

HCL Technologies

Performance Highlights

(₹ cr) – Consl.	1QFY17	3QFY16	% chg (qoq)	1QFY16	% chg (yoy)
Net revenue	11,336	10,698	6.0	9,267	22.3
EBIT	2,333	2,222	5.0	1,978	17.9
Adj. EBITDA margin (%)	20.6	20.6	(19)bp	21.3	(76)bp
PAT	2,047	1,925	6.3	1,683	21.6

Source: Company, Angel Research

For 1QFY2017, HCL Technologies (HCL Tech) posted better-than-expected numbers on all fronts. In US\$ terms, revenue came in at US\$1,691mn V/s US\$1,674mn expected and V/s US\$1,587mn in 3QFY2016, ie a growth of 6.5% qoq (6.0% qoq in constant currency [CC] terms). On the operating front, the EBIT margin came in at 20.6% V/s 19.4% expected and V/s 20.8% in 3QFY2016, ie a qoq dip of 19bp. Thus, the adj. net profit came in at ₹2,047cr V/s ₹1,925cr in 3QFY2016, a qoq growth of 6.3%. 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 1QFY2017, the company posted better-than-expected numbers on all fronts. In US\$ terms, revenue came in at US\$1,691mn V/s US\$1,674mn expected and V/s US\$1,587mn in 3QFY2016, ie a growth of 6.5% qoq (6.0% qoq in CC terms). The growth was driven by Europe which posted a 16.9% CC qoq growth; USA posted a 2.0% qoq growth and ROW posted a flat growth. In terms of industries, Manufacturing grew 12.0% qoq CC, Public Services posted an 11.8% qoq CC growth and Retail & CPG posted a 14.5% qoq CC growth. On the operating front, the EBIT margin came in at 20.6% V/s 19.4% expected and V/s 20.8% in 3QFY2016, ie a qoq dip of 19bp. Thus, the adj. net profit came in at ₹2,047cr V/s ₹1,925cr in 3QFY2016, a qoq growth of 6.3%

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)	16.0	20.5	14.7	12.8
P/BV (x)	4.7	4.1	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)	2.8	3.4	1.9	1.4
EV/EBITDA (x)	12.0	15.8	9.1	6.8

Source: Company, Angel Research; Note: CMP as of August 5, 2016

BUY

CMP	₹822
Target Price	₹1,000

Investment Period	12 Months
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Stock Info

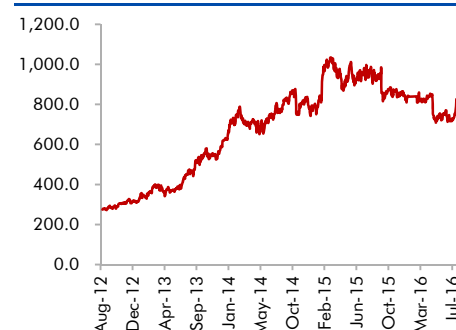
Sector	IT
Market Cap (₹ cr)	115,908
Net Debt (₹ cr)	(101,878)
Beta	0.6
52 Week High / Low	997/707
Avg. Daily Volume	202,406
Face Value (₹)	2
BSE Sensex	28,078
Nifty	8,683
Reuters Code	HCLT.BO
Bloomberg Code	HCLT@IN

Shareholding Pattern (%)

Promoters	60.4
MF / Banks / Indian Fls	10.0
FII / NRIs / OCBs	26.2
Indian Public / Others	3.4

