

BUY

TP: Rs 920 | ▲ 16%

HCL TECHNOLOGIES

| IT Services

| 14 September 2020

Favourable quarter ahead; earnings upgraded

HCL Technologies (HCLT) provided a surprising mid-quarter update today, guiding for above-expected revenue growth of at least 3.5% QoQ CC and operating margin in the range of 20.5-21% for Q2FY21. This bold announcement indicates good market share gains, operational efficiency and impressive pipeline conversion across life sciences, telecom and BFSI. We upgrade FY21-FY23 EPS estimates by ~3-5% and raise our Sep'21 TP to Rs 920 from Rs 810. Maintain BUY.

Ruchi Burde | Seema Nayak

research@bobcaps.in

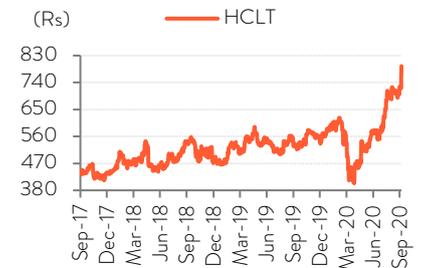
Surprise outlook upgrade: HCLT's updated QoQ CC revenue growth for Q2FY21 stands at upwards of 3.5% vs. our previous estimate of 1% and the company's earlier indication of 1.5-2.5% CQGR for the residual three quarters of FY21. EBIT margin is now pegged at 20.5-21% for Q2 vs. 20.5% in Q1 and 19.5-20.5% last guided for FY21. This bold announcement indicates HCLT's strong execution capability and sets the stage for an FY21 guidance upgrade.

Ticker/Price	HCLT IN/Rs 795
Market cap	US\$ 29.3bn
Shares o/s	2,713mn
3M ADV	US\$ 59.5mn
52wk high/low	Rs 825/Rs 375
Promoter/FPI/DII	60%/27%/13%

Source: NSE

Strong pipeline conversion: In Q1FY21, HCLT had reported 11 new transformational deals across the telecom, manufacturing, life sciences and healthcare verticals. Though the company hadn't provided the TCv figure, it had reported 40% QoQ growth in pipeline. The current announcement indicates that it has been able to convert these deals, with good momentum in life sciences, telecom, media and financial services.

STOCK PERFORMANCE



Source: NSE

Positive on HCLT: We were already expecting a BFSI-led recovery for the sector starting Q2FY21 (see [Deep Dive 3: Swift BFSI recovery ahead](#)). The outlook upgrade by HCLT further reinforces our positive stance and BUY recommendation on the stock. We believe its digital capabilities, commitment towards expanding Mode-2 and 3 portfolios, and operational efficiencies have helped the company gain market share as it benefits from vendor consolidation.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	604,280	706,780	752,867	842,502	921,977
EBITDA (Rs mn)	140,020	166,930	196,347	217,607	241,057
Adj. net profit (Rs mn)	99,757	110,940	124,938	135,450	153,388
Adj. EPS (Rs)	36.7	40.9	46.0	49.9	56.5
Adj. EPS growth (%)	16.3	11.5	12.6	8.4	13.2
Adj. ROAE (%)	25.2	23.5	22.5	21.8	22.0
Adj. P/E (x)	21.7	19.4	17.3	15.9	14.1
EV/EBITDA (x)	15.3	12.8	10.9	9.8	8.4

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



Scope for double-digit growth in FY22

HCLT's earlier revenue growth guidance of 1.5-2.5% on average for the remaining three quarters of FY21 (constant currency) implied a revenue decline in the range of 0.8-2.3% YoY for the year. The revised Q2 growth outlook of at least 3.5% QoQ CC growth coupled with its earlier indicated outlook for H2FY21 (1.5-2.5%) now implies that FY21 will likely see flat-to-low single-digit revenue growth (of -0.5% to +0.3%) vs. a decline earlier.

This is a very positive signal, especially in the current economic climate, and indicates strong recovery. Revised Q2 expectations coupled with strong deal momentum also prepares the ground for an FY21 guidance upgrade and the possibility of double-digit YoY growth in FY22 (we bake in 9.5% YoY dollar revenue growth).

Valuation methodology

We increase FY21/FY22/FY23 EPS estimates by 4.5%/2.8%/2.8% and revise our Sep'21 target price up to Rs 920 (from Rs 810), set at a target P/E multiple of 17x (vs. 15.6x before) – this is at 20% discount to target multiple for Infosys and 1.2SD above the last five-year average P/E. Our TP revision factors in HCLT’s swifter-than-expected revenue and operating margin recovery as established by the company’s surprise mid-quarter outlook upgrade.

