

# HCL Tech Ltd.

## Slow growth disappoints again

**BUY**

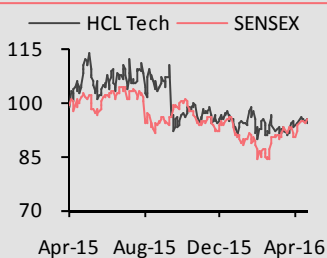
 Sector: IT  
 Sector View: Positive

**Analyst:**  
**Rajiv Mehta**  
*research@indiaonline.com*
**Stock Data**

Sensex:	25603
52 Week h/l (Rs):	1,048/785
Market cap (Rscr) :	112,838
6m Avg t/o (Rscr):	163
Bloomberg code:	HCLT IN
BSE code:	532281
NSE code:	HCLTECH
FV (Rs):	2
Div yield (%):	2.1

*Prices as on April 28, 2016*
**Shareholding Pattern**

	Sep-15	Dec-15	Mar-16
Promoters	60.6	60.4	60.4
FII+DII	33.3	33.0	32.6
Others	6.1	6.6	7.0

**Share Price Trend**

**April 29, 2016**
**Result Update**
**CMP: Rs800 1-yr Target: Rs959 Upside: 19.9%**

- ✧ Revenue traction remains sluggish; constant currency growth falls to 8% yoy
- ✧ Execution on order backlog to uplift growth trajectory
- ✧ Operating margin improved by 70bps qoq; recovery likely to be gradual over medium term
- ✧ Investment risk-reward favourable; Retain BUY

**Result table**

(Rs cr)	Q4 FY16	Q3 FY16	% qoq	Q4 FY15	% yoy
<b>Net sales</b>	<b>10,698</b>	<b>10,341</b>	<b>3.5</b>	<b>9,267</b>	<b>15.4</b>
<b>Operating profit</b>	<b>2,378</b>	<b>2,225</b>	<b>6.9</b>	<b>2,091</b>	<b>13.7</b>
<b>OPM (%)</b>	<b>22.2</b>	<b>21.5</b>	<b>70 bps</b>	<b>22.6</b>	<b>(335) bps</b>
Depreciation	(157)	(153)	2.6	(113)	38.9
Other income	200	355	(43.7)	179	-
<b>PBT</b>	<b>2,421</b>	<b>2,427</b>	<b>(0.2)</b>	<b>2,157</b>	<b>12.2</b>
Tax	(497)	(508)	(2.2)	(473)	5.1
<b>Effective tax rate (%)</b>	<b>20.5</b>	<b>20.9</b>	<b>-</b>	<b>21.9</b>	<b>-</b>
<b>Reported PAT</b>	<b>1,924</b>	<b>1,919</b>	<b>0.3</b>	<b>1,682</b>	<b>14.4</b>
<b>PAT margin (%)</b>	<b>18.0</b>	<b>18.6</b>	<b>(57) bps</b>	<b>18.2</b>	<b>(168) bps</b>

*Source: Company, India Infoline Research*

### Revenue traction remains sluggish; constant currency growth falls to 8% yoy

Behind our expectation, HCL Tech delivered a modest constant currency (CC) dollar revenue growth of 1.7% qoq. The annual revenue growth further moderated to 8% yoy from 9.3% yoy in the previous quarter. At current rate, company's growth is lowest among the larger Indian offshore vendors. In Q4 FY16, growth in IMS services (36% of total revenue) strengthened further to 3.9% qoq from 3.4% qoq in the preceding quarter. BPO revenues declined materially qoq after having growth strongly in the preceding 12 months. Application services (40% of total revenue) remain a soft spot for HCL Tech; revenues were largely flattish in Q4 FY16 and grew by just 5.5% on a trailing year basis. Growth in Engineering and R&D services (18.6% of total revenue) was muted this quarter at 1.9% qoq; however, the service line grew by healthy 16% yoy on a trailing year basis. Growth was disparate within verticals with Lifesciences & Healthcare (up 6.4% qoq), Public Services (up 7.1% qoq) and Telecom/Media (up 4.2% qoq) growing at faster pace. Regionally, strong growth traction in America continued as the revenues grew by 3.7% qoq.

## Execution on order backlog to uplift growth trajectory

Impressive deal win momentum continued with the company signing 7 transformational engagements aggregating over US\$2bn in TCV during Q4 FY16. This includes the large IT outsourcing deal signed with the Volvo Group but excludes the acquired external IT business of the vehicle manufacturer. Over the past nine months, the order wins aggregated over US\$4bn. HCL Tech's order backlog stands at a historic high thus providing encouraging growth visibility. A smooth execution on it should help the company in improving its growth trajectory materially over next couple of years. We estimate HCL Tech's dollar revenue growth to accelerate to 12-13% pa by FY18.

