FIRST LIGHT

22 April 2022

RESEARCH

[#5 Watch Out] India Strategy | Climate Action

Coal merely a band-aid for Europe

HCL Technologies | Target: Rs 1,610 | +46% | BUY

Growth muted; TCV and guidance robust

Metals & Mining

Aluminium – Read-across from Alcoa results

Daily macro indicators

Indicator	19-Apr	20-Apr	Chg (%)
US 10Y yield (%)	2.94	2.83	(10bps)
India 10Y yield (%)	7.15	7.11	(5bps)
USD/INR	76.51	76.21	0.4
Brent Crude (US$/bbl)	107.3	106.8	(0.4)
Dow	34,911	35,161	0.7
Hang Seng	21,028	20,945	(0.4)
Sensex	56,463	57,038	1.0
India FII (US$ mn)	**18-Apr**	**19-Apr**	**Chg ($ mn)**
FII-D	42.3	(67.2)	(109.5)
FII-E	(848.9)	(667.3)	181.6

Source: Bank of Baroda Economics Research

SUMMARY

India Strategy | Climate Action

- Europe's continuing reluctance to enter into long-term contracts for LNG highlights its resolve to green up its energy sources
- Despite falling back on coal usage amid the Russia-Ukraine war, the EU is unlikely to accept coal as a long-term energy source
- We remain cautious on emitting sectors such as coal; expect oil price to stay high during US summer months while gas may see another spike in winter

Click here for the full report.

HCL Technologies

- Q4 revenue growth of 0.5% QoQ USD underperformed our estimate owing to a double-digit slowdown in Mode-3 business
- EBIT margin at 18% (-110bps QoQ) fell slightly below expectations despite deft operations. TCV stood at US$ 2.3bn, up 6% QoQ
- We cut FY23/FY24 EPS by 3%/0.4%; on rollover, our TP remains at Rs 1,610 – retain BUY on robust growth and margin guidance

Click here for the full report.

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Metals & Mining

- Alcoa's Jan-Mar quarter EBITDA improved 36% QoQ in aluminium but declined 48% in alumina; guiding for a stronger Apr-Jun quarter
- Aluminium price supported near-term by supply disruptions, low inventory and high transportation cost despite slower demand growth outlook
- Alumina price easing with improved supply and a softer demand outlook following smelter cuts

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CLIMATE ACTION | #5 Watch Out | 21 April 2022

Coal merely a band-aid for Europe

- **Europe's continuing reluctance to enter into long-term contracts for LNG highlights its resolve to green up its energy sources**
- **Despite falling back on coal usage amid the Russia-Ukraine war, the EU is unlikely to accept coal as a long-term energy source**
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Carbon emission likely to exceed COP's target for CY22: Given the sudden reduction in Russian oil & gas volumes and the high price of LNG cargo, many European countries have silently restarted their coal plants – this is partly reflected in all-time-high coal prices at US$ 300/mt, nearly 3x higher than mid-cycle prices. China too has been steadily ramping up coal production due to elevated LNG prices over the last one year. Given significantly higher coal usage in CY22, carbon emission during the year is likely to materially exceed COP's implied 2°C warming trajectory, in our view.

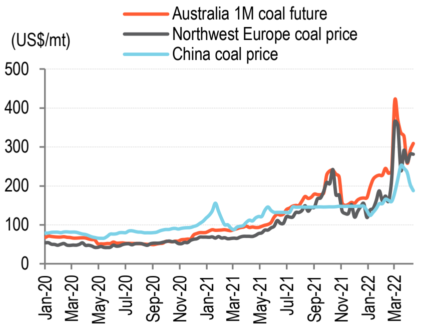
EU expected to double down on climate targets: We note the EU's reluctance to enter into long-term contracts for LNG to set off lower Russian gas volumes, with the region instead continuing its search for short-to-medium-term cargo. Note that long-term contracts are much cheaper than spot prices. Even at current elevated oil prices, most long-term contracts, which are typically oil-linked, would likely cost US$ 12-14/ mmbtu against the current spot price of US$ 30-35/mmbtu. We, therefore, believe that once the Russia-Ukraine situation eases and the EU is able to diversify its energy sources, it will likely double down on climate targets.

Plans to diversify away from Russia gas: The EU's plan to replace Russian gas includes a combination of higher use of renewables, an increase in energy efficiency and diversification of supply sources.

Summer oil & winter gas: Oil consumption usually rises in June-August, in part due to the summer driving season in the US and demand for oil-fired power in Asia and the Middle East. Lower Russian volumes are likely to put further pressure on oil prices during the summer season despite releases from strategic storage. Peak gas demand, on the other hand, occurs in winter months (Dec-Feb) due to heating requirements. Given the visible reduction in Russian oil and gas volumes, we expect oil prices to remain elevated in summer months while gas prices could rise even further in winter.

Cautious on emitters: We continue to maintain that high carbon-emitting sectors, in particular coal-based companies, will face headwinds. Please refer to our note Climate Action: Taking the bull by the horns of 2 November 2021 for details.