Abs.(%)	3m	1yr	3yr
Sensex	11.3	(0.4)	46.5
HCL Tech	41.9	52.0	559.1

3-year price chart



Source: Company, Angel Research

Sarabjit kour Nangra

+91 22 3935 7800 Ext: 6806

sarabjit@angelbroking.com

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

Y/E March (₹ cr)	1QFY17	3QFY16	% chg (qoq)	1QFY16	% chg (yoy)	FY16	FY15	% chg(yoy)
Net revenue	11,336	10,698	6.0	9,267	22.3	40,913	35,708	14.6
Cost of revenue	7,440	6,961	6.9	5,997	24.1	26,901	22,583	19.1
Gross profit	3,896	3,737	4.3	3,270	19.1	14,012	13,125	6.8
SG&A expense	1,375	1,358	1.3	1,179	16.6	5,217	4,308	21.1
EBITDA	2,521	2,378	6.0	2,091	20.6	8,795	8,817	(0.2)
Dep. and amortization	188	157	19.7	113	66.4	569	504	12.9
EBIT	2,333	2,222	5.0	1,978	17.9	8,226	8,313	(1.0)
Other income	253	200	26.5	179	41.3	1,009	856	
PBT	2,586	2,422	6.8	2,157	19.9	9,235	9,169	0.7
Income tax	543	497	9.3	473	14.8	1,883	1,864	1.0
PAT	2,047	1,925	6.3	1,683	21.6	7,352	7,305	0.6
Forex gain/(loss)	-	-	-	-	-	-	-	-
Adjusted PAT	2,047	1,925	6.3	1,683	21.6	7,352	7,305	0.6
EPS	14.5	13.6	6.3	11.9	21.6	52.3	52.0	0.6
Gross margin (%)	34.4	34.9	(56)bp	35.3	(92)bp	34.2	36.8	(251)bp
EBITDA margin (%)	22.2	22.2	1bp	22.6	(33)bp	21.5	24.7	(320)bp
EBIT margin (%)	20.6	20.8	(19)bp	21.3	(76)bp	20.1	23.3	(317)bp
PAT margin (%)	18.1	18.0	6bp	18.2	(10)bp	18.0	20.5	(249)bp

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

Exhibit 2: 1QFY2017 – Actual Vs Angel estimates

(₹ cr)	Actual	Estimate	Variation (%)
Net revenue	11,336	11,219	1.0
EBIT margin (%)	20.6	19.4	120bp
PAT	2,047	1,891	8.2

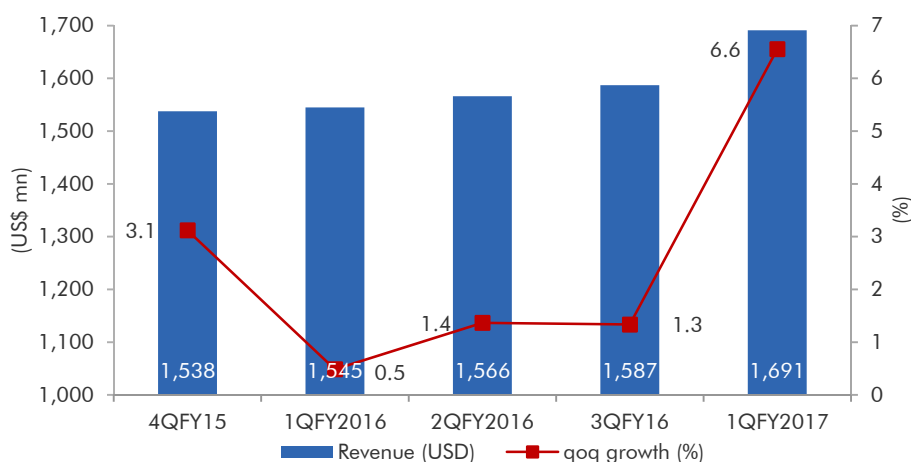
Source: Company, Angel Research

Sales higher than expected

For 1QFY2017, the company posted better than expected numbers on all fronts. It posted sales of ₹11,336cr V/s ₹11,219cr expected and V/s ₹10,698cr in 3QFY2016 (the company has migrated to financial year reporting, ie to March-end), ie a qoq growth of 6.0%. In US\$ terms, sales came in at US\$1,691mn V/s US\$1,674mn expected and V/s US\$1,587mn in 3QFY2016, a qoq growth of 6.5% (6.0% qoq in CC terms).

The growth was driven by Europe which posted a 16.9% CC qoq growth; USA posted a 2.0% qoq growth and RoW posted a flat growth. In terms of industries, Manufacturing grew 12.0% qoq CC, Public Services posted a 11.8% qoq CC growth and Retail & CPG posted a 14.5% qoq CC growth.

The company signed 13 transformational deals during the 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.

Exhibit 3: Revenue growth trend


Source: Company, Angel Research

In terms of services, the Engineering & R&D services (which constituted 17.7% of sales) posted a growth 0.7% qoq (CC), while Application services (accounting for 38.3% of sales) grew by 1.9% qoq CC. Infrastructure services, another important segment of the company, which contributes by around 39.8% to overall sales, posted a growth of 16.5% qoq. Business services, which constituted 4.1% of sales, de-grew by 15.9% qoq CC.

