

HCL Technologies

Performance Highlights

(₹ cr) – Consl.	2QFY17	1QFY17	% chg (qoq)	2QFY16	% chg (yoy)
Net revenue	11,519	11,336	1.6	10,097	14.1
EBIT	2,318	2,333	(0.6)	1,957	18.4
Adj. EBITDA margin (%)	20.1	20.6	(46)bps	19.4	74bps
PAT	2,014	2,047	(1.6)	1,726	16.7

Source: Company, Angel Research

HCL Technologies (HCL Tech) announced its results and they are more or less in line with expectations. The company posted a 1.9% sequential growth in USD revenues to US\$1,722mn (V/s US\$1,726mn expected and V/s US\$1,691mn in 1QFY2017). On Constant Currency (CC) basis, the company posted a revenue growth of 2.8% qoq. The EBIT margins came in at 20.1% (V/s 20.0% expected), a dip of ~46bp qoq. Consequently, the PAT came in at ₹2,014cr (V/s ₹1,979cr), a dip of 1.6% qoq. For FY2017, the company gave a revenue growth guidance of 12.0-14.0% in CC terms, which translates into an 11.2% to 13.2% growth in US\$ terms. The operating margin (EBIT) for FY'2017 is expected to be in the range of 19.5% to 20.5%. **We maintain our Buy rating on the stock.**

Quarterly highlights: For 2QFY2017, the company posted a 1.9% sequential growth in USD revenues to US\$1,722mn (V/s US\$1,726mn expected and V/s US\$1,691mn in 1QFY2017). In terms of verticals, the CC qoq growth was driven by Life Sciences & Healthcare at 8.2%, Retail & CPG at 7.7% and Financial Services at 5.6%. USA posted a CC qoq growth of 5.5%, ROW posted a CC qoq growth of 2.0%, and Europe posted a CC qoq de-growth of 2.1%. On the employee front, the attrition in IT services (LTM) was 18.6%, while the blended utilization rate came in at 85.3% (V/s 85.8% in 1QFY2017). The EBIT margins came in at 20.1% (V/s 20.0% expected), a dip of ~46bp qoq. Consequently, the PAT came in at ₹2,014cr (V/s ₹1,979cr), a dip of 1.6% qoq.

Outlook and valuation: We expect HCL Tech to post a USD and INR revenue CAGR of 16.0% and 18.0%, respectively, over FY2016–18E. On 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)	FY2015	FY2016	FY2017E	FY2018E
Net sales	37,061	30,781	49,242	57,168
% chg	12.6	(16.9)	60.0	16.1
Net profit	7,253	5,643	7,862	9,037
% chg	17.2	(22.2)	39.3	14.9
EBITDA margin (%)	23.5	21.5	20.5	20.5
EPS (₹)	51.4	40.0	55.7	64.1
P/E (x)	16.2	20.8	14.9	13.0
P/BV (x)	4.7	4.2	3.0	2.3
RoE (%)	29.3	20.1	20.3	17.9
RoCE (%)	23.1	15.6	17.2	15.9
EV/Sales (x)	2.9	3.5	1.9	1.4
EV/EBITDA (x)	12.2	16.1	9.2	7.0

Source: Company, Angel Research; Note: CMP as of October 24, 2016

BUY

CMP	₹811
Target Price	₹1,000

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	114,383
Net Debt (₹ cr)	(101,878)
Beta	0.6
52 Week High / Low	890/707
Avg. Daily Volume	195,755
Face Value (₹)	2
BSE Sensex	28,179
Nifty	8,709
Reuters Code	HCLT.BO
Bloomberg Code	HCLT@IN

Shareholding Pattern (%)

Promoters	60.4
MF / Banks / Indian Fls	10.1
FII / NRIs / OCBs	26.2
Indian Public / Others	3.3

Abs.(%)	3m	1yr	3yr
Sensex	1.4	2.6	36.0
HCL Tech	11.2	(5.1)	54.5

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2017 performance (Consolidated, US GAAP)

