



**DALAL & BROACHA**  
STOCK BROKING PVT. LTD.

Analyst: Mayank Babla (022) 67141442

## Q3FY20 Result Update@ Dalal &Broacha

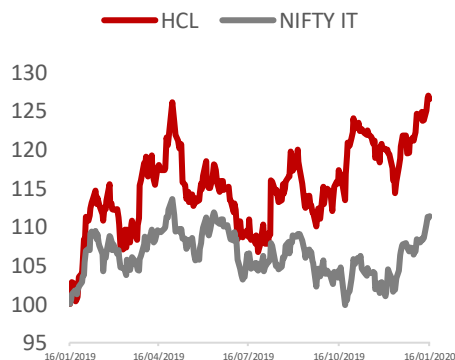
### BUY

Current Price	599
Target Price	668
Upside (%)	11.2%
52 Week Range	467/602

### Key Share Data

Market Cap (Rs.bn)	1625
Market Cap (US\$ Bn)	22.88
No of o/s shares (mn)	2713
Face Value	2
Monthly Avg. Vol(BSE+NSE) Nos '000	2805
BSE Code	532281
NSE Code	HCLTECH
Bloomberg	HCLT.IN

### Price performance



% Shareholding	Dec-19	Sept-19
Promoters	59.98	60
Public	40.02	40
Others	-	-
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

### Consolidated Financials (In INR Mn)

Year	Net Sales	% Growth	EBIT	EBIT Margin (%)	PAT	PAT Margin (%)	EPS	PE (x)	ROE (%)	ROCE (%)
<b>FY18</b>	505,690	8%	99,870	19.7%	87,810	17%	63.0	9.5x	25.3%	26.3%
<b>FY19</b>	604,280	19%	118,210	19.6%	101,530	17%	72.9	8.2x	26.1%	25.3%
<b>FY20E</b>	704,278	17%	134,574	19.1%	108,513	15%	40.0	15.0x	24.0%	25.0%
<b>FY21E</b>	773,415	9.8%	150,516	19.5%	118,268	15.3%	43.6	13.8x	22.4%	24.0%
<b>FY22E</b>	839,767	8.6%	161,666	19.3%	129,374	15.4%	47.7	12.6x	21.4%	22.9%

Source: Company, Dalal & Broacha Research

HCL Tech reported its Q3FY20 results which were in line with our estimates on the revenue front and marginally above our estimates on the profitability front

The Revenue in USD terms stood at \$2,543.4 Mn, grew by 2.3%qoq /15.5%yoy, and grew by 0.12% vs our est. of \$2,539 Mn. Revenue in INR terms stood at INR 1,81,350 Mn, grew by 3.5%qoq / 15.5%yoy, and grew by 0.29% vs our est. of INR 1,80,827 Mn. HCL's EBIT was reported at INR 36,700 Mn, up by 5.0%qoq /18.9%yoy, up by 1.9% vs our est. of INR 36,023 Mn. EBIT margin stood at 20.2% in Q3FY20 vs our est. of 19.9%. Further, PAT at INR 30,370 Mn, grew by 14.6%qoq / 16.3% yoy, also grew by 3.0% vs our est. of INR 29,478 Mn. PAT margin stood at 16.8% vs our est. of 16.3%. HCL Tech also declared dividend of INR 2 per share.

#### Guidance Revision (on the lower end) -

- The management revised their EBIT Margin guidance from 18.5-19.5% to 19.0% to 19.5% for FY20e.

- It also revised Constant Currency (CC) growth guidance for FY20E from 15-17% to 16.5-17% (Inorganic Growth - 6% and Organic Growth - 10.5%-11%) for FY20e

#### Mode I-II-III Highlights-

**MODE I** (Under Mode 1, HCL delivers core services in the areas of applications, infrastructure, DPO and Engineering & R&D) (**66% of Revenue/19.9% EBIT Margins**) - This witnessed constant currency growth of 0.3% as company dropped off a few clients as they weren't margin accretive. The management also guided that going ahead a few clients could be dropped off if they aren't margin accretive.

**MODE II** (Under Mode 2, HCL delivers experience-centric and outcome-oriented integrated offerings of Digital & Analytics, IoTWORKS™, Cloud Native Services and Cyber-security & GRC services) (**18.2% of Revenue/15.2% EBIT Margins**) - This witnessed constant currency growth of 1.1%. The company signed 12 transformational deals during the quarter.