Exhibit 4: Revenue growth trend (Service wise)

	% of revenue	% growth CC (qoq)	% growth (yoy)
Application services	38.3	1.9	4.3
Infrastructure services	39.8	16.5	25.8
Business services	4.1	(15.9)	(11.5)
Engineering and R&D services	17.7	0.7	4.8

Source: Company, Angel Research

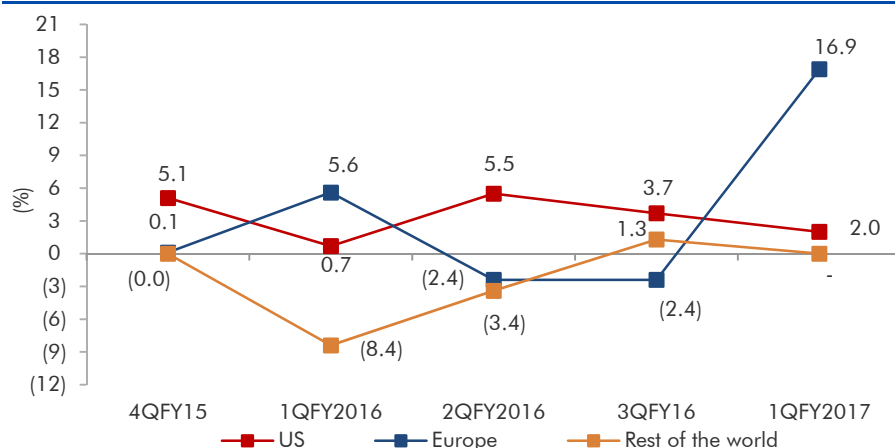
Industry segment wise, the company's Financial Services vertical (contributed 23.0% to revenue) posted a 0.1% qoq de-growth in CC terms. The Manufacturing vertical (contributed 33.2% to revenue) posted a 12.0% qoq growth in CC terms. Public services; Life sciences & Healthcare; and Telecommunication, Media, Publishing & Entertainment reported a QoQ growth of 11.8%, (1.0)%, and (2.8)%, all in CC terms, respectively. Retail & CPG (contributed 10.0% of the revenue) on the other hand reported a growth of 14.5% qoq CC terms, during the quarter.

Exhibit 5: Revenue growth trend (Industry wise)

	% of revenue	% growth (CC qoq)	% growth (yoy)
Financial services	23.6	(0.1)	5.7
Manufacturing	33.2	12.0	7.7
Life sciences & Healthcare	11.9	(1.0)	21.5
Public Services	11.7	11.8	24.7
Retail & CPG	10.0	14.5	14.9
Telecom, MPE	9.1	(2.8)	17.8

Source: Company, Angel Research

Among geographies, in CC terms, Americas grew by 2.0%, Europe grew by 16.9%, while RoW was flat on a sequential basis.

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 10,515 to 1,07,968 employees. The attrition rate in IT Services inched up to 17.8% V/s 17.3% in 3QFY2016. The blended utilization level of the company inched up to 85.8% V/s 85.6% in 3QFY2016.

Exhibit 7: Hiring trend

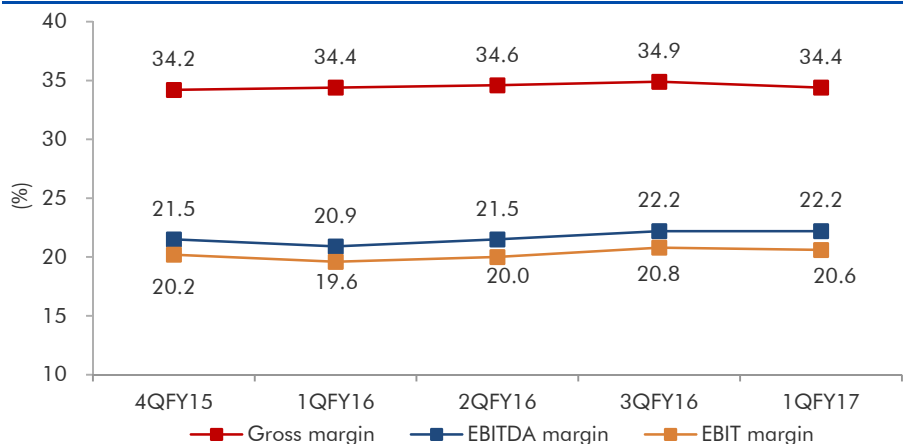
Particulars	4QFY15	1QFY16	2QFY16	3QFY16	1QFY17
Technical	97,135	96,541	94,652	95,649	98,225
Support	8,972	9,030	9,044	9,247	9,743
Total employee base	1,06,107	105,571	103,696	104,896	107,968
Gross addition	9,448	7,889	6,234	9,280	10,515
Net addition	1,923	(1559)	(1875)	1200	3,072
Attrition - IT services (LTM) - %	16.5	16.3	16.7	17.3	17.8