Y/E March (₹ cr)	2QFY17	1QFY17	% chg (qoq)	2QFY16	% chg (yoy)	1HFY17	1HFY16	% chg(yoy)
Net revenue	11,519	11,336	1.6	10,097	14.1	22,855	20,438	11.8
Cost of revenue	7,653	7,440	2.9	6,742	13.5	15,093	13,391	12.7
Gross profit	3,866	3,896	(0.8)	3,355	15.2	7,762	7,047	10.1
SG&A expense	1,355	1,375	(1.5)	1,263	7.3	2,730	2,708	0.8
EBITDA	2,511	2,521	(0.4)	2,092	20.0	5,032	4,339	16.0
Dep. and amortization	193	188	2.7	135	43.0	381	288	32.3
EBIT	2,318	2,333	(0.6)	1,957	18.4	4,651	4,051	14.8
Other income	235	253	(7.1)	241	(2.5)	488	596	
PBT	2,553	2,586	(1.3)	2,198	16.2	5,139	4,647	10.6
Income tax	538	543	(0.9)	472	14.0	1,081	1,002	7.9
PAT	2,014	2,047	(1.6)	1,726	16.7	4,058	3,645	11.3
Forex gain/(loss)	-	-	-	-	-	-	-	-
Adjusted PAT	2,014	2,047	(1.6)	1,726	16.7	4,058	3,645	11.3
EPS	14.3	14.5	(1.6)	12.2	16.7	28.8	25.8	11.3
Gross margin (%)	33.6	34.4	(81)bp	33.2	33bps	34.0	36.8	(279)bp
EBITDA margin (%)	21.8	22.2	(44)bp	20.7	108bps	22.0	24.7	(267)bp
EBIT margin (%)	20.1	20.6	(46)bp	19.4	74bps	20.4	23.3	(293)bp
PAT margin (%)	17.5	18.1	(57)bp	17.1	39bps	17.8	20.5	(270)bp

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

Exhibit 2: 2QFY2017 – Actual Vs Angel estimates

(₹ cr)	Actual	Estimate	Variation (%)
Net revenue	11,519	11,548	(0.3)
EBITDA margin (%)	21.8	21.6	1bp
PAT	2,014	1,979	1.8

Source: Company, Angel Research

Sales just in line with expectation

For 2QFY2017, the company posted a 1.9% sequential growth in USD revenues to US\$1,722mn (V/s US\$1,726mn expected and V/s US\$1,691mn in 1QFY2017). In INR terms, revenues grew by 1.6% qoq to ₹11,519cr (V/s ₹11,548cr expected). On CC basis, the company posted a revenue growth of 2.8% qoq.

In terms of verticals, the CC qoq growth was driven by Life Sciences & Healthcare at 8.2%, Retail & CPG at 7.7%, Financial Services at 5.6%, Public Services at -3.7%, and Telecommunications, Media, Publishing & Entertainment at 6.1%.

USA posted a CC qoq growth of 5.5%, ROW posted a CC qoq growth of 2.0% and Europe posted a CC qoq de-growth of 2.1%.

The company signed 12 transformational deals this quarter. These deals were led by the geographies of America and Europe, spanning across service lines and verticals of manufacturing, life sciences & healthcare, consumer services, financial services, and energy & utilities.

Exhibit 3: Revenue growth trend


Source: Company, Angel Research

In terms of services, the Engineering & R&D services (which constituted 17.8% of sales) posted a growth of 2.3% qoq (CC), while Application services (accounting for 37.8% of sales) grew by 1.4% qoq (CC). Infrastructure services, another important segment of the company, which contributes by around 40.3% to overall sales, posted a growth of 4.4% qoq (CC). Business services, which constituted 4.1% of sales, grew by 2.1% qoq (CC).

