



DALAL & BROACHA
STOCK BROKING PVT. LTD.

Analyst: Mayank Babla (022) 67141442

Q2FY20 Result Update@ Dalal &Broacha

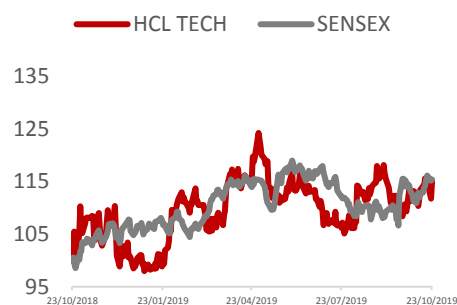
BUY

| | |
|---------------|----------|
| Current Price | 1096 |
| Target Price | 1299 |
| Upside (%) | 19% |
| 52 Week Range | 1190/920 |

Key Share Data

| | |
|-----------------------|---------|
| Market Cap (Rs.Bn) | 1486 |
| Market Cap (US\$ Bn) | 20.1 |
| No of o/s shares (mn) | 1356 |
| Face Value | 2 |
| Monthly Avg. | |
| Vol(BSE+NSE) Nos | |
| '000 | 2024 |
| BSE Code | 532281 |
| NSE Code | HCLTECH |
| Bloomberg | HCLT.IN |

Price performance



% Shareholding

| | Sept-19 | June-19 |
|--------------|---------------|---------------|
| Promoters | 60 | 60 |
| Public | 40 | 40 |
| Others | - | - |
| Total | 100.00 | 100.00 |

HCL Tech reported its Q2FY20 results which were marginally below our estimates on the revenue front and beat our estimates on the EBIT margin front

- Revenue in USD terms stood at \$2,486 Mn, +5.2%qoq / +18.5%yoy, -1% vs our est. of \$2,512 Mn
- Revenue in INR terms stood at INR 1,75,820 Mn, +6.7%qoq / +17.9%yoy, -0.9% vs our est. of INR 1,76,845 Mn
- EBIT was reported at INR 34,970 Mn, +24.7%qoq / +17.9%yoy, +1.8% vs our est. of INR 34,354 Mn. EBIT margin @ 20% in Q2FY20 vs our est. of 19.4%
- PAT at INR 26,510 Mn, +18.6%qoq / +4.4% yoy, -5.7% vs our est. of INR 28,111 Mn. PAT came below our estimates mainly due to lower Other Income which came in at a loss of INR 30 Mn vs INR 1280 Mn / INR 2520 Mn in Q1FY20 / Q2FY19 respectively and way below our estimate of INR 2653 Mn. PAT margin @ 15.1% vs our est. of 15.9%
- EBIT Margin guidance unchanged at 18.5-19.5%
- CC growth guidance for FY20E increased from 14-16% to 15-17%
- Company announced bonus issue in the ratio of 1:1
- Guidance for FY20 maintained

Complete absorption of IBM products drives growth in Mode III and P&P supported by healthy growth in Mode II

- Products & Platforms (11.7% of revenues) grew at 56.8% qoq in CC terms, driven by absorption of IBM products business
- ERS (16.9% of revenue) grew at 5.4% qoq in cc terms
- IT and Business Services (71.4% of revenue) grew at 0.9% qoq in cc terms
- Company signed 15 transformational deals in FS, Lifesciences & Healthcare, Mfg, Retail & CPG
- FS grew at 7.4% qoq followed by Telecom and Media which grew at 6.1% qoq and Lifesciences and Healthcare at 3.4% qoq in cc terms
- Europe grew at 6.9% qoq, America at 5.5% qoq and ROW at 7.3% qoq
- Company launched the HCL Software brand in the quarter under which it will offer the recently acquired IBM products

Key Concall Takeaways

- Migration of IBM acquired products to HCL Software which was launched in Q2FY20 with major enhancements and releases planned over the next 4 quarters
- Revenue recognition in HCL Software will be like a typical product company with Licensing, Implementation and AMC revenues
- Strong bookings in H1FY20 provides confidence to maintain current momentum through H2FY20
- Revised guidance includes 10% of organic growth coupled with 5-6% of inorganic growth
- Margin improvement of 290 bps mainly due to higher contribution of P&P which has an EBIT margin of 32.9%
- Many clients which had stopped Support Services (AMC) under erstwhile IBM products have resumed services due to revamp of the products and a solid roadmap set out by HCL Software Sales
- Financial Services showing healthy growth due to Retail Banks and certain capital market players
- Retail should be soft in Q3 due to lower customer spending but long term story is intact
- However any softness in IT services and BP services should be offset by P&P
- HCL Tech will inherit the cyclical of IBM products which was typically in the Q3 of any FY