Source: Company, Angel Research

Operating margin higher than expectation

On the operating front, the EBIT margin came in at 20.6% V/s 19.4% expected and V/s 20.8% in 3QFY2016, qoq dip of 19bp. Margins beat our estimates on back of higher than expected volume growth.

Exhibit 8: Margin profile



Source: Company, Angel Research

Client pyramid

HCL Tech signed 13 transformational deals during the 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.

Exhibit 9: Client pyramid

Particulars	4QFY15	1QFY16	2QFY16	3QFY16	1QFY17
US\$1mn–5mn	265	262	267	262	245
US\$5mn–10mn	87	91	87	84	91
US\$10mn–20mn	51	58	66	49	66
US\$20mn–30mn	33	32	32	35	32
US\$30mn–40mn	17	19	16	16	16
US\$40mn–50mn	6	6	4	5	12
US\$50mn–100mn	10	11	12	10	13
US\$100mn plus	7	7	7	7	7

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%.

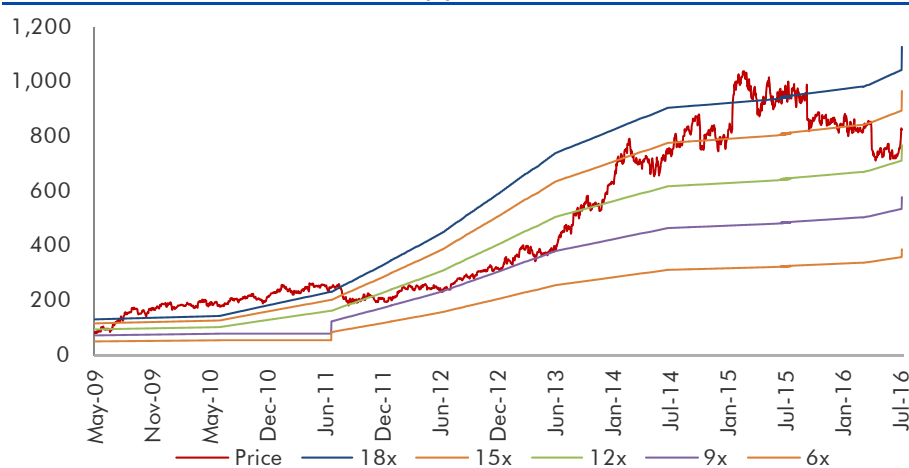
We expect HCL Tech to post a USD and INR revenue CAGR of 16.3% and 18.0%, respectively, over FY2016–18E (inclusive of the acquisition of Geometric Software and Volvo deals).

Healthy pipeline: HCL Tech signed 13 transformational deals during the 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 14.7x FY2017E and 12.8x 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	822	1,000	21.7	20.5	12.8	9.6	1.4	17.9
Infosys	Accumulate	1,067	1,370	28.4	27.5	14.8	10.4	2.6	22.3
TCS	Buy	2,649	3,004	13.4	27.3	17.6	13.0	3.6	35.5
Tech Mahindra	Accumulate	495	700	41.4	17.0	12.0	13.2	1.1	20.7
Wipro	Buy	545	680	24.8	17.9	14.8	9.9	2.1	19.6

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 and 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	39,767	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 (deferred)/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)	18.7	16.0	20.5	14.7	12.8
P/CEPS	16.7	15.1	19.2	13.6	11.9
P/BVPS	5.8	4.7	4.1	3.0	2.3
Dividend yield (%)	1.7	1.7	2.1	2.1	2.1
EV/Sales	3.2	2.8	3.4	1.9	1.4
EV/EBITDA	12.3	12.0	15.8	9.1	6.8
EV/Total assets	3.5	2.9	2.6	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

Research Team Tel: 022 - 39357800

E-mail: research@angelbroking.com

Website: www.angelbroking.com

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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%)