Exhibit 4: Revenue growth trend (Service wise)

	% of revenue	% growth CC (qoq)	% growth (yoy)
Application services	37.8	1.4	4.7
Infrastructure services	40.3	4.4	21.4
Business services	4.1	2.1	2.5
Engineering and R&D services	17.8	2.3	5.7

Source: Company, Angel Research

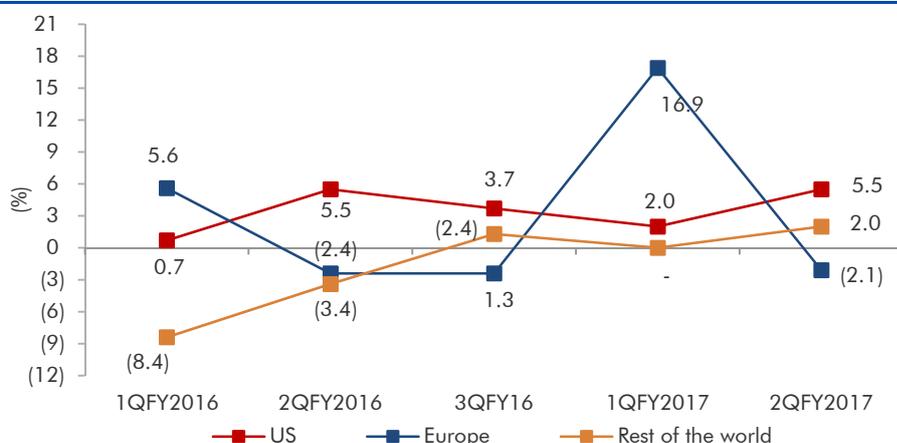
Industry segment wise, the company's Financial Services vertical (contributed 24.1% to revenue) posted a 5.6% qoq growth in CC terms. The Manufacturing vertical (contributed 32.2% to revenue) posted a 0.9% qoq de-growth in CC terms. Public services, Life sciences & Healthcare, and Telecommunication, Media, Publishing & Entertainment reported a qoq growth of (3.7)%, 8.2%, and 6.1%, all in CC terms, respectively. Retail & CPG (contributed 10.4% of the revenue), on the other hand, reported a growth of 7.7% qoq CC terms, during the quarter.

Exhibit 5: Revenue growth trend (Industry wise)

	% of revenue	% growth (CC qoq)	% growth (yoy)
Financial services	24.1	5.6	5.3
Manufacturing	32.2	(0.9)	7.1
Life sciences & Healthcare	12.6	8.2	15.9
Public Services	10.9	(3.7)	25.0
Retail & CPG	10.4	7.7	21.6
Telecom, MPE	9.4	6.1	14.9

Source: Company, Angel Research

Among geographies, in CC terms, America grew by 5.5% qoq, RoW grew by 2.0% qoq, while Europe de-grew by 2.1% 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 9,083 to 1,09,795 employees. The attrition rate in IT Services inched up to 18.6% (V/s 17.8% in 1QFY2017) and the blended utilization level of the company inched up to 85.3% (V/s 85.8% in 1QFY2017).

Exhibit 7: Hiring trend

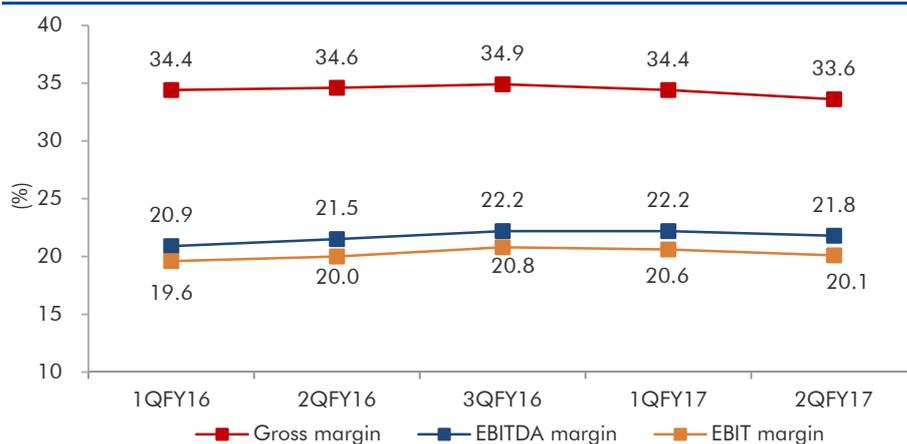
Particulars	1QFY16	2QFY16	3QFY16	1QFY17	2QFY17
Technical	96,541	94,652	95,649	98,225	99,897
Support	9,030	9,044	9,247	9,743	9,898
Total employee base	105,571	103,696	104,896	107,968	109,795
Gross addition	7,889	6,234	9,280	10,515	9,083
Net addition	(1559)	(1875)	1200	3,072	2,097
Attrition - IT services (LTM) - %	16.3	16.7	17.3	17.8	18.6

