

HCL Technologies

Performance Highlights

(` cr) – Consl.	3QFY18	2QFY18	% chg (qoq)	3QFY17	% chg (yoy)
Net revenue	12,808	12,434	3.0	11,814	8.4
EBIT	2,509	2,451	2.4	2,408	4.2
EBIT margin (%)	19.6	19.7	(12)bp	20.4	(79)ps
PAT	2,194	2,188	0.3	2,070	6.0

Source: Company, Angel Research

HCL Tech, for 3QFY2018 the sales came in at US\$1,988mn (v/s US\$1,977mn expected and) v/s US\$1,929mn in 2QFY2018, registering a qoq growth of 3.1%. In constant Currency (CC) terms, the company posted a qoq growth of 3.3%. On EBIT front, the company posted an EBIT of 19.6% (v/s 19.7% expected and) v/s 19.7% in 2QFY2018. Consequently, the PAT came in at `2,194cr (v/s `2,168cr expected and) v/s `2,188cr in 2QFY2018, growth of 0.3% qoq. In terms of guidance, the company expects FY'2018 revenues to grow between 10.5-12.5% in Constant Currency. Operating Margin (EBIT) for FY'2018 expected from 19.5% to 20.5%. **We maintain our accumulate rating,**

Quarterly highlights: The sales came in at US\$1,988mn (v/s US\$1,977mn expected and) s/s US\$1,929mn in 2QFY2018, registering a qoq growth of 3.1%. On constant Currency (CC) terms, the company posted a qoq growth of 3.3%. In terms of the geography, the USA posted a qoq 4.9% CC growth, Europe posted a 1.9% qoq CC growth & ROW posted a 3.9% CC dip during the quarter. In terms, of the verticals, Manufacturing, and Retail & CPG were the key growth driver for the company registering a CC qoq growth of 6.6%. On EBIT front, the company posted an EBIT of 19.6% (v/s 19.7% expected and) v/s 19.7% in 2QFY2017. The margins held up only on the back of 85.8% capacity utilization v/s 86.0% in 2QFY2018. Consequently, the PAT came in at `2,194cr (v/s `2,168cr expected and) v/s `2,188cr in 2QFY2017, a growth of 0.3% qoq.

Outlook and valuation: We expect HCL Tech to post a USD and INR revenue CAGR of 9.7% and 8.2% respectively over FY2017–19E. On the back of strong order book and given the attractive valuations, we **recommend an Accumulate on the stock.**

Key financials (Consolidated, US GAAP)

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
Net sales	30,781	46,723	50,099	54,608
% chg	(16.9)	51.8	7.2	9.0
Net profit	5,643	8,457	8,857	9,534
% chg	(22.2)	49.9	4.7	7.6
EBITDA margin (%)	21.5	22.1	22.1	22.1
EPS (`)	40.0	60.0	62.8	67.6
P/E (x)	23.9	16.0	15.3	14.2
P/BV (x)	4.8	4.0	3.4	2.9
RoE (%)	20.1	25.3	22.4	20.6
RoCE (%)	15.6	20.4	18.7	17.7
EV/Sales (x)	4.0	2.6	2.3	2.0
EV/EBITDA (x)	18.5	11.7	10.4	9.1

Source: Company, Angel Research; Note: CMP as of January 19, 2018

ACCUMULATE

CMP	`958
Target Price	`1,014
Investment Period	12 Months

Stock Info

Sector	IT
Market Cap (` cr)	133,335
Net Debt (` cr)	(12140)
Beta	0.2
52 Week High / Low	965/778
Avg. Daily Volume	151,423
Face Value (`)	2
BSE Sensex	35,512
Nifty	10,895
Reuters Code	HCLT.BO
Bloomberg Code	HCLT@IN

Shareholding Pattern (%)

Promoters	60.1
MF / Banks / Indian FIs	10.5
FII / NRIs / OCBs	26.4
Indian Public / Others	3.0

Abs.(%)	3m	1yr	3yr
Sensex	6.4	30.0	25.7
HCL Tech	13.6	13.5	16.3

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2018 performance (Consolidated, US GAAP)