Consolidated Financials (In INR Mn)

| Year | Net Sales | % Growth | EBIT | EBIT Margin (%) | PAT | PAT Margin (%) | EPS | PE (x) | ROE (%) | ROCE (%) |
|--------------|-----------|----------|----------|-----------------|----------|----------------|------|--------|---------|----------|
| FY18 | 5,05,690 | 8% | 99,870 | 19.7% | 87,810 | 17% | 63.0 | 17.4x | 24.6% | 23.6% |
| FY19 | 6,04,280 | 19% | 1,18,210 | 19.6% | 1,01,530 | 17% | 72.9 | 15.0x | 25.7% | 23.7% |
| FY20E | 6,99,194 | 16% | 1,35,142 | 19.3% | 1,07,746 | 15% | 77.2 | 14.2x | 23.0% | 20.8% |
| FY21E | 7,96,907 | 14.0% | 1,55,950 | 20% | 1,22,232 | 15.3% | 87.6 | 12.5x | 21.9% | 20.1% |

Source: Company, Dalal & Broacha Research



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Q2FY20 Result Overview

| YE March (Rs mn) | Q2 FY20 | Q1 FY20 | Q-o-Q change % | Q2 FY19 | Y-o-Y change % | Q1 FY20 Estimates | Deviation % |
|-------------------------------|-----------------|-----------------|----------------------|-----------------|----------------------|-------------------|---------------|
| Revenues (\$) | 2,486 | 2,364 | 5.2% | 2,099 | 18.4% | 2,512 | (1.1%) |
| Revenues (INR) | 1,75,280 | 1,64,250 | 6.7% | 1,48,610 | 17.9% | 1,76,845 | (0.9%) |
| Direct Cost | 1,10,610 | 1,09,200 | 1.3% | 95,890 | 15.4% | 1,13,551 | (2.6%) |
| Gross Profit | 64,670 | 55,050 | 17.5% | 52,720 | 22.7% | 63,293 | 2.2% |
| SG&A | 23,640 | 21,050 | 12.3% | 17,730 | 33.3% | 22,990 | 2.8% |
| EBITDA | 41,030 | 34,000 | 20.7% | 34,990 | 17.3% | 40,304 | 1.8% |
| Depreciation & Amortisation | 6,060 | 5,950 | 1.8% | 5,330 | 13.7% | 5,950 | 1.8% |
| EBIT | 34,970 | 28,050 | 24.7% | 29,660 | 17.9% | 34,354 | 1.8% |
| Foreign Exchange Gains/(Loss) | | | | | | | |
| Other Income, net | -30 | 1,280 | (102.3%) | 2,520 | (101.2%) | 2,653 | (101.1%) |
| PreTax Income | 34,940 | 29,330 | 19.1% | 32,180 | 8.6% | 37,006 | (5.6%) |
| Adjusted Pretax Income | 34,940 | 29,330 | 19.1% | 32,180 | 8.6% | 37,006 | |
| Tax | 8,350 | 7,050 | 18.4% | 6,780 | 23.2% | 8,895 | |
| Share of Minority Interest | 0 | 80 | | 0 | | 0 | |
| Net Profit | 26,590 | 22,360 | 18.9% | 25,400 | 4.7% | 28,111 | (5.4%) |
| Adjusted Net Profit | 26,590 | 22,360 | 18.9% | 25,400 | 4.7% | 28,111 | (5.4%) |
| Diluted EPS (Rs) | 19.6 | 16.5 | 18.9% | 18.2 | 7.7% | 20.1 | |
| Adjusted Diluted EPS | 19.6 | 16.5 | 18.9% | 18.2 | 7.7% | 20.1 | (2.7%) |
| No. of Shares (mn) - Diluted | 1,357 | 1,357 | | 1,396 | | 1,396 | |
| Margin Analysis (%) | | | Change in bps | | Change in bps | | |
| Operating Profit Margin (%) | 20.0% | 17.1% | 287 | 20.0% | (1) | 19.4% | 53 |
| EBITDA Margin (%) | 23.4% | 20.7% | 271 | 23.5% | (14) | 22.8% | 62 |
| Net Profit Margin (%) | 15.2% | 13.6% | 156 | 17.1% | (192) | 15.9% | (73) |
| Adjusted NPM (%) | 15.2% | 13.6% | 156 | 17.1% | (192) | 15.9% | (73) |
| Effective Tax rate (%) | 23.9% | 24.0% | (14) | 21.1% | 283 | 24.0% | (14) |
| Cost Analysis (%) | | | Change in bps | | Change in bps | | |
| Direct cost as % of Sales | 63.1% | 66.5% | (338) | 64.5% | (142) | 64.2% | (110) |
| SG&A as % of Sales | 13.5% | 12.8% | 67 | 11.9% | 156 | 13.0% | 49 |

