

BUY

TP: Rs 1,260 | ▲ 26%

HCL TECHNOLOGIES

| IT Services

| 19 June 2021

Second Covid wave hinders growth

- HCLT reported 0.9% QoQ dollar revenue growth in Q1FY22, underperforming our estimate of 1.5% due to the Covid2.0 impact
- Growth was primarily driven by life sciences and BFSI with other verticals muted. New TCV grew 37% YoY to US\$ 1.6bn
- We revise FY22/FY23 EPS by -4%/ -6% and roll over to a new Jun'22 TP of Rs 1,260 (vs. Rs 1,190). Retain BUY as FY22 guidance remains intact

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Covid impacts growth: HCLT's Q1 revenue grew 0.9% QoQ USD, falling short of our estimate of 1.5% as employees in the national capital region (NCR) were hampered by Covid-19 restrictions. Growth was led by life sciences and BFSI, which were up 5.2% and 3.2% respectively. Retail, manufacturing, ENU, and media, publishing & entertainment remained weak. New TCV stood at US\$ 1.6bn (+37% YoY) vs. US\$ 3.1bn in Q4FY21. Mode-2 business grew the most at 2.3% QoQ CC. Geography-wise, the Europe pipeline remains strong despite an underwhelming quarterly performance. In terms of services, engineering and R&D posted good growth of 2.2% QoQ CC led by digital engineering demand in hi-tech and life sciences.

Margin in line: EBIT margin was in line at 19.6%, down 70bps QoQ. Employee cost/SG&A as a percentage of sales increased 100bps/50bps QoQ. The Q1 margin decline stemmed from (1) the pandemic-led impact (-90bps), (2) investments in sales, marketing and R&D (-30bps), and (3) talent retention costs (-30bps). This was partly offset by a lack of amortisation cost (+60bps) and forex gains (+20bps).

Hiring ramped up: HCLT has been able to rein in attrition at 11.4% by using various measures such as special allowances, retention bonuses and onshore fresher hiring. The company hired ~7,500 employees in Q1FY22 to meet the increasing demand and help backfill attrition. Management expects to maintain hiring at the current level for the next couple of quarters.

FY22 guidance intact: In Q4FY21, management had guided for double-digit revenue growth and EBIT margin of 19-21% for FY22. This guidance remains unchanged, based on 12 deal wins in the first quarter (vs. 19 in Q4FY21 and 11 in Q1FY21). HCLT expects the growth lost in Q1 to be recouped in Q2.

Maintain BUY: In our view, Q1 was an aberration due to the impact of Covid and seasonality. Growth is guided to recover and the FY22 margin outlook also remains robust. We lower EPS estimates post Q1 and roll to a new Jun'22 TP of Rs 1,260 (vs. Rs 1,190), set at an unchanged 20.8x P/E (30% discount to TCS' multiple). We retain BUY on strong sector demand, robust bookings and steady growth guidance.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HCLT IN/Rs 1,000
Market cap	US\$ 36.2bn
Free float	38%
3M ADV	US\$ 61.9mn
52wk high/low	Rs 1,067/Rs 627
Promoter/FPI/DII	60%/27%/13%

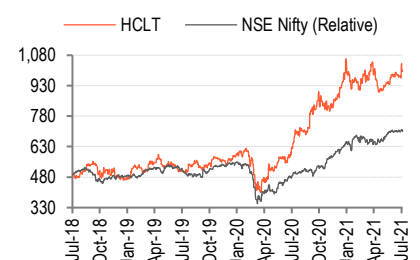
Source: NSE | Price as of 19 Jul 2021

Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	753,790	868,806	986,201
EBITDA (Rs mn)	200,560	221,729	255,566
Adj. net profit (Rs mn)	130,660	141,546	160,138
Adj. EPS (Rs)	48.1	52.2	59.0
Consensus EPS (Rs)	48.1	50.8	57.4
Adj. ROAE (%)	22.9	21.5	21.8
Adj. P/E (x)	20.8	19.2	16.9
EV/EBITDA (x)	13.5	12.2	10.3
Adj. EPS growth (%)	17.8	8.3	13.1

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Earnings call highlights

- C Vijay Kumar has been appointed as CEO and MD of HCLT as Shiv Nadar passes the baton.
- HCLT's total headcount hit a peak of 176,499 with strong net additions of 7,522 employees during the quarter.
- The company exited the IP partnership with CFT as revenue was stagnating.
- The board has declared dividend of Rs 6/sh.