Y/E March (₹ cr)	3QFY18	2QFY18	% chg (qoq)	3QFY17	% chg (yoy)	9MFY18	9MFY17	% chg(yoy)
Net revenue	12,808	12,434	3.0	11,814	8.4	37,391	34,670	7.8
Cost of revenue	8,412	8,208	2.5	7,809	7.7	24,677	24,540	0.6
Gross profit	4,396	4,226	4.0	4,005	9.8	12,714	10,130	25.5
SG&A expense	1,432	1,467	(2.4)	1,377	4.0	4,310	2,352	83.2
EBITDA	2,964	2,759	7.4	2,628	12.8	8,404	7,778	8.0
Dep. and amortization	455	308	47.7	220	106.8	999	569	75.6
EBIT	2,509	2,451	2.4	2,408	4.2	7,405	7,209	2.7
Other income	264	298	(11.4)	231	14.3	831	648	28.2
PBT	2,773	2,749	0.9	2,639	5.1	8,236	7,857	4.8
Income tax	579	561	3.2	568	1.9	1,683	1,662	1.3
PAT	2,194	2,188	0.3	2,070	6.0	6,553	6,195	5.8
Forex gain/(loss)	-	-	-	-	-	-	(61)	
Adjusted PAT	2,194	2,188	0.3	2,070	6.0	6,553	6,133	6.8
EPS	15.6	15.5	0.4	14.7	6.0	46.5	43.5	6.8
Gross margin (%)	34.3	34.0	33bp	33.9	42bps	34.0	29.2	478bp
EBITDA margin (%)	23.1	22.2	95bp	22.2	90bps	22.5	22.4	4bp
EBIT margin (%)	19.6	19.7	(12)bp	20.4	(79)ps	19.8	20.8	(99)bp
PAT margin (%)	17.1	17.6	(47)bp	17.5	(39)bps	17.5	17.7	(16)bp

Source: Company, Angel Research

Exhibit 2: 3QFY2018 – Actual Vs Angel estimates

(₹ cr)	Actual	Estimate	Variation (%)
Net revenue	12,808	12,795	0.1
EBITDA margin (%)	23.1	23.2	(5.8)bps
PAT	2,194	2,168	1.2

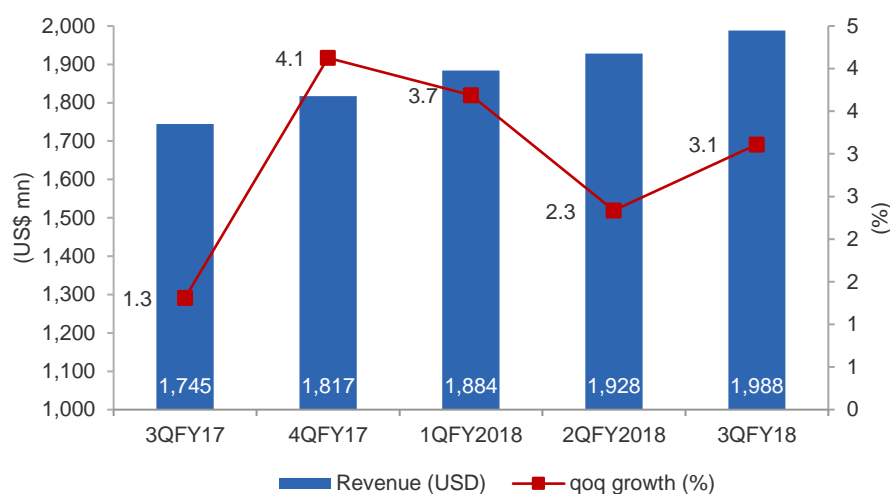
Source: Company, Angel Research

Sales just in line with expectation

The sales came in at US\$1,988mn (v/s US\$1,977mn expected and) v/s US\$1,929mn in 2QFY2018, registering a qoq growth of 3.1%. In constant Currency (CC) terms, the company posted a qoq growth of 3.3%. In Rupee terms, revenues came in at ₹12,808cr v/s. ₹12,795cr, up 3.0% qoq.

In terms, of the geography the USA posted a qoq 4.9% CC growth, Europe posted a 1.9% qoq CC growth & ROW posted a 3.9% CC dip during the quarter.

In terms of the verticals, the Manufacturing, and Retail & CPG were the key growth driver for the company registering a CC qoq growth of 6.6%. FSI posted qoq growth of 1.4%, Public Services grew by 0.2% qoq, Life Sciences and Health grew by 2.4% qoq and Telecommunications, Media, Publishing & Entertainment de-grew by 3.8% qoq.

Exhibit 3: Revenue growth trend


Source: Company, Angel Research

In terms of services, Engineering & R&D services (which constituted 24.2% of sales) posted a growth of 13.6% qoq (CC), while Application services (accounting for 35.3% of sales) grew by 1.6% qoq (CC). Infrastructure services, another important segment of the company, which contributes around 36.7% to overall sales, posted de-growth of 1.2% qoq (CC). Business services, which constituted 3.7% of sales, grew by 5.0% qoq (CC).

