4,005	1.5	3,737	8.8	15,833	14,012	13.0
SG&A expense	1,417	1,377	2.9	1,358	4.3	5,524	5,217	5.9
EBITDA	2,649	2,628	0.8	2,379	11.3	10,309	8,795	17.2
Dep. and amortization	233	220	5.9	157	48.4	835	569	46.7
EBIT	2,416	2,408	0.3	2,222	8.7	9,474	8,226	15.2
Other income	215	231	(6.9)	200	7.5	934	1,009	(7.4)
PBT	2,631	2,639	(0.3)	2,422	8.6	10,408	9,235	12.7
Income tax	303	568	(46.7)	497	(39.0)	1,952	1,883	3.7
PAT	2,325	2,070	12.3	1,926	20.7	8,456	7,352	15.0
Forex gain/(loss)	-	-	-	-	-	-	-	-
Adjusted PAT	2,325	2,070	12.3	1,926	20.7	8,456	7,352	15.0
EPS	16.5	14.7	12.3	13.7	20.7	60.0	52.1	15.0
Gross margin (%)	33.7	33.9	(17)bp	34.9	(120)bps	33.9	34.2	(36)bp
EBITDA margin (%)	22.0	22.2	(27)bp	22.2	(26)bps	22.1	21.5	57bp
EBIT margin (%)	20.0	20.4	(34)bp	20.8	(73)ps	20.3	20.1	17bp
PAT margin (%)	19.3	17.5	179bp	18.0	131bps	18.1	18.0	13bp

Source: Company, Angel Research, Note-FY2016 is 12month results for meaningful comparison, From FY2017, company has March ending company

Exhibit 2: 4QFY2017 – Actual Vs Angel estimates

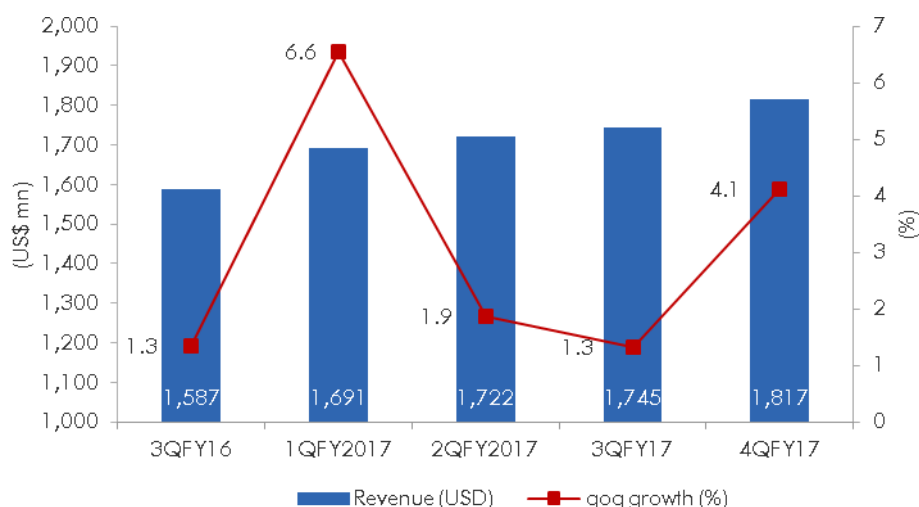
(₹ cr)	Actual	Estimate	Variation (%)
Net revenue	12,053	12,064	(0.1)
EBIDTA margin (%)	22.0	21.9	59bp
PAT	2,325	1,982	17.3

Source: Company, Angel Research

Sales just in-line with expectation

On the revenue front, the company posted a 4.1% sequential growth in USD revenues to US\$1,817mn (v/s US\$1,810mn expected) v/s US\$1,745mn in 3QFY2017. Revenue in Constant Currency (CC) was up 3.8% qoq. In Rupee terms, revenues came in at ₹12,053cr (v/s ₹12,064cr expected) v/s ₹11,814cr in 3QFY2017, up 2.0% qoq.

On the growth front, USA posted a CC qoq growth of 5.3%, Europe posted a dip of 3.0% CC and ROW posted a CC qoq growth of 15.8%. In terms of verticals, the Financial Services posted a CC qoq growth of 3.0%, Manufacturing posted a CC qoq growth of 6.3%, Life sciences & Healthcare posted a CC qoq growth of 0.1%, Public Services posted a CC qoq growth of 8.1%, while Retail & CPG posted a CC qoq growth of 2.1%. The vertical which posted a dip was Telecommunication, Media, and Publishing & Entertainment which came in at 2.1%.