## Operating margin improved by 70bps qoq; recovery likely to be gradual over medium term

The operating margin improved by 70bps qoq to Q4 FY16. The key contributors were sharp uptick in employee utilization and rupee depreciation. The company has been working towards operating at higher productivity level which is manifested in marginal resource addition in trailing 12 months and consequent significant improvement in utilization. HCL Tech has also been operating at an optimal SG&A level of 12.5-13%. In the medium to longer term, HCL Tech has scope to reap benefits from fixed price/managed services contracts and leverage on the initial investments incurred on large deals.

## Investment risk-reward favourable; Retain BUY

In our view, a combination of healthy dollar revenue growth recovery and some margin expansion would drive a decent 13-14% pa earnings growth for HCL Tech in the coming years. With the stock having underperformed in the past 12 months, valuation at near 12x FY18 P/E is undemanding and represents an attractive investment risk-reward for long term investors. Retain BUY recommendation on HCL Tech with a 12-month target of Rs. 959.

### Financial summary

Y/e 31 Mar (Rs cr)	F6/15	FY16*	FY17E	FY18E
Revenues	37,062	31,136	45,761	51,861
yoy growth (%)	12.6	(16.0)	47.0	13.3
Operating profit	8,702	6,695	9,798	11,288
OPM (%)	23.5	21.5	21.4	21.8
Reported PAT	7,256	5,569	7,956	9,094
Pre-exceptional PAT	7,256	5,569	7,956	9,094
yoy growth (%)	13.9	(23.2)	42.9	14.3
EPS (Rs)	51.9	39.8	56.9	65.0
P/E (x)	15.4	20.1	14.1	12.3
P/BV (x)	4.5	4.0	3.3	2.8
EV/EBITDA (x)	11.6	15.1	9.9	8.1
ROE (%)	(0.5)	(0.4)	(0.5)	(0.5)
ROCE (%)	32.4	21.1	25.9	24.8

\* FY16 only has nine months due to shift to fiscal year reporting

Source: Company, India Infoline Research

## 'Best Broker of the Year' – by Zee Business for contribution to broking

Nirmal Jain, Chairman, IIFL, received the award for The Best Broker of the Year (for contribution to broking in India) at India's Best Market Analyst Awards 2014 organised by the Zee Business in Mumbai. The award was presented by the guest of Honour Amit Shah, president of the Bharatiya Janata Party and Piyush Goel, Minister of state with independent charge for power, coal new and renewable energy.

### Recommendation parameters for fundamental reports:

**Buy** – Absolute return of over +15%

**Accumulate** – Absolute return between 0% to +15%

**Reduce** – Absolute return between 0% to -10%

**Sell** – Absolute return below -10%

**Call Failure** - In case of a Buy report, if the stock falls 20% below the recommended price on a closing basis, unless otherwise specified by the analyst; or, in case of a Sell report, if the stock rises 20% above the recommended price on a closing basis, unless otherwise specified by the analyst

---

India Infoline Group (hereinafter referred as IIFL) is engaged in diversified financial services business including equity broking, DP services, merchant banking, portfolio management services, distribution of Mutual Fund, insurance products and other investment products and also loans and finance business. India Infoline Ltd ("hereinafter referred as IIL") is a part of the IIFL and is a member of the National Stock Exchange of India Limited ("NSE") and the BSE Limited ("BSE"). IIL is also a Depository Participant registered with NSDL & CDSL, a SEBI registered merchant banker and a SEBI registered portfolio manager. IIL is a large broking house catering to retail, HNI and institutional clients. It operates through its branches and authorised persons and sub-brokers spread across the country and the clients are provided online trading through internet and offline trading through branches and Customer Care.