Valuation & Outlook

HCL Tech is currently trading at 14.2x / 12.5x FY20 / FY21E EPS. The company has reported strong growth in its Mode II or Digital segment and in P&P segment with a healthy guidance for H2FY20 irrespective of global slowdown given its robust pipeline. Launch of HCL Software and its roadmap to reinvent IBM products should bode well for the segment as well as offer cross-selling opportunities which in turn can be a major trigger for IT services and Business Process services which have been lagging growth. We maintain our BUY rating on the stock with a revised target price of INR 1299, ie 15x FY21E EPS.



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| P&L Statement | | | | | |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| YE March (Rs. mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
| Total Revenues | 4,67,220 | 5,05,690 | 6,04,280 | 6,99,194 | 7,96,907 |
| Revenue Growth (Y-o-Y) | 14.2% | 8.2% | 19.5% | 15.7% | 14.0% |
| Less: | | | | | |
| Employees Cost | 3,08,890 | 3,32,370 | 3,92,680 | 4,44,398 | 4,98,949 |
| SG&A | 55,200 | 58,930 | 71,910 | 93,198 | 1,07,582 |
| Total Op. Expenditure | 3,64,090 | 3,91,300 | 4,64,590 | 5,37,595 | 6,06,531 |
| EBIDTA | 1,03,130 | 1,14,390 | 1,39,690 | 1,61,598 | 1,90,376 |
| EBIDTA Growth (Y-o-Y) | 15.7% | 10.9% | 22.1% | 15.7% | 17.8% |
| Less: Depreciation | 8,340 | 14,520 | 21,480 | 26,456 | 34,426 |
| Operating Profit | 94,790 | 99,870 | 1,18,210 | 1,35,142 | 1,55,950 |
| Operating Profit Growth (Y-o-Y) | 13.6% | 5.4% | 18.4% | 14.3% | 15.4% |
| Non-operating Income | 9,340 | 11,110 | 8,050 | 6,645 | 7,969 |
| Profit Before tax | 1,04,130 | 1,10,980 | 1,26,260 | 1,41,787 | 1,63,919 |
| Tax | 19,520 | 23,170 | 24,810 | 34,201 | 41,686 |
| Share of Minority Interest | 0 | 0 | 80 | 160 | 0 |
| Net Profit | 84,610 | 87,810 | 1,01,530 | 1,07,746 | 1,22,232 |
| Adjusted Net Profit | 84,610 | 87,810 | 1,01,530 | 1,07,746 | 1,22,232 |
| Diluted EPS (Rs.) | 59.8 | 63.0 | 72.9 | 77.2 | 87.6 |
| Growth (Y-o-Y) % | 13.4% | 5.4% | 15.6% | 5.9% | 13.4% |
| Adjusted Diluted EPS | 59.8 | 63.0 | 72.9 | 77.2 | 87.6 |
| Growth (Y-o-Y) % | 13.4% | 5.4% | 15.6% | 5.9% | 13.4% |

| Key Ratios | | | | | |
|------------------------|--------------|--------------|--------------|--------------|--------------|
| EBITDA Margin % | 22.1% | 22.6% | 23.1% | 23.1% | 23.9% |
| EBIT Margins % | 20.3% | 19.7% | 19.6% | 19.3% | 19.6% |
| NPM (%) | 18.1% | 17.4% | 16.8% | 15.4% | 15.3% |
| RoE (%) | 26.3% | 24.6% | 25.7% | 23.0% | 21.9% |
| RoCE (%) | 24.8% | 23.6% | 23.7% | 20.8% | 20.1% |
| BV/Per Share Rs. | 233 | 261 | 297 | 356 | 423 |

| Valuation Ratios | | | | | |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| YE March (Rs. mn) | FY17 | FY18E | FY19E | FY19E | FY19E |
| P/E (x) | 18.3x | 17.4x | 15.0x | 14.2x | 12.5x |
| EV/EBITDA | 14.2x | 13.0x | 10.6x | 9.4x | 7.9x |
| P/BV (x) | 4.7x | 4.2x | 3.7x | 3.1x | 2.6x |
| Market Cap / Sales | 3.3x | 3.0x | 2.5x | 2.2x | 1.9x |