Exhibit 4: Revenue growth trend (Service wise)

	% of revenue	% growth CC (qoq)	% growth (yoy)
Application services	35.3	1.6	4.4
Infrastructure services	36.7	(1.2)	1.6
Business services	3.7	5.0	1.2
Engineering and R&D services	24.2	13.6	47.7

Source: Company, Angel Research

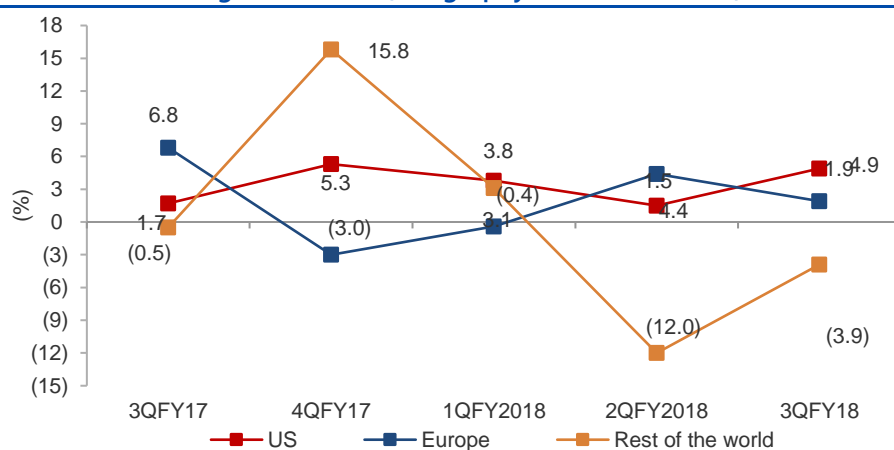
Industry segment wise, the company's Financial Services vertical (contributing 24.6% to revenue) posted a 1.4% qoq growth in CC terms. The Manufacturing vertical (contributing 36.5% to revenue) posted a 6.6% qoq growth in CC terms. Public services, Life Sciences & Healthcare, and Telecommunication, Media, Publishing & Entertainment reported a qoq growth of 0.2%, 2.4% and (3.8) % respectively, all in CC terms. Retail & CPG (contributing 9.6% of the revenue), on the other hand, reported growth of 6.6% qoq in CC terms during the quarter.

Exhibit 5: Revenue growth trend (Industry wise)

	% of revenue	% growth (CC qoq)	% growth (yoy)
Financial services	24.6	1.4	10.6
Manufacturing	36.5	6.6	21.0
Life sciences & Healthcare	11.7	2.4	9.7
Public Services	10.2	0.2	1.0
Retail & CPG	9.6	6.6	13.1
Telecom, MPE	7.4	(3.8)	(6.8)

Source: Company, Angel Research

Among geographies, in CC terms, America grew by 4.9% qoq, RoW de-grew by 3.9% qoq, and Europe grew 1.9% 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 10,460 to 1,19,291 employees. The attrition rate in IT Services inched downwards to 15.2% (v/s. 15.7% in 3QFY2018) and the blended utilization level of the company remained stagnant at 85.8% (86.0% in 2QFY2018).

Exhibit 7: Hiring trend

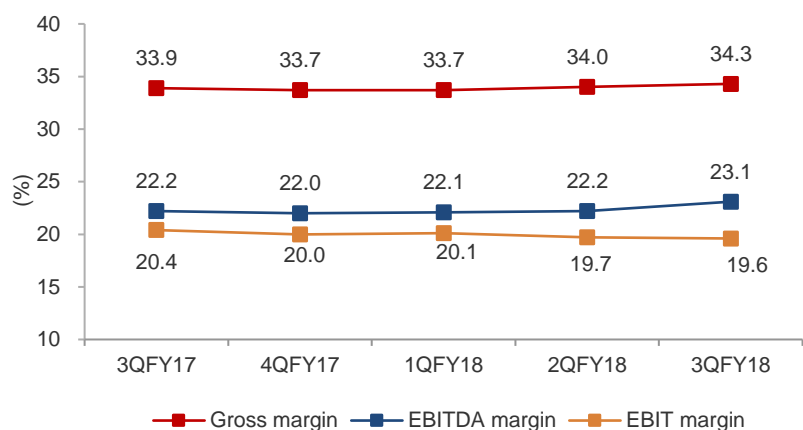
Particulars	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Technical	1,01,154	1,05,547	1,07,029	1,08,351	1,08,831
Support	9,938	10,426	10,752	10,689	10,460
Total employee base	1,11,092	1,15,973	1,17,781	1,19,040	1,19,291
Gross addition	8,467	10,605	9,462	8,645	7,113
Net addition	3,124	6,178	1,808	1,259	251
Attrition - IT services (LTM) - %	17.9	16.9	16.2	15.7	15.2