Source: Company, Angel Research

Operating margin higher than expectation

On the operating front, the EBDITA margins came in at 21.8% (V/s 22.2% in 1QFY2017), a qoq dip of 44bp; while the EBIT margins came in at 20.1% (V/s 20.0% expected), a qoq dip of ~46bp. Margins beat our estimates on back of better utilization & lower attrition.

Exhibit 8: Margin profile



Source: Company, Angel Research

Client pyramid

The company signed 12 transformational deals this quarter. These deals were led by the geographies of America and Europe, spanning across service lines and verticals of manufacturing, life sciences & healthcare, consumer services, financial services, and energy & utilities.

Exhibit 9: Client pyramid

Particulars	1QFY16	2QFY16	3QFY16	1QFY17	2QFY17
US\$1mn–5mn	262	267	262	245	259
US\$5mn–10mn	91	87	84	91	89
US\$10mn–20mn	58	66	49	66	64
US\$20mn–30mn	32	32	35	32	33
US\$30mn–40mn	19	16	16	16	15
US\$40mn–50mn	6	4	5	12	14
US\$50mn–100mn	11	12	10	13	12
US\$100mn plus	7	7	7	7	8

Source: Company, Angel Research

Investment arguments

Robust outlook: The company's engineering services has been seeing lumpy growth over the last few quarters. However, on back of the deals on hand, the company gave a revenue growth guidance of 12-14% in CC for FY2017. The revenue guidance is based on FY2016 (April to March 2016) average exchange rates. The above constant currency guidance translates to 11.2-13.2% in US\$ terms based on June 30 2016 exchange rates. The operating margin (EBIT) for FY'2017 is expected to be in the range of 19.5% to 20.5%.

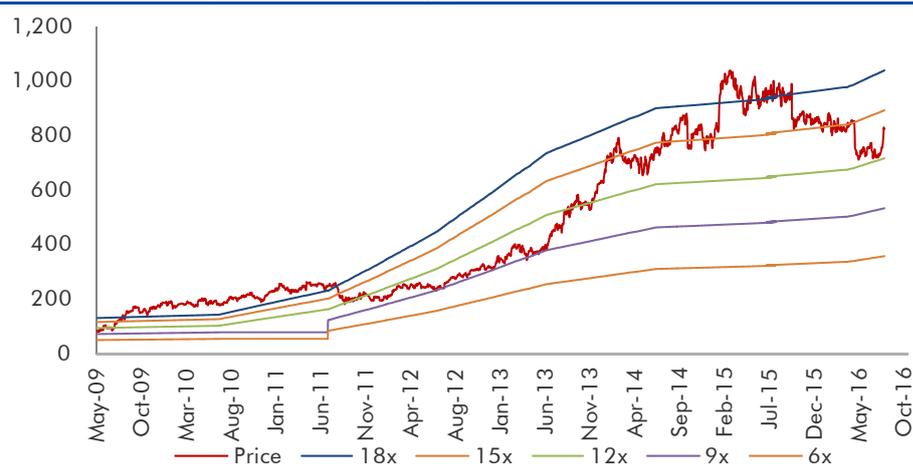
We expect HCL Tech to post a USD and INR revenue CAGR of 16.3% and 18.0%, respectively, over FY2016–18E (inclusive of the acquisition of Geometric Software and Volvo deals).