### Terms & Conditions and Other Disclosures:-

- a) This research report ("Report") is for the personal information of the authorised recipient(s) and is not for public distribution and should not be reproduced or redistributed to any other person or in any form without IIL's prior permission. The information provided in the Report is from publicly available data, which we believe, are reliable. While reasonable endeavors have been made to present reliable data in the Report so far as it relates to current and historical information, but IIL does not guarantee the accuracy or completeness of the data in the Report. Accordingly, IIL or any of its connected persons including its directors or subsidiaries or associates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained, views and opinions expressed in this publication.
- b) Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect a judgment of its original date of publication by IIFL and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. The value of securities and financial instruments is subject to exchange rate fluctuation that may have a positive or adverse effect on the price or income of such securities or financial instruments.
- c) The Report also includes analysis and views of our research team. The Report is purely for information purposes and does not construe to be investment recommendation/advice or an offer or solicitation of an offer to buy/sell any securities. The opinions expressed in the Report are our current opinions as of the date of the Report and may be subject to change from time to time without notice. IIL or any persons connected with it do not accept any liability arising from the use of this document.
- d) Investors should not solely rely on the information contained in this Report and must make investment decisions based on their own investment objectives, judgment, risk profile and financial position. The recipients of this Report may take professional advice before acting on this information.
- e) IIL has other business segments / divisions with independent research teams separated by 'chinese walls' catering to different sets of customers having varying objectives, risk profiles, investment horizon, etc and therefore, may at times have, different and contrary views on stocks, sectors and markets.
- f) This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to local law, regulation or which would subject IIL and its affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this Report may come are required to inform themselves of and to observe such restrictions.
- g) As IIL along with its associates, are engaged in various financial services business and so might have financial, business or other interests in other entities including the subject company/ies mentioned in this Report. However, IIL encourages independence in preparation of research report and strives to minimize conflict in preparation of research report. IIL and its associates did not receive any compensation or other benefits from the subject company/ies mentioned in the Report or from a third party in connection with preparation of the Report. Accordingly, IIL and its associates do not have any material conflict of interest at the time of publication of this Report.

- h) As IIL and its associates are engaged in various financial services business, it might have:-
- (a) received any compensation (except in connection with the preparation of this Report) from the subject company in the past twelve months;
  - (b) managed or co-managed public offering of securities for the subject company in the past twelve months;
  - (c) received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months;
  - (d) received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months;
  - (e) engaged in market making activity for the subject company.
- i) IIL and its associates collectively do not own (in their proprietary position) 1% or more of the equity securities of the subject company/ies mentioned in the report as of the last day of the month preceding the publication of the research report.
- j) The Research Analyst/s engaged in preparation of this Report or his/her relative
- (a) does not have any financial interests in the subject company/ies mentioned in this report;
  - (b) does not own 1% or more of the equity securities of the subject company mentioned in the report as of the last day of the month preceding the publication of the research report;
  - (c) does not have any other material conflict of interest at the time of publication of the research report.
- k) The Research Analyst/s engaged in preparation of this Report:-
- (a) has not received any compensation from the subject company in the past twelve months;
  - (b) has not managed or co-managed public offering of securities for the subject company in the past twelve months;
  - (c) has not received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months;
  - (d) has not received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months;
  - (e) has not received any compensation or other benefits from the subject company or third party in connection with the research report;
  - (f) has not served as an officer, director or employee of the subject company;
  - (g) is not engaged in market making activity for the subject company.

We submit that no material disciplinary action has been taken on IIL by any regulatory authority impacting Equity Research Analysis.

A graph of daily closing prices of securities is available at <http://www.nseindia.com/ChartApp/install/charts/mainpage.jsp>, [www.bseindia.com](http://www.bseindia.com) and <http://economictimes.indiatimes.com/markets/stocks/stock-quotes>. (Choose a company from the list on the browser and select the “three years” period in the price chart).

**Published in 2016. © India Infoline Ltd 2016**

**India Infoline Limited (Formerly “India Infoline Distribution Company Limited”), CIN No.: U99999MH1996PLC132983**, Corporate Office – IIFL Centre, Kamala City, Senapati Bapat Marg, Lower Parel, Mumbai – 400013 Tel: (91-22) 4249 9000 .Fax: (91-22) 40609049, Regd. Office – IIFL House, Sun Infotech Park, Road No. 16V, Plot No. B-23, MIDC, Thane Industrial Area, Wagle Estate, Thane – 400604 Tel: (91-22) 25806650. Fax: (91-22) 25806654 E-mail: [mail@indiainfoline.com](mailto:mail@indiainfoline.com) Website: [www.indiainfoline.com](http://www.indiainfoline.com), Refer [www.indiainfoline.com](http://www.indiainfoline.com) for detail of Associates.

National Stock Exchange of India Ltd. SEBI Regn. No. : INB231097537/ INF231097537/ INE231097537, Bombay Stock Exchange Ltd. SEBI Regn. No.:INB011097533/ INF011097533/ BSE-Currency, MCX Stock Exchange Ltd. SEBI Regn. No.: INB261097530/ INF261097530/ INE261097537, United Stock Exchange Ltd. SEBI Regn. No.: INE271097532, PMS SEBI Regn. No. INP000002213, IA SEBI Regn. No. INA000000623, SEBI RA Regn.:- INH000000248.

**For Research related queries, write to: Amar Ambani, Head of Research at [research@indiainfoline.com](mailto:research@indiainfoline.com)**

**For Sales and Account related information, write to customer care: [cs@indiainfoline.com](mailto:cs@indiainfoline.com) or call on 91-22 4007 1000**