We reiterate BUY as we see relatively higher near-to-mid-term growth visibility for the company vis-à-vis peers on the back of:

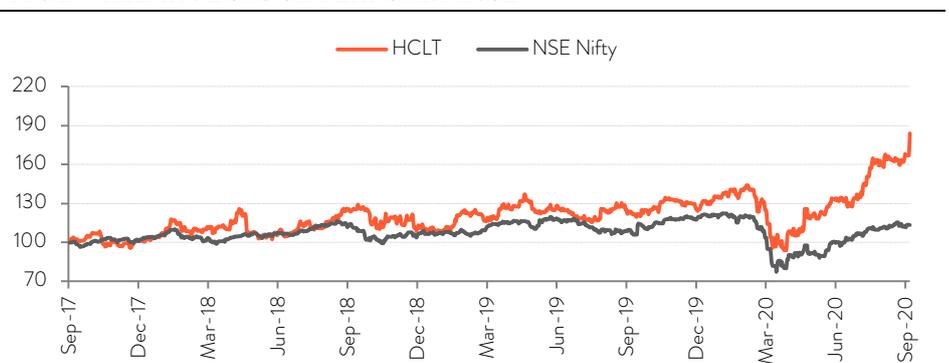
- its growing software (Mode-3) business which forms 16.2% of revenue and is relatively immune to Covid-led volatility (this also brings in structural potential for margin improvement),
- healthy large deal wins (11 contracts won in Q1FY21), and
- its IMS heritage which offers unique positioning to leverage the cloud migration opportunity accelerated by the pandemic.

FIG 1 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	9,711	9,865	1.6	10,613	10,801	1.8	11,614	11,820	1.8
YoY growth (%)	(2.3)	(0.7)	-	9.3	9.5	-	9.4	9.4	-
Revenues	741,066	752,867	1.6	827,812	842,502	1.8	905,901	921,977	1.8
EBITDA	189,568	196,347	3.6	212,819	217,607	2.3	235,768	241,057	2.2
EBITDA margins (%)	25.6	26.1	-	25.7	25.8	-	26.0	26.1	-
EBIT margins (%)	20.0	20.6	-	20.3	20.5	-	20.7	21.0	-
Net profits	119,522	124,938	4.5	131,738	135,450	2.8	149,253	153,388	2.8
EPS (Rs)	44.0	46.0	4.5	48.5	49.9	2.8	55.0	56.5	2.8

Source: BOBCAPS Research

FIG 2 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key downside risks

- Slowdown in deal momentum
- Less market share gain going forward due to high competition
- Cloud spending contraction

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	604,280	706,780	752,867	842,502	921,977
EBITDA	140,020	166,930	196,347	217,607	241,057
Depreciation	21,480	28,400	41,518	45,014	47,808
EBIT	118,540	138,530	154,829	172,593	193,249
Net interest income/(expenses)	(1,693)	0	0	0	0
Other income/(expenses)	7,720	1,790	3,444	3,316	5,956
Exceptional items	0	0	0	0	0
EBT	124,567	140,320	158,273	175,909	199,206
Income taxes	24,810	29,380	33,334	40,459	45,817
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	99,757	110,940	124,938	135,450	153,388
Adjustments	0	0	0	0	0
Adjusted net profit	99,757	110,940	124,938	135,450	153,388

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	126,860	259,090	263,503	294,876	322,692
Provisions	0	0	15,057	16,850	18,440
Debt funds	39,860	50,930	50,930	50,930	50,930
Other liabilities	4,540	5,280	5,280	5,280	5,280
Equity capital	2,812	2,812	2,812	2,812	2,812
Reserves & surplus	414,888	514,048	578,866	649,137	728,715
Shareholders' fund	422,240	522,140	586,958	657,229	736,807
Total liabilities and equities	588,960	832,160	916,449	1,019,885	1,128,869
Cash and cash eq.	59,290	48,430	122,505	254,544	358,728
Accounts receivables	146,100	177,720	195,952	207,740	227,337
Inventories	0	0	0	0	0
Other current assets	37,160	79,030	90,344	84,250	92,198
Investments	58,520	105,680	105,680	105,680	105,680
Net fixed assets	132,396	62,440	40,000	14,486	(13,822)
CWIP	0	0	0	0	0
Intangible assets	102,564	294,210	294,210	294,210	294,210
Deferred tax assets, net	0	0	0	0	0
Other assets	52,930	64,650	67,758	58,975	64,538
Total assets	588,960	832,160	916,449	1,019,885	1,128,869