Exhibit 3: Revenue growth trend


Source: Company, Angel Research

In terms of services, Engineering & R&D services (which constituted 20.5% of sales) posted a growth of 14.6% qoq (CC), while Application services (accounting for 36.8% of sales) grew by 1.8% qoq (CC). Infrastructure services, another important segment of the company, which contributes around 38.8% to overall sales, posted a growth of 0.9% qoq (CC). Business services, which constituted 3.9% of sales, grew by 0.2% qoq (CC).

Exhibit 4: Revenue growth trend (Service wise)

	% of revenue	% growth CC (qoq)	% growth (yoy)
Application services	36.8	1.8	7.2
Infrastructure services	38.8	0.9	24.8
Business services	3.9	0.2	(11.7)
Engineering and R&D services	20.5	14.6	26.0

Source: Company, Angel Research

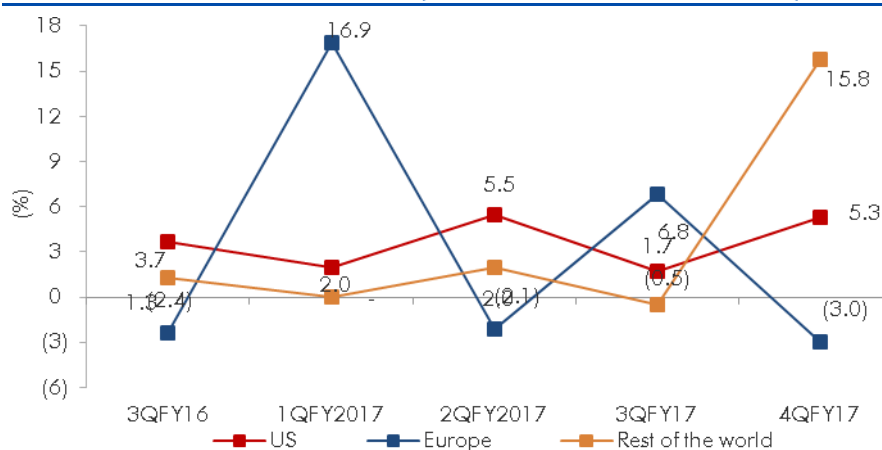
Industry segment wise, the company's Financial Services vertical (contributing 24.2% to revenue) posted a 3% qoq growth in CC terms. The Manufacturing vertical (contributing 34.6% to revenue) posted a 6.3% qoq growth in CC terms. Public services, Life sciences & Healthcare, and Telecommunication, Media, Publishing & Entertainment reported a qoq growth of 8.1%, 2.1% and (2.1)%, all in CC terms, respectively. Retail & CPG (contributing 9.2% of the revenue), on the other hand, reported a growth of 2.1% qoq CC terms, during the quarter.

Exhibit 5: Revenue growth trend (Industry wise)

	% of revenue	% growth (CC qoq)	% growth (yoy)
Financial services	24.2	3.0	13.4
Manufacturing	34.6	6.3	27.4
Life sciences & Healthcare	11.5	0.1	3.5
Public Services	11.7	8.1	22.4
Retail & CPG	9.2	2.1	17.2
Telecom, MPE	8.4	(2.1)	(2.6)

Source: Company, Angel Research

Among geographies, in CC terms, America grew by 5.3% qoq, RoW grew by 15.8% qoq, while Europe de-grew by 3.0% qoq, during the period.

Exhibit 6: Revenue growth trend (Geography wise in CC terms)


Source: Company, Angel Research

Hiring and utilization

During the quarter, the overall headcount of HCL Tech increased by 10,426 to 1,15,973 employees. The attrition rate in IT Services inched downwards to 16.9% (v/s 17.9% in 3QFY2017) and the blended utilization level of the company inched up to 85.7% (v/s 84.6% in 3QFY2017).