| Key Operating Ratios | | | | | |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|
| YE March (Rs. mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
| EBITDA Margin (%) | 22.1% | 22.6% | 23.1% | 23.1% | 23.9% |
| Tax / PBT (%) | 18.7% | 20.9% | 19.6% | 24.1% | 25.4% |
| Net Profit Margin (%) | 18.1% | 17.4% | 16.8% | 15.4% | 15.3% |
| RoE (%) | 26.3% | 24.6% | 25.7% | 23.0% | 21.9% |
| RoCE (%) | 24.8% | 23.6% | 23.7% | 20.8% | 20.1% |
| Current Ratio (x) | 2.2x | 2.2x | 2.3x | 1.9x | 1.9x |
| Dividend Payout (%) | 48.1% | 23.1% | 11.0% | 23.1% | 23.1% |
| BV Per Share (Rs.) | 232.9 | 261.2 | 296.9 | 355.6 | 422.9 |
| Gross Block Growth (%) | 11.8% | 13.0% | 17.7% | 9.7% | 8.8% |
| Sales Growth (%) | 14.2% | 8.2% | 19.5% | 15.7% | 14.0% |
| EBITDA Growth (%) | 15.7% | 10.9% | 22.1% | 15.7% | 17.8% |
| Net Profit Growth (%) | 13.6% | 3.8% | 15.6% | 6.1% | 13.4% |
| Diluted EPS Growth (%) | 13.4% | 5.4% | 15.6% | 5.9% | 13.4% |
| Turnover Ratios | | | | | |
| Debtors days | 65 | 70 | 71 | 70 | 70 |

| Balance Sheet | | | | | |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| YE March (Rs. mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
| Equity Capital | 2,854 | 2,780 | 2,710 | 2,711 | 2,711 |
| Reserves & Surplus | 3,26,645 | 3,61,080 | 4,10,950 | 4,93,775 | 5,87,736 |
| Equity | 3,29,499 | 3,63,860 | 4,13,660 | 4,96,486 | 5,90,447 |
| Net Worth | 3,29,499 | 3,63,860 | 4,13,660 | 4,96,486 | 5,90,447 |
| Other Non-current Liabilities | 9,228 | 11,580 | 16,040 | 16,011 | 18,249 |
| Total Loans | 4,447 | 3,800 | 37,010 | 30,720 | 38,880 |
| Capital Employed | 3,44,899 | 3,79,262 | 4,66,868 | 5,43,217 | 6,47,575 |
| Assets | | | | | |
| Gross Block | 77,651 | 87,740 | 1,03,260 | 1,13,260 | 1,23,260 |
| Less: Depreciation | 37,668 | 42,140 | 50,330 | 75,634 | 1,00,286 |
| Net Block | 39,983 | 45,600 | 52,930 | 37,626 | 22,974 |
| Investments | 8,697 | 13,950 | 16,410 | 46,701 | 63,239 |
| Intangible Assets | 1,12,377 | 1,41,930 | 1,75,950 | 2,50,887 | 3,17,203 |
| Current Assets | | | | | |
| Sundry Debtors | 83,013 | 96,390 | 1,17,060 | 1,33,274 | 1,51,899 |
| Cash and Bank Balance | 90,438 | 39,862 | 75,588 | 41,312 | 55,216 |
| Total Current Assets | 2,53,241 | 2,21,692 | 2,71,888 | 2,80,106 | 3,27,349 |
| Less: Current Liabilities | | | | | |
| Sundry Creditors | 8,006 | 9,180 | 13,050 | 10,426 | 11,705 |
| Total Current Liabilities | 1,12,796 | 1,00,650 | 1,15,750 | 1,46,424 | 1,68,244 |
| Capital Applied | 3,44,899 | 3,79,262 | 4,66,868 | 5,43,217 | 6,47,575 |

| Free Cash Flow Analysis | | | | | |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | FY17 | FY18 | FY19 | FY20E | FY20E |
| EBITDA | 1,03,130 | 1,14,390 | 1,39,690 | 1,61,598 | 1,90,376 |
| Add: Depreciation Tax Shield | 1,563 | 3,031 | 4,221 | 6,382 | 8,755 |
| Working Capital Changes | 4,959 | -31,173 | 630 | -11,821 | -11,518 |
| Less: Inc in FC Investment | -59,393 | -39,643 | -49,540 | -84,937 | -76,316 |
| Taxes Paid | 19,520 | 23,170 | 24,810 | 34,201 | 41,686 |
| Total Free Cash Flows | 30,739 | 23,436 | 70,191 | 37,021 | 69,611 |



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