Source: Company, Angel Research

Operating margin better than expectation

On the operating front, the EBDITA margins came in at 23.1% (v/s. 22.2% in 2QFY2018), a qoq expansion of 95bps, while the EBIT margins came in at 19.6%, a qoq dip of 12bps. This was against the EBDITA margin expectations of 23.0% mainly on account of an increase of 100bp in depreciation and amortization expense.

Exhibit 8: Margin profile



Source: Company, Angel Research

Client pyramid

The company signed 20 transformational deals this quarter. These deals represented a well-balanced mix across service lines, industry verticals and geographies. Company added 3 clients each in the US\$5+ mn and US\$40+ mn categories.

Exhibit 9: Client pyramid

Particulars	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
US\$1mn–5mn	259	260	259	277	291
US\$5mn–10mn	89	93	95	102	105
US\$10mn–20mn	64	68	68	73	71
US\$20mn–30mn	33	36	34	32	29
US\$30mn–40mn	15	15	17	15	16
US\$40mn–50mn	14	9	10	12	15
US\$50mn–100mn	12	17	17	16	16
US\$100mn plus	8	8	8	9	9

Source: Company, Angel Research

Investment arguments

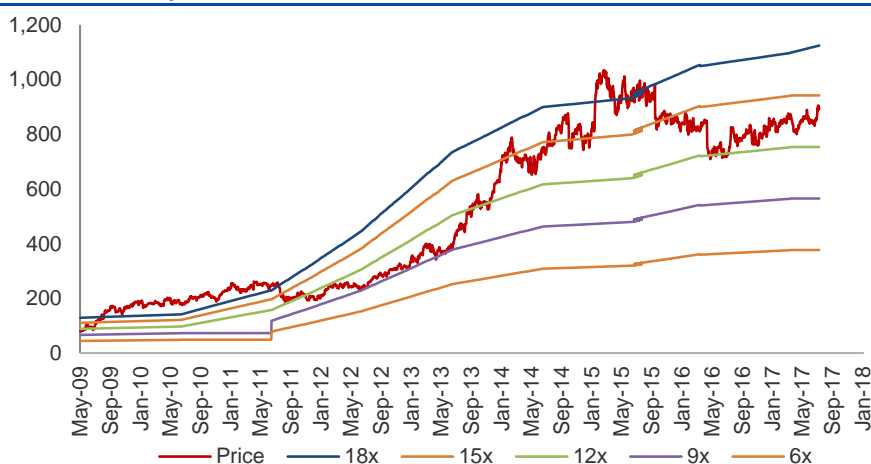
Robust outlook re-iterated for FY2018: On the basis of deals on hand, the company gave a revenue growth guidance of 10.5-12.5% in CC terms for FY2018, which includes a component of inorganic growth, adjusting for which, the organic growth would be in the range of 7.5-9.5% in CC for FY2018. The operating margin (EBIT) for FY2018 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 9.7% and 8.2% respectively, over FY2017-19E (inclusive of the acquisition of Geometric Software and Volvo deal).

Healthy pipeline: HCL Tech signed 20 transformational deals this quarter, across service lines and industry verticals. The broad-based business wins were driven by next-generation integrated offerings or Next-Gen ITO, BEYONDigital, and IoT WoRKS, reflecting investments in Internet of Things, digital technologies, cloud, automation and artificial intelligence. Company added 3 clients each in the US\$5+ mn and US\$40+ mn categories.