Exhibit 7: Hiring trend

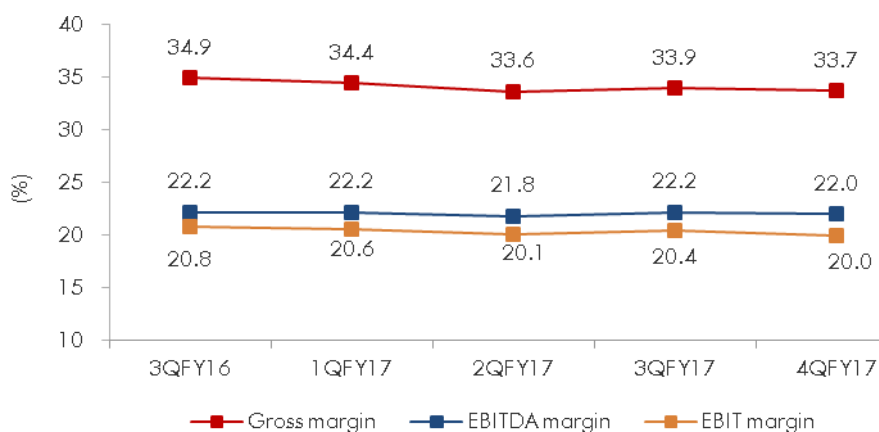
Particulars	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Technical	95,649	98,225	99,897	1,01,154	1,05,547
Support	9,247	9,743	9,898	9,938	10,426
Total employee base	104,896	107,968	109,795	1,11,092	1,15,973
Gross addition	9,280	10,515	9,083	8,467	10,605
Net addition	1,200	3,072	2,097	3,124	6,178
Attrition - IT services (LTM) - %	17.3	17.8	18.6	17.9	16.9

Source: Company, Angel Research

Operating margin just in line with the expectation

On the operating front, the EBDITA margins came in at 22.0% (v/s 22.2% in 3QFY2017), a qoq dip of 27bp, while the EBIT margins came in at 20.0%, a qoq dip of 34bp. This was against the EBDITA & EBIT margin expectations of 21.9% & 20.1% respectively.

Exhibit 8: Margin profile



Source: Company, Angel Research

Client pyramid

The company signed 8 transformational deals this quarter. These deals represented a well-balanced mix across service lines, industry verticals and geographies. This takes the total number of transformational wins to 42 for FY'2017. Company added 5 clients in the US\$50+mn and 3 in the US\$20+mn.

Exhibit 9: Client pyramid

Particulars	3QFY16	1QFY17	2QFY17	3QFY17	4QFY17
US\$1mn–5mn	267	262	245	259	260
US\$5mn–10mn	87	84	91	89	93
US\$10mn–20mn	66	49	66	64	68
US\$20mn–30mn	32	35	32	33	36
US\$30mn–40mn	16	16	16	15	15
US\$40mn–50mn	4	5	12	14	9
US\$50mn–100mn	12	10	13	12	17
US\$100mn plus	7	7	7	8	8

Source: Company, Angel Research

Investment arguments

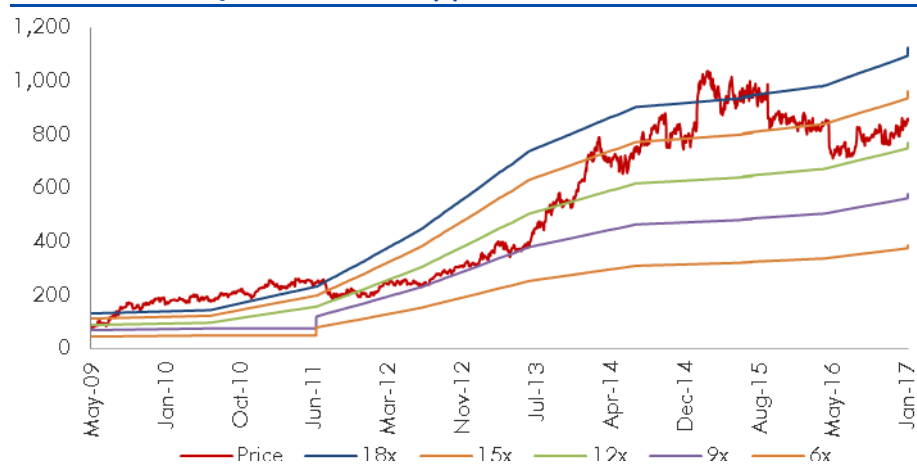
Robust outlook for FY2018: On the basis of deals on hand, the company gave a revenue growth guidance of 10.5-12.5% in CC for FY2018, which includes a component of inorganic growth, adjusting for which, the organic growth would be 7.5-9.5% in CC for FY2018. The operating margin (EBIT) for FY'2018 is expected to be in the range of 19.5-20.5%. We expect HCL Tech to post a USD and INR revenue CAGR of 10.7% and 10.7% respectively, over FY2017–19E (inclusive of the acquisition of Geometric Software and Volvo deals).

Healthy pipeline: HCL Tech signed 8 transformational deals this quarter, across service lines and industry verticals. The broad-based business wins were driven by next-generation integrated offerings – Next-Gen ITO, BEYONDigital, and IoT WoRKS, reflecting investments in Internet of Things, digital technologies, cloud, automation and artificial intelligence. Company added 5 clients in the US\$50+mn and 3 in the US\$20+mn. Overall, in FY2017 the company added 42 clients.