**MODE III** (Under Mode 3 includes the external IP partnership with IBM extending now to half a dozen products) (**15.8% of Revenue/27.3% EBIT Margins**) - This is the fastest growing MODE in the company. Mode III grew by 11.1%. Further, going ahead this would remain the growth driver for the company.

#### Key Conference Call Takeaways -

- The company completed acquisition of Sankalp (Sankalp is a semiconductor design service partners to several Fortune 500 companies in Automotive, Consumer Electronics, Industrial IoT and Medical electronics space)
- The EBIT margin stood at 20.2%, which is 28 bps improvement. The company witnessed 6bps headwinds. The margin expansion was largely attributable by higher growth from HCL software (22bps). Further, 60 bps wage hike was offset by 60 bps of operational efficiency.
- The company witnessed, lower order bookings as compared to earlier quarter due to absence of mega deals, however, since the pipeline is healthy and therefore order conversion is expected to be high in the coming quarters. Absence of mega deals may continue in FY21e, which could in turn impact organic growth and restrict it to mid to high single digit



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- Weakness in Mode I and Mode II – The weakness is mainly due to dropping of some clients which were not yielding margins. Majority of the clients were dropped in Mode I. The management also added that, they would drop out more customers if they aren't margin accretive
- Mode III highlighted robust growth of 11.1% in constant current terms and generating 27.3% EBIT Margins for the Q3FY20.
- 5 out of 7 verticals grew in double digit and geographically, ROW led the growth with 27.3% YoY growth
- Days sales outstanding stands at 83 as against 90 days in Q2FY20(including unbilled transactions), and 66 days as against 70 days in Q2FY20 (without unbilled transactions)
- The effective tax rate for the full year would be 22% as compared to 24% guided in the beginning of FY20.
- Under the BFSI segment, the management guided that their existing clients are spending where needed on regulatory aspects.

### Quarterly Result Analysis

YE March (Rs mn)	Q3 FY20	Q2 FY20	Q-o-Q change %	Q3 FY19	Y-o-Y change %
Revenues (\$)	2,543	2,486	2.3%	2,202	15.5%
<b>Revenues (INR)</b>	<b>181,350</b>	<b>175,280</b>	<b>3.5%</b>	<b>156,990</b>	<b>15.5%</b>
Direct Cost	111,760	110,610	1.0%	101,520	10.1%
<b>Gross Profit</b>	<b>69,590</b>	<b>64,670</b>	<b>7.6%</b>	<b>55,470</b>	<b>25.5%</b>
SG&A	24,890	23,640	5.3%	19,000	31.0%
<b>EBITDA</b>	<b>44,700</b>	<b>41,030</b>	<b>8.9%</b>	<b>36,470</b>	<b>22.6%</b>
Depreciation & Amortisation	8,000	6,060	32.0%	5,610	42.6%
<b>EBIT</b>	<b>36,700</b>	<b>34,970</b>	<b>4.9%</b>	<b>30,860</b>	<b>18.9%</b>
Foreign Exchange Gains/(Loss)					
Other Income, net	670	(30)		1,050	(36.2%)
<b>PreTax Income</b>	<b>37,370</b>	<b>34,940</b>	<b>7.0%</b>	<b>31,910</b>	<b>17.1%</b>
<b>Adjusted Pretax Income</b>	<b>37,370</b>	<b>34,940</b>	<b>7.0%</b>	<b>31,910</b>	<b>17.1%</b>
Tax	6,910	8,350	(17.2%)	5,660	22.1%
Share of Minority Interest	0	80		0	
<b>Net Profit</b>	<b>30,460</b>	<b>26,670</b>	<b>14.2%</b>	<b>26,250</b>	<b>16.0%</b>
<b>Adjusted Net Profit</b>	<b>30,460</b>	<b>26,670</b>	<b>14.2%</b>	<b>26,250</b>	<b>16.0%</b>
<b>Diluted EPS (Rs)</b>	<b>11.2</b>	<b>9.8</b>	<b>14.2%</b>	<b>9.7</b>	<b>16.1%</b>
<b>Adjusted Diluted EPS</b>	<b>11.2</b>	<b>9.8</b>	<b>14.2%</b>	<b>9.7</b>	<b>16.1%</b>
No.of Shares (mn) - Diluted	2,713	2,713		2,713	