Outlook and valuation

We expect the EBIT and PAT to post 7.7% and 6.2% CAGR respectively over FY2017-19E. At the current market price, the stock is trading at 15.3x FY2018E and 14.2x FY2019E EPS. **We recommend a Buy on the stock, with a Target Price 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 (%)	FY2019E EBITDA (%)	FY2019E P/E (x)	FY2017-19E EPS CAGR (%)	FY2019E EV/Sales (x)	FY2019E RoE (%)
HCL Tech	Accumulate	958	1,014	5.9	22.1	14.2	6.2	1.9	20.6
Infosys	Neutral	1150	-	-	26.5	17.1	3.8	2.8	18.7
TCS	Sell	3,113	2,493	(19.9)	26.3	21.2	3.4	4.0	28.3
Tech Mahindra	Reduce	570	526	(7.7)	15.0	15.1	8.6	1.4	16.2
Wipro	Reduce	321	280	(12.7)	22.3	16.5	4.4	1.9	13.6

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	50,099	54,608
Cost of revenues	23,798	20,235	30,890	33,116	36,096
Gross profit	13,263	10,546	15,833	16,984	18,512
<i>% of net sales</i>	35.8	34.3	33.9	33.9	33.9
SG&A expenses	4,563	3,940	5,524	5,912	6,444
<i>% of net sales</i>	12.3	12.8	11.8	11.8	11.8
EBITDA	8,700	6,606	10,309	11,072	12,068
<i>% of net sales</i>	23.5	21.5	22.1	22.1	22.1
Depreciation and amort.	451	393	835	935	1085
<i>% of net sales</i>	1.2	1.3	1.8	1.9	2.0
EBIT	8,249	6,213	9,474	10,137	10,983
<i>% of net sales</i>	22.3	20.2	20.3	20.2	20.1
Other income, net	912	756	934	934	934
Profit before tax	9,161	6,969	10,408	11,071	11,917
Provision for tax	1,908	1,364	1,952	2,214	2,383
<i>% of PBT</i>	20.8	19.6	18.8	20.0	20.0
PAT	7,253	5,605	8,457	8,857	9,534
Share from equity invest.	-	-	-	-	-
Forex loss	-	-	-	-	-
ESOP charges	103	38	-	-	-
Reported net profit	7,253	5,643	8,457	8,857	9,534
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	1,484	1,680
Account receivables, net	6,563	7,721	8,301	8,652	9,431
Unbilled receivables	2,923	3,002	2,501	3,006	3,276
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	32,778	40,281
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	54,110	61,914
Current liabilities	9,232	9,509	11,148	11,948	13,023
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	14,568	15,643
Minority interest	-	-	-	-	-
Total stockholder equity	24,751	28,022	33,490	39,542	46,271
Total liab. and stock holder equity	35,711	39,767	46,432	54,110	61,914

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	8,857	9,534
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	9,744	10,571
Other income/prior period ad	912	756	934	934	934
Net cash from operations	8,448	6,744	10,178	10,678	11,505
Tax	(1,908)	(1,364)	(1,952)	(2,214)	(2,383)
Cash profits	6,540	5,381	8,226	8,464	9,121
(Inc)/dec in current assets	(1,991)	(1,309)	(653)	(1,156)	(1,349)
Inc/(dec) in current liabilities	1,035	277	1,639	800	1,075
Net trade working capital	(956)	(1,033)	987	(355)	(274)
Cashflow from operating activities	5,584	4,348	9,213	8,108	8,848
(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	1,703	2,103
Cashflow from financing activities	(1,962)	(523)	(2,294)	(1,205)	(805)
Cash generated/(utilised)	331	(623)	587	168	196
Cash at start of the year	1,021	1,352	729	1,317	1,484
Cash at end of the year	1,352	729	1,317	1,484	1,680

Note: FY2016 Numbers are 9 month figures

Key ratios

Y/E Mar	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation ratio (x)					
P/E (on FDEPS)	18.6	23.9	16.0	15.3	14.2
P/CEPS	17.5	22.4	14.5	13.8	12.7
P/BVPS	5.5	4.8	4.0	3.4	2.9
Dividend yield (%)	1.5	1.8	1.8	1.8	1.8
EV/Sales	3.3	4.0	2.6	2.3	2.0
EV/EBITDA	14.0	18.5	11.7	10.4	9.1
EV/Total assets	3.4	3.1	2.6	2.1	1.8
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	0.9	0.9
Leverage ratio (Assets/Equity)	1.4	1.4	1.4	1.4	1.3
Operating ROE	29.3	20.0	25.3	22.4	20.6
Return ratios (%)					
RoCE (pre-tax)	23.1	15.6	20.4	18.7	17.7
Angel RoIC	34.5	22.4	28.2	28.1	29.1
RoE	29.3	20.1	25.3	22.4	20.6
Turnover ratios (x)					
Asset turnover (fixed assets)	10.6	7.6	10.4	10.4	10.6
Receivables days	68	83	78	65	66

Note: FY2016 Numbers are 9 month figures

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