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	120,740	139,340	166,457	180,464	201,196
Interest expenses	(4,480)	(1,790)	(3,444)	(3,316)	(5,956)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(24,660)	47,020	(13,183)	36,253	(3,702)
Other operating cash flows	(1,936)	(40,905)	0	0	0
Cash flow from operations	89,664	143,665	149,830	213,401	191,538
Capital expenditures	(34,340)	(150,090)	(19,079)	(19,500)	(19,500)
Change in investments	5,200	47,160	0	0	0
Other investing cash flows	(3,604)	1,790	3,444	3,316	5,956
Cash flow from investing	(32,744)	(101,140)	(15,635)	(16,184)	(13,544)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	36,230	0	0	0	0
Interest expenses	(39,860)	0	0	0	0
Dividends paid	(10,990)	(53,384)	(60,120)	(65,178)	(73,810)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(14,620)	(53,384)	(60,120)	(65,178)	(73,810)
Changes in cash and cash eq.	42,300	(10,859)	74,075	132,038	104,184
Closing cash and cash eq.	59,290	48,430	122,505	254,544	358,728

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	36.7	40.9	46.0	49.9	56.5
Adjusted EPS	36.7	40.9	46.0	49.9	56.5
Dividend per share	14.7	16.4	18.4	20.0	22.6
Book value per share	155.2	192.4	216.3	242.2	271.5

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.6	3.0	2.9	2.5	2.2
EV/EBITDA	15.3	12.8	10.9	9.8	8.4
Adjusted P/E	21.7	19.4	17.3	15.9	14.1
P/BV	5.1	4.1	3.7	3.3	2.9

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	80.1	79.1	78.9	77.0	77.0
Interest burden (PBT/EBIT)	105.1	101.3	102.2	101.9	103.1
EBIT margin (EBIT/Revenue)	19.6	19.6	20.6	20.5	21.0
Asset turnover (Revenue/Avg TA)	112.6	99.5	86.1	87.0	85.8
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.6	1.6	1.5
Adjusted ROAE	25.2	23.5	22.5	21.8	22.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	19.5	17.0	6.5	11.9	9.4
EBITDA	22.4	19.2	17.6	10.8	10.8
Adjusted EPS	16.3	11.5	12.6	8.4	13.2
Profitability & Return ratios (%)					
EBITDA margin	23.2	23.6	26.1	25.8	26.1
EBIT margin	19.6	19.6	20.6	20.5	21.0
Adjusted profit margin	16.5	15.7	16.6	16.1	16.6
Adjusted ROAE	25.2	23.5	22.5	21.8	22.0
ROCE	24.9	23.4	23.3	27.1	33.3
Working capital days (days)					
Receivables	81	84	91	87	86
Inventory	0	0	0	0	0
Payables	92	130	171	163	166
Ratios (x)					
Gross asset turnover	4.8	7.3	14.7	30.9	2,774.1
Current ratio	2.3	1.4	1.7	1.9	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.1)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

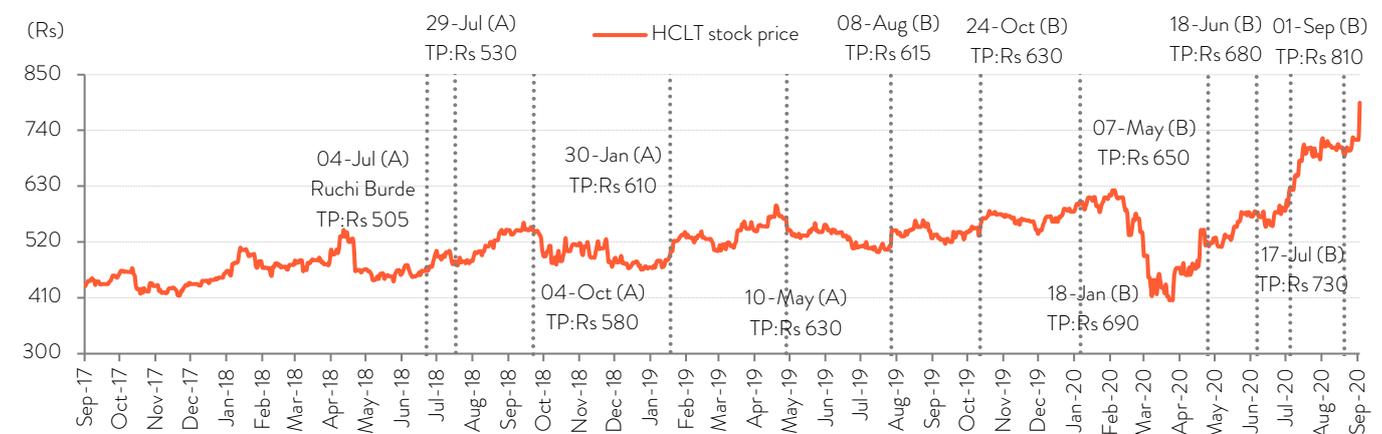
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): HCL TECHNOLOGIES (HCLT IN)



B – Buy, A – Add, R – Reduce, S – Sell

Rating distribution

As of 31 August 2020, out of 100 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 48 have BUY ratings, 21 have ADD ratings, 11 are rated REDUCE and 20 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.