Outlook and valuation

On the operating front, HCL Tech's EBIT margin had been around 19.3% in FY2017, a dip of 1000bp over the previous financial year. With the acquisition of Geometric Software and Volvo, we expect the EBIT margin to be under pressure during FY2017. We expect the EBIT and PAT to post a 7.9% and 7.1% CAGR respectively over FY2017-19E. At the current market price, the stock is trading at 13.5x FY2018E and 12.5x FY2019E EPS. **We recommend a Buy, with a price target of ₹1,014.**

Exhibit 10: One-year forward PE (x) chart



Source: Company, Angel Research

Exhibit 11: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2018E EBITDA (%)	FY2018E P/E (x)	FY2016-18E EPS CAGR (%)	FY2018E EV/Sales (x)	FY2018E RoE (%)
HCL Tech	Buy	847	1,014	19.7	20.9	13.5	3.0	2.0	22.4
Infosys	Buy	964	1,179	22.3	26.0	15.1	4.4	2.6	19.7
TCS	Accumulate	2,360	2,651	12.4	27.6	16.3	8.5	3.3	29.7
Tech Mahindra	Buy	442	600	35.7	17.0	11.1	11.4	1.0	20.7
Wipro	Accumulate	507	570	12.5	20.3	13.9	4.0	1.4	14.6

Source: Company, Angel Research

Company Background

HCL Tech is India's fifth largest IT services company, with over 1,00,000 employees catering to more than 450 clients. The company's service offerings include Enterprise Application Services (EAS), Custom Applications, Engineering Research & Development (ERD), and Infrastructure Management Services (IMS). In December 2008, HCL Tech acquired UK-based SAP consulting company - Axon, which now contributes ~10% to its consolidated revenue. Recently, during 3QFY2016, the company acquired Geometric Software.

Profit and loss statement (Consolidated, US GAAP)

Y/E Mar (` cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Net sales	37,061	30,781	46,723	52,342	57,053
Cost of revenues	23,798	20,235	30,890	34,598	37,712
Gross profit	13,263	10,546	15,833	17,744	19,341
% of net sales	35.8	34.3	33.9	33.9	33.9
SG&A expenses	4,563	3,940	5,524	6,804	7,417
% of net sales	12.3	12.8	11.8	13.0	13.0
EBITDA	8,700	6,606	10,309	10,939	11,924
% of net sales	23.5	21.5	22.1	20.9	20.9
Depreciation and amort.	451	393	835	935	1085
% of net sales	1.2	1.3	1.8	1.8	1.9
EBIT	8,249	6,213	9,474	10,004	10,839
% of net sales	22.3	20.2	20.3	19.1	19.0
Other income, net	912	756	934	934	934
Profit before tax	9,161	6,969	10,408	10,938	11,773
Provision for tax	1,908	1,364	1,952	2,078	2,237
% of PBT	20.8	19.6	18.8	19.0	19.0
PAT	7,253	5,605	8,457	8,860	9,536
Share from equity invest.	-	-	-	-	-
Forex loss	-	-	-	-	-
ESOP charges	103	38	-	-	-
Reported net profit	7,253	5,643	8,457	8,860	9,536
Fully diluted EPS (`)	51.4	40.0	60.0	62.8	67.6

Note: FY2016 Numbers are 9 month figures

Balance sheet (Consolidated, US GAAP)

Y/E Mar (` cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Cash and cash equivalent	1,352	729	1,317	1,500	1,700
Account receivables, net	6,563	7,721	8,301	9,039	9,853
Unbilled receivables	2,923	3,002	2,501	3,141	3,423
Deposit with banks	9,670	10,587	10,220	14,102	20,059
Deposit (one year with HDFC Ltd)	-	-	-	-	-
Invest. securities, available for sale	767	537	1,146	2,250	2,251
Other current assets	2,338	2,410	2,983	3,283	3,583
Total current assets	23,613	24,986	26,468	33,315	40,870
Property and equipment, net	3,820	4,323	4,681	4,981	5,281
Intangible assets, net	5,204	6,419	11,426	11,426	11,426
Deposits with HDFC Ltd.	-	-	-	-	-
Fixed deposits with banks	-	-	-	-	-
Investment securities HTM	8	160	147	147	147
Investment in equity investee	-	-	-	-	-
Other assets	3,066	3,879	3,712	4,780	4,780
Total assets	35,711	39,768	46,432	54,648	62,502
Current liabilities	9,232	9,509	11,148	12,483	13,606
Borrowings	469	973	542	542	542
Other liabilities	1,259	1,264	1,253	2,078	2,078
Total liabilities	10,960	11,745	12,942	15,103	16,226
Minority interest	-	-	-	-	-
Total stockholder equity	24,751	28,022	33,490	39,545	46,276
Total liab. and stock holder equity	35,711	39,767	46,432	54,648	62,502