Healthy pipeline: HCL Tech signed 12 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, BEYONDDigital, and IoT WoRKS, reflecting investments in Internet of Things, digital technologies, cloud, automation and artificial intelligence.

Outlook and valuation

On the operating front, HCL Tech's EBIT margin has been around 20.1% in FY2016, a dip of 317bp over the previous financial year. With the acquisition of Geometric Software and Volvo, we expect the EBIT margin to be under pressure. We expect the EBIT and PAT to post a 10.0% and 7.6% CAGR, respectively, over FY2016-18E. At the current market price, the stock is trading at 14.9x FY2017E and 13.0x FY2018E EPS. **We recommend a Buy, with a price target of ₹1,000.**

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	811	1,000	23.4	20.5	12.6	9.6	1.8	17.9
Infosys	Buy	1,029	1,249	21.4	27.0	14.8	8.4	2.5	21.6
TCS	Accumulate	2,428	2,867	7.9	27.6	16.7	8.5	3.3	33.1
Tech Mahindra	Buy	428	700	38.6	17.0	10.4	13.2	0.9	20.7
Wipro	Buy	484	590	22.0	18.1	12.1	5.3	1.7	19.3

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)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	32,908	37,061	30,781	49,242	57,168
Cost of revenues	20,209	23,798	20,235	32,549	37,788
Gross profit	12,699	13,263	10,546	16,693	19,380
% of net sales	38.6	35.8	34.3	33.9	33.9
SG&A expenses	4,070	4,563	3,940	6,598	7,661
% of net sales	12.4	12.3	12.8	13.4	13.4
EBITDA	8,629	8,700	6,606	10,095	11,719
% of net sales	26.2	23.5	21.5	20.5	20.5
Depreciation and amort.	753	451	393	640	740
% of net sales	2.3	1.2	1.3	1.3	1.3
EBIT	7,876	8,249	6,213	9,454	10,979
% of net sales	23.9	22.3	20.2	19.2	19.2
Other income, net	492	912	756	756	756
Profit before tax	8,369	9,161	6,969	10,211	11,736
Provision for tax	1,629	1,908	1,364	2,349	2,699
% of PBT	19.5	20.8	19.6	23.0	23.0
PAT	6,739	7,253	5,605	7,862	9,037
Share from equity invest.	-	-	-	-	-
Forex loss	(549)	-	-	-	-
ESOP charges	25	103	38	38	38
Reported net profit	6,190	7,253	5,643	7,862	9,037
Fully diluted EPS (₹)	43.9	51.4	40.0	55.7	64.1

Note: FY2016 Numbers are 9 month figures

Balance sheet (Consolidated, US GAAP)

Y/E Mar (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Cash and cash equivalent	1,021	1,352	729	6,950	13,473
Account receivables, net	5,684	6,563	7,721	8,504	9,873
Unbilled receivables	2,024	2,923	3,002	2,955	3,430
Deposit with banks	8,370	9,670	10,587	15,587	20,587
Deposit (one year with HDFC Ltd)	-	-	-	-	-
Invest. securities, available for sale	609	767	537	2,250	2,250
Other current assets	2,125	2,338	2,410	2,710	3,010
Total current assets	19,833	23,613	24,986	38,956	52,624
Property and equipment, net	3,147	3,820	4,323	4,623	4,923
Intangible assets, net	5,149	5,204	6,419	6,419	6,419
Deposits with HDFC Ltd.	-	-	-	-	-
Fixed deposits with banks	-	-	-	-	-
Investment securities HTM	-	8	160	160	160
Investment in equity investee	16	-	-	-	-
Other assets	2,346	3,066	3,879	4,780	4,780
Total assets	30,490	35,711	39,768	54,939	68,906
Current liabilities	8,197	9,232	9,509	13,199	15,323
Borrowings	751	469	973	973	973
Other liabilities	1,462	1,259	1,264	2,077	2,078
Total liabilities	10,409	10,960	11,745	16,249	18,374
Minority interest	-	-	-	-	-
Total stockholder equity	20,081	24,751	28,022	38,690	50,532
Total liab. and stock holder equity	30,490	35,711	39,768	54,939	68,906