Margin Analysis (%)			Change in bps		Change in bps
Operating Profit Margin (%)	20.2%	20.0%	29	19.7%	58
EBITDA Margin (%)	24.6%	23.4%	124	23.2%	142
Net Profit Margin (%)	16.8%	15.2%	158	16.7%	8
Adjusted NPM (%)	16.8%	15.2%	158	16.7%	8
Effective Tax rate (%)	18.5%	23.9%	(541)	17.7%	75

CostAnalysis (%)			Change in bps		Change in bps
Direct cost as % of Sales	61.6%	63.1%	(148)	64.7%	(304)
SG&A as % of Sales	13.7%	13.5%	24	12.1%	162

### Valuation & Outlook

HCL Tech is trading at 13.8x and 12.6x FY21e and FY22e EPS. A slowdown in mega deals in FY21e might impact organic growth, which can possibly be offset by higher growth in products business (once HCL gets accustomed to the industry over the next few quarters and due to cross sell opportunities via IT Services) and higher (lower value) deal conversions. We rollover our estimates to FY22e while we maintain our multiple at 14x FY22e as we still await some clarity on the trajectory of the product business and HCL's capability in the product industry (as the management mentioned indicated that it had underestimated the effort to onboard new clients and hence revenue from IBM products was lower than estimated in Q3FY20). We maintain a BUY rating on the stock and arrive at a **revised target price of INR 668**.



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P&L Statement					
YE March (Rs. mn)	FY18	FY19	FY20E	FY21E	FY22E
<b>Total Revenues</b>	<b>505,690</b>	<b>604,280</b>	<b>704,278</b>	<b>773,415</b>	<b>839,767</b>
Revenue Growth (Y-o-Y)	8.2%	19.5%	16.5%	9.8%	8.6%
<b>Less:</b>					
Employees Cost	332,370	392,680	445,015	480,195	534,800
SG&A	58,930	71,910	94,751	108,278	118,649
<b>Total Op. Expenditure</b>	<b>391,300</b>	<b>464,590</b>	<b>539,766</b>	<b>588,473</b>	<b>653,449</b>
<b>EBIDTA</b>	<b>114,390</b>	<b>139,690</b>	<b>164,511</b>	<b>184,942</b>	<b>186,318</b>
EBIDTA Growth (Y-o-Y)	10.9%	22.1%	17.8%	12.4%	0.7%
Less: Depreciation	14,520	21,480	29,937	34,426	24,652
<b>Operating Profit</b>	<b>99,870</b>	<b>118,210</b>	<b>134,574</b>	<b>150,516</b>	<b>161,666</b>
Growth (Y-o-Y)	5.4%	18.4%	13.8%	11.8%	7.4%
Non-operating Income	11,110	8,050	2,837	3,867	4,199
<b>Profit Before tax</b>	<b>110,980</b>	<b>126,260</b>	<b>137,411</b>	<b>154,383</b>	<b>165,865</b>
Tax	23,170	24,810	29,137	36,115	36,490
<b>Net Profit</b>	<b>87,810</b>	<b>101,530</b>	<b>108,513</b>	<b>118,268</b>	<b>129,374</b>
Adjusted Net Profit	87,810	101,530	108,513	118,268	129,374
<b>Diluted EPS (Rs.)</b>	<b>63.0</b>	<b>72.9</b>	<b>40.0</b>	<b>43.6</b>	<b>47.7</b>
Growth (Y-o-Y) %	5.4%	15.6%	-45.1%	9.0%	9.4%
<b>Adjusted Diluted EPS</b>	<b>63.0</b>	<b>72.9</b>	<b>40.0</b>	<b>43.6</b>	<b>47.7</b>
Growth (Y-o-Y) %	5.4%	15.6%	-45.1%	9.0%	9.4%

Key Ratios					
YE March (Rs. mn)	FY18	FY19	FY20E	FY21E	FY22E
<b>EBITDA Margin %</b>	<b>22.6%</b>	<b>23.1%</b>	<b>23.4%</b>	<b>23.9%</b>	<b>22.2%</b>
EBIT Margins %	19.7%	19.6%	19.1%	19.5%	19.3%
<b>NPM (%)</b>	<b>17.4%</b>	<b>16.8%</b>	<b>15.4%</b>	<b>15.3%</b>	<b>15.4%</b>
RoE (%)	25.3%	26.1%	24.0%	22.4%	21.4%
<b>RoCE (%)</b>	<b>26.3%</b>	<b>25.3%</b>	<b>25.0%</b>	<b>24.0%</b>	<b>22.9%</b>
BV/Per Share Rs.	261	297	180	209	237