Coal price at significant premium to mid-cycle level



Source: Bloomberg, BOBCAPS Research

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TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 1,610 | 46%

HCL TECHNOLOGIES | Technology & Internet | 21 April 2022

Growth muted; TCV and guidance robust

- **Q4 revenue growth of 0.5% QoQ USD underperformed our estimate owing to a double-digit slowdown in Mode-3 business**
- **EBIT margin at 18% (-110bps QoQ) fell slightly below expectations despite deft operations. TCV stood at US$ 2.3bn, up 6% QoQ**
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Growth affected by Mode-3 seasonality: HCLT's Q4FY22 revenue grew 0.5% QoQ USD, below our estimate of 1.9% due to a slowdown in Mode-3 business (-20.3%). Mode-2 and Mode-1 were up 7.2% and 2.9% QoQ USD respectively. Growth in the US market was muted whereas APAC performed well, rising 2.8% QoQ USD. Within verticals, BFSI was subdued (-0.4%) while retail saw the sharpest decline (-6.4%). Media & entertainment/life sciences grew by 6.7%/4%. HCLT continues to see traction in ER&D services (driven by IoT), SaaS and cloud. The company has guided for double-digit revenue growth of 12-14% CC for FY23.

Margin stable: EBIT margin declined 110bps QoQ to 18%, falling slightly below our estimate. SG&A expense and employee cost both increased sequentially. Although the services margin expanded 85bps QoQ, this was offset by a 178bps P&P (products and platforms) seasonality impact. Net profit margin expanded 50bps QoQ to 15.9% due to a lower tax rate and higher forex and other income. Management has guided for an FY23 EBIT margin in the range of 18-20%.

TCV robust: TCV at US$ 2.3bn increased 6% QoQ as HCLT signed a total of 10 new transformational deals in Q4. Bookings and deal pipeline remain strong, per management, with the latter comprising a mix of small and large projects. Deal cycles have become shorter due to faster digital transformation adoption. Cloud has become one of the key demand drivers for HCLT and its AWS offerings have been expanded

Attrition rises: Attrition stood at 21.9% in Q4, up 210bps QoQ, but still lower than industry levels. HCLT hired ~11.1k employees during the quarter. Management is leaning towards hiring more freshers and indicated that it continues to invest in training to prepare for future demand.

Maintain BUY: We lower our FY23/FY24 EPS estimates by 3%/0.4% to factor in the Q4 results. On rolling valuations over to Jun'23, our TP remains at Rs 1,610 based on an unchanged target P/E of 26x. Maintain BUY on robust FY23 revenue growth and margin guidance coupled with strong TCV.

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	HCLT IN/Rs 1,099
Market cap	US$ 39.2bn
Free float	38%
3M ADV	US$ 56.4mn
52wk high/low	Rs 1,378/Rs 891
Promoter/FPI/DII	60%/27%/13%

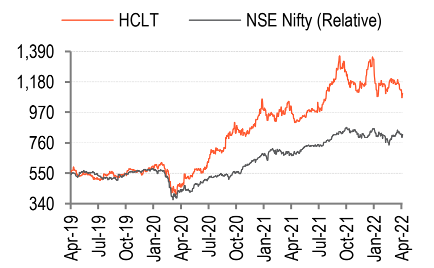
Source: NSE | Price as of 21 Apr 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	856,510	973,266	1,070,517
EBITDA (Rs mn)	201,920	237,538	268,946
Adj. net profit (Rs mn)	135,560	147,414	171,499
Adj. EPS (Rs)	50.0	54.3	63.2
Consensus EPS (Rs)	49.8	56.7	63.5
Adj. ROAE (%)	20.7	20.2	21.1
Adj. P/E (x)	22.0	20.2	17.4
EV/EBITDA (x)	14.7	12.2	10.4
Adj. EPS growth (%)	4.3	8.7	16.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

METALS & MINING

21 April 2022

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In-line aluminium profits but alumina a miss: Alcoa's (AA US, Not Rated) Q1CY22 EBITDA growth of 19% QoQ was broadly in line with Bloomberg consensus estimates for the company (+3% vs. consensus) and for its aluminium segment (-2%), though it reported a sharp miss for its alumina segment (-19%). EBITDA per tonne improved by US$ 363/t QoQ (+48%) in aluminium but declined by US$ 66/t (-45%) in alumina. The aluminium segment benefitted as higher realisations and lower alumina prices offset the rise in other raw material cost. The alumina segment declined due to weaker realisations and higher input costs. Alcoa's working capital increased from 50 days (Sep'21) to 68 days (Mar'22) on higher prices.

Guides for a strong Apr-Jun'22: Management has guided for a QoQ increase in margins with higher prices to offset the impact of raw material and energy inflation.

Aluminium to see near-term support: Supply disruptions, low inventory levels and high transportation cost should support aluminium price near term. While Alcoa guides for lower demand growth of 2% for CY22 (down from 2-3%), it sees even higher supply disruptions, keeping the market tight. Russian supply faces the challenges of securing adequate alumina and difficulty in selling into Western markets. European supply has seen cuts in January/February due to higher energy prices. While Chinese aluminium production is increasing with smelter restarts, Alcoa believes that overall discipline remains intact.

Alumina price eased on better supply: Alumina demand has fallen due to global smelter aluminium cuts. Prices have eased somewhat with the restart of Chinese refineries and improved supply outside China as Australia redirects supply away from Russian markets (export ban), offsetting disruptions at Ukrainian refineries.

Near-term read-across for domestic players: Though the Indian industry will benefit from higher aluminium realisations, the benefit will be partly offset by higher coal cost due to exposure to e-auctions and imports. While players with long alumina positions (such as NALCO) will continue to benefit from above-average prices, alumina segment profit will likely ease QoQ owing to lower realisations and higher raw material costs.

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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