Note: FY2016 Numbers are 9 month figures

Cash flow statement (Consolidated, US GAAP)

Y/E Mar (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Pre tax profit from operations	7,797	7,253	5,643	7,862	9,037
Depreciation	733	451	393	640	740
Expenses (deffered)/written off/others	(584)	(168)	(48)	(48)	(48)
Pre tax cash from operations	7,946	7,536	5,988	8,455	9,729
Other income/prior period ad	572	912	756	756	756
Net cash from operations	8,518	8,448	6,744	9,211	10,485
Tax	(1,547)	(1,908)	(1,364)	(2,349)	(2,699)
Cash profits	6,971	6,540	5,381	6,863	7,786
(Inc)/dec in current assets	(1,749)	(1,991)	(1,309)	(1,036)	(2,144)
Inc/(dec) in current liabilities	1,654	1,035	277	3,690	2,124
Net trade working capital	(95)	(956)	(1,033)	2,654	(20)
Cashflow from operating activities	6,875	5,584	4,348	9,517	7,766
(Inc)/dec in fixed assets	(1,094)	(674)	(503)	(300)	(300)
(Inc)/dec in intangibles	(248)	(55)	(1,215)	-	-
(Inc)/dec in investments	(4,688)	(1,458)	(687)	(6,714)	(5,000)
(Inc)/dec in minority interest	-	-	-	-	-
Inc/(dec) in non current liabilities	(54)	(203)	5	814	-
(Inc)/dec in non current assets	(107)	(214)	(72)	(300)	(300)
Cashflow from investing activities	(6,191)	(2,602)	(2,473)	(6,500)	(5,600)
Inc/(dec) in debt	55	-	-	-	-
Inc/(dec) in equity/premium	-	-	-	-	-
ESOP charges	(25)	(103)	(103)	(103)	(103)
Dividends	(296)	(1,651)	(2,805)	(2,805)	(2,805)
Others	(129)	(208)	2,385	621	7,692
Cashflow from financing activities	(396)	(1,962)	(523)	(2,287)	4,784
Cash generated/(utilised)	289	331	(623)	6,221	6,523
Cash at start of the year	732	1,021	1,352	729	6,950
Cash at end of the year	1,021	1,352	729	6,950	13,473

Note: FY2016 Numbers are 9 month figures

Key ratios

Y/E Mar	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio (x)					
P/E (on FDEPS)	18.9	16.2	20.8	14.9	13.0
P/CEPS	16.9	15.2	19.4	13.8	12.0
P/BVPS	5.8	4.7	4.2	3.0	2.3
Dividend yield (%)	1.7	1.7	2.0	2.0	2.0
EV/Sales	3.3	2.9	3.5	1.9	1.4
EV/EBITDA	12.5	12.2	16.1	9.2	7.0
EV/Total assets	3.5	3.0	2.7	1.7	1.2
Per share data (₹)					
EPS (Fully diluted)	43.9	51.4	40.0	55.7	64.1
Cash EPS	49.2	54.6	42.8	60.3	69.3
Dividend	14.0	14.0	17.0	17.0	17.0
Book value	142	175	199	274	358
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)	1.1	1.0	0.8	0.9	0.8
Leverage ratio (Assets/Equity)	1.5	1.4	1.4	1.4	1.4
Operating ROE	33.6	29.3	20.0	20.3	17.9
Return ratios (%)					
RoCE (pre-tax)	25.8	23.1	15.6	17.2	15.9
Angel RoIC	38.4	34.5	22.4	31.5	33.8
RoE	30.8	29.3	20.1	20.3	17.9
Turnover ratios (x)					
Asset turnover (fixed assets)	11.2	10.6	7.6	11.0	12.0
Receivables days	71	68	83	78	68

Note: FY2016 Numbers are 9 month figures

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Disclosure of Interest Statement

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%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)