Valuation Ratios					
YE March (Rs. mn)	FY18E	FY19E	FY19E	FY19E	FY19E
P/E (x)	9.5x	8.2x	15.0x	13.8x	12.6x
<b>EV/EBITDA</b>	<b>7.0x</b>	<b>5.7x</b>	<b>9.7x</b>	<b>8.5x</b>	<b>8.5x</b>
P/BV (x)	2.3x	2.0x	3.3x	2.9x	2.5x
<b>Market Cap / Sales</b>	<b>1.7x</b>	<b>1.4x</b>	<b>2.3x</b>	<b>2.1x</b>	<b>1.9x</b>

Free Cash Flow Analysis					
	FY18	FY19	FY20E	FY20E	FY20E
<b>EBITDA</b>	<b>114,390</b>	<b>139,690</b>	<b>164,511</b>	<b>184,942</b>	<b>186,318</b>
<b>Add: Depreciation Tax Shield</b>	<b>3,031</b>	<b>4,221</b>	<b>6,348</b>	<b>8,053</b>	<b>5,423</b>
<b>Less: Inc in FC Investment</b>	<b>(39,643)</b>	<b>(49,540)</b>	<b>(84,937)</b>	<b>(76,316)</b>	<b>(83,646)</b>
<b>Taxes Paid</b>	<b>23,170</b>	<b>24,810</b>	<b>29,137</b>	<b>36,115</b>	<b>36,490</b>
<b>Total Free Cash Flows</b>	<b>23,436</b>	<b>70,191</b>	<b>37,443</b>	<b>75,894</b>	<b>64,986</b>

Balance Sheet					
YE March (Rs. mn)	FY18	FY19	FY20E	FY21E	FY22E
Equity Capital	2,780	2,710	5,351	5,351	5,351
Reserves & Surplus	361,080	410,950	484,268	561,142	638,767
<b>Equity</b>	<b>363,860</b>	<b>413,660</b>	<b>489,619</b>	<b>566,494</b>	<b>644,118</b>
<b>Net Worth</b>	<b>363,860</b>	<b>413,660</b>	<b>489,619</b>	<b>566,494</b>	<b>644,118</b>
Minority Interest	0	0	0	0	0
Net Deferred tax liability/(Asset)	22	158	0	0	0
Other Non-current Liabilities	11,580	16,040	18,694	20,530	22,291
<b>Total Loans</b>	<b>3,800</b>	<b>37,010</b>	<b>30,720</b>	<b>38,880</b>	<b>39,860</b>
<b>Capital Employed</b>	<b>379,262</b>	<b>466,868</b>	<b>539,034</b>	<b>625,903</b>	<b>706,269</b>
<b>Assets</b>					
Gross Block	87,740	103,260	113,260	123,260	133,260
Less: Depreciation	42,140	50,330	79,115	103,767	109,930
<b>Net Block</b>	<b>45,600</b>	<b>52,930</b>	<b>34,145</b>	<b>19,493</b>	<b>23,330</b>
<b>Investments</b>	<b>13,950</b>	<b>16,410</b>	<b>18,905</b>	<b>20,630</b>	<b>22,286</b>
Intangible Assets	141,930	175,950	250,887	317,203	390,849
Other Non-current Assets	35,170	38,540	44,918	49,327	53,559
Deferred Income Tax Assets	18,370	24,550	20,612	23,157	24,880
<b>Current Assets</b>					
Inventories	1,720	910	872	941	1,048
Sundry Debtors	96,390	117,060	136,431	149,825	162,678
Cash and Bank Balance	39,862	75,588	66,936	88,522	76,918
Other Current Assets	49,620	65,210	76,001	83,462	90,622
<b>Total Current Assets</b>	<b>221,692</b>	<b>271,888</b>	<b>315,454</b>	<b>361,419</b>	<b>373,254</b>
<b>Less: Current Liabilities</b>					
Sundry Creditors	9,180	13,050	12,500	13,488	15,022
Provisions	12,160	15,100	34,029	42,728	48,395
Other Current Liabilities	79,310	87,600	102,096	112,119	121,738
<b>Total Current Liabilities</b>	<b>100,650</b>	<b>115,750</b>	<b>148,626</b>	<b>168,335</b>	<b>185,154</b>
<b>Capital Applied</b>	<b>379,262</b>	<b>466,868</b>	<b>539,034</b>	<b>625,903</b>	<b>706,269</b>



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