Note: FY2016 Numbers are 9 month figures

Cash flow statement (Consolidated, US GAAP)

Y/E Mar (' cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Pre tax profit from operations	7,253	5,643	8,457	8,860	9,536
Depreciation	451	393	835	935	1,085
Expenses (deferred)/written off/others	(168)	(48)	(48)	(48)	(48)
Pre tax cash from operations	7,536	5,988	9,244	9,747	10,573
Other income/prior period ad	912	756	934	934	934
Net cash from operations	8,448	6,744	10,178	10,681	11,507
Tax	(1,908)	(1,364)	(1,952)	(2,078)	(2,237)
Cash profits	6,540	5,381	8,226	8,603	9,270
(Inc)/dec in current assets	(1,991)	(1,309)	(653)	(1,677)	(1,396)
Inc/(dec) in current liabilities	1,035	277	1,639	1,335	1,123
Net trade working capital	(956)	(1,033)	987	(342)	(273)
Cashflow from operating activities	5,584	4,348	9,213	8,261	8,998
(Inc)/dec in fixed assets	(674)	(503)	(358)	(300)	(300)
(Inc)/dec in intangibles	(55)	(1,215)	(5,006)	-	-
(Inc)/dec in investments	(1,458)	(687)	(242)	(4,987)	(5,958)
(Inc)/dec in minority interest	-	-	-	-	-
Inc/(dec) in non current liabilities	(203)	5	(11)	-	-
(Inc)/dec in non current assets	(214)	(72)	(573)	(300)	(300)
Cashflow from investing activities	(2,602)	(2,473)	(6,189)	(5,587)	(6,558)
Inc/(dec) in debt	-	-	-	-	-
Inc/(dec) in equity/premium	-	-	-	-	-
ESOP charges	(103)	(103)	(103)	(103)	(103)
Dividends	(1,651)	(2,805)	(2,805)	(2,805)	(2,805)
Others	(208)	2,385	614	1,551	1,969
Cashflow from financing activities	(1,962)	(523)	(2,294)	(1,357)	(939)
Cash generated/(utilised)	331	(623)	587	184	200
Cash at start of the year	1,021	1,352	729	1,317	1,500
Cash at end of the year	1,352	729	1,317	1,500	1,700

Note: FY2016 Numbers are 9 month figures

Key ratios

Y/E Mar	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation ratio (x)					
P/E (on FDEPS)	16.5	21.2	14.1	13.5	12.5
P/CEPS	15.5	19.8	12.9	12.2	11.3
P/BVPS	4.8	4.3	3.6	3.0	2.6
Dividend yield (%)	1.7	2.0	2.0	2.0	2.0
EV/Sales	3.0	3.6	2.3	2.0	1.7
EV/EBITDA	12.6	16.6	10.5	9.5	8.2
EV/Total assets	3.1	2.8	2.3	1.9	1.6
Per share data (₹)					
EPS (Fully diluted)	51.4	40.0	60.0	62.8	67.6
Cash EPS	54.6	42.8	65.9	69.4	75.3
Dividend	14.0	17.0	17.0	17.0	17.0
Book value	175	199	237	280	328
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.8	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.1	1.1	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.2	0.2	0.2	0.2	0.2
Asset turnover ratio (Sales/Assets)	1.0	0.8	1.0	1.0	0.9
Leverage ratio (Assets/Equity)	1.4	1.4	1.4	1.4	1.4
Operating ROE	29.3	20.0	25.3	22.4	20.6
Return ratios (%)					
RoCE (pre-tax)	23.1	15.6	20.4	18.3	17.3
Angel RoIC	34.5	22.4	28.2	27.3	28.3
RoE	29.3	20.1	25.3	22.4	20.6
Turnover ratios (x)					
Asset turnover (fixed assets)	10.6	7.6	10.4	10.8	11.1
Receivables days	68	83	78	67	66

Note: FY2016 Numbers are 9 month figures

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HCL Technologies

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)

Neutral (-5 to 5%)

Reduce (-5% to -15%)

Sell (< -15)