Fig 1 – Quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenues (US\$ mn)	2,720	2,356	15.4	2,696	0.9	10,279	9,936	3.5
Revenue	200,680	178,410	12.5	196,420	2.2	761,450	706,780	7.7
Operating Expenditure	151,600	132,750	14.2	145,450	4.2	566,230	539,850	4.9
Cost of revenues	121,970	107,280	13.7	117,400	3.9	455,940	443,080	2.9
as % of sales	60.8	60.1	-	59.8	-	59.9	62.7	-
SG&A expenses	29,630	25,470	16.3	28,050	5.6	110,290	96,770	14.0
as % of sales	14.8	14.3	-	14.3	-	14.5	13.7	-
EBITDA	49,080	45,660	7.5	50,970	(3.7)	195,220	166,930	16.9
Depreciation	9,770	9,060	-	11,170	-	39,350	28,400	38.6
EBIT	39,310	36,600	7.4	39,800	(1.2)	155,870	138,530	12.5
Other Income	1,940	2,050	-	1,900	-	6,570	1,780	269.1
PBT	41,250	38,650	6.7	41,700	(1.1)	162,440	140,310	15.8
Total Tax	8,940	9,290	-	11,910	-	40,130	29,380	36.6
Adjusted PAT	32,310	29,360	10.0	29,790	8.5	122,310	110,930	10.3
(Profit)/loss from JV's/Ass/MI	(160)	(130)	-	(170)	-	(570)	(320)	-
APAT after MI	32,150	29,230	10.0	29,620	8.5	121,740	110,620	10.1
Extra ordinary items	0	0	-	5750	-	5,750	0	-
Reported PAT	32,150	29,230	10.0	23,870	34.7	127,490	110,620	15.3
Reported EPS	11.8	10.8	10.0	10.9	8.5	45	41	10.7
Margins (%)			(bps)		(bps)			(bps)
EBITDA	24.5	25.6	(110)	25.9	(150)	25.6	23.6	200
EBIT	19.6	20.5	(90)	20.3	(70)	20.5	19.6	90
EBT	20.6	21.7	(110)	21.2	(70)	21.3	19.9	150
PAT	16.0	16.4	(40)	15.1	90	16.0	15.7	30
Effective Tax Rate	21.7	24.0	(240)	28.6	(690)	24.7	20.9	380

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

(in US\$ terms)	Q1FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Business Segment			
Mode 1	61.5	1.1	12.0
Mode 2	23.7	2.3	34.8
Mode 3	14.8	(1.8)	5.5
Revenue by Geography			
US	63.1	2.7	14.4
Europe	27.9	(3.3)	13.8
Asia Pacific	9	2.0	29.9
Revenue by Service Offering			
IT and Business Services	71.6	0.5	17.8
Engineering and R&D Services	15.3	2.2	10.4
Products & Platforms	13.10	1.7	9.6
Revenues by Industry			
BFSI	22.1	3.2	13.9
Retail	10.0	(0.1)	15.4
Media, Publishing & Entertainment	7.9	(1.6)	20.0
Life Sciences	14.7	5.2	23.9
Energy Utilities -Public Sector	10.8	(2.7)	13.4
Manufacturing	17.2	(2.0)	9.7
Technology Services	17.3	1.5	16.1
Client Concentration			
Top 5	13.0	(0.6)	8.0
Top 10	20.8	0.4	14.9
Top 20	30.4	(0.4)	14.0
Employee Metrics			
Total Employees	176,499	168,977	150,287
Net Addition	7,522	9,295	(136)
Revenues by Contract Type (%)			
Time & material	33.5	32.3	33.3
Fixed Price	66.5	67.7	66.7

Source: Company, BOBCAPS Research

Valuation methodology

Following the Q1FY22 results, we revise our FY22/FY23 EPS estimates down by 4%/6%. On rollover, we move to a new Jun'22 TP of Rs 1,260 (vs. Rs 1,190), set at an unchanged one-year forward P/E multiple of 20.8x (30% discount to TCS' multiple). Our target price pencils in HCLT's robust margin guidance for FY22 and its commitment towards enhancing the Mode-2 and 3 portfolios (which command higher margins).

We reiterate BUY as we see relatively strong near-to-mid-term growth visibility for the company on the back of its growing Mode-2 software business (23.7% of revenue), healthy large-deal wins (12 contracts won in Q1FY22), and IMS heritage that offers unique positioning to leverage the cloud migration opportunity being accelerated by the pandemic.

Fig 3 – Revised estimates

(Rs mn)	FY22E			FY23E			FY24E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	11,503	11,434	(0.6)	12,678	12,602	(0.6)	13,909
YoY growth (%)	13.0	12.4	-	10.2	10.2	-	10.4
Revenues	875,755	868,806	(0.8)	992,162	986,201	(0.6)	1,088,452
EBITDA	237,295	221,729	(6.6)	269,435	255,566	(5.1)	275,190
EBITDA margin (%)	27.1	25.5	-	27.2	25.9	-	25.3
EBIT margin (%)	21.8	20.8	-	22.2	20.9	-	20.6
Net profits	147,110	141,546	(3.8)	170,732	160,138	(6.2)	175,218
EPS (Rs)	54.2	52.2	(3.8)	62.9	59.0	(6.2)	64.6

Source: BOBCAPS Research, Company

Key risks

Key downside risks to our estimates are:

- above-expected revenue contraction in IMS due to automation,
- above-expected HCL Software client attrition,
- an inability to renew existing contracts, and
- adverse currency movement.

Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	36	1,000	1,260	BUY
Info Edge	INFOE IN	9	5,123	2,880	SELL
Infosys	INFO IN	88	1,542	1,860	BUY
L&T Infotech	LTI IN	10	4,380	4,990	BUY
Mindtree	MTCL IN	6	2,730	2,270	SELL
Mphasis	MPHL IN	6	2,343	1,580	SELL
Persistent Systems	PSYS IN	3	2,821	1,340	SELL
Tata Consultancy Services	TCS IN	160	3,185	3,890	BUY
Tech Mahindra	TECHM IN	13	1,094	1,190	BUY
Wipro	WPRO IN	42	574	590	HOLD

Source: BOBCAPS Research, NSE | Price as of 19 Jul 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Total revenue	706,780	753,790	868,806	986,201	1,088,452
EBITDA	166,930	200,560	221,729	255,566	275,190
Depreciation	28,400	39,850	40,848	49,427	51,227
EBIT	138,530	160,710	180,881	206,139	223,962
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	1,790	6,580	4,101	5,965	8,115
Exceptional items	0	0	0	0	0
EBT	140,320	167,290	184,981	212,104	232,077
Income taxes	29,380	36,630	43,435	51,965	56,859
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	110,940	130,660	141,546	160,138	175,218
Adjustments	0	0	0	0	0
Adjusted net profit	110,940	130,660	141,546	160,138	175,218

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	259,090	217,050	304,082	345,170	380,958
Provisions	0	0	17,376	19,724	21,769
Debt funds	50,930	39,070	39,070	39,070	39,070
Other liabilities	5,280	5,850	5,850	5,850	5,850
Equity capital	2,812	2,812	2,812	2,812	2,812
Reserves & surplus	514,048	612,248	685,682	768,762	859,665
Shareholders' fund	522,140	620,910	694,344	777,424	868,327
Total liab. and equities	832,160	877,030	1,054,872	1,181,388	1,310,124
Cash and cash eq.	48,430	65,150	192,587	283,235	382,530
Accounts receivables	177,720	175,250	214,226	243,173	268,385
Inventories	0	0	0	0	0
Other current assets	79,030	74,290	86,881	98,620	108,845
Investments	105,680	140,220	168,264	185,090	203,599
Net fixed assets	62,440	62,450	40,598	10,735	(20,928)
CWIP	0	0	0	0	0
Intangible assets	294,210	291,500	291,500	291,500	291,500
Deferred tax assets, net	0	0	0	0	0
Other assets	64,650	68,170	60,816	69,034	76,192
Total assets	832,160	877,030	1,054,872	1,181,388	1,310,124

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Cash flow from operations	143,665	78,334	238,489	198,133	213,569
Capital expenditures	(150,090)	(39,860)	(18,997)	(19,564)	(19,564)
Change in investments	47,160	34,540	28,044	16,826	18,509
Other investing cash flows	1,790	6,580	(51,988)	(27,688)	(28,903)
Cash flow from investing	(101,140)	1,260	(42,941)	(30,426)	(29,959)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(53,384)	(62,874)	(68,112)	(77,059)	(84,315)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(53,384)	(62,874)	(68,112)	(77,059)	(84,315)
Chg in cash & cash eq.	(10,859)	16,720	127,436	90,649	99,295
Closing cash & cash eq.	48,430	65,151	192,587	283,235	382,530

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21P	FY22E	FY23E	FY24E
Reported EPS	40.9	48.1	52.2	59.0	64.6
Adjusted EPS	40.9	48.1	52.2	59.0	64.6
Dividend per share	16.4	19.3	20.9	23.6	25.8
Book value per share	192.4	228.8	255.9	286.5	320.0

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21P	FY22E	FY23E	FY24E
EV/Sales	3.8	3.6	3.1	2.7	2.3
EV/EBITDA	16.2	13.5	12.2	10.3	9.1
Adjusted P/E	24.5	20.8	19.2	16.9	15.5
P/BV	5.2	4.4	3.9	3.5	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21P	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	79.1	78.1	76.5	75.5	75.5
Interest burden (PBT/EBIT)	101.3	104.1	102.3	102.9	103.6
EBIT margin (EBIT/Revenue)	19.6	21.3	20.8	20.9	20.6
Asset turnover (Rev./Avg TA)	99.5	88.2	89.9	88.2	87.4
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.5	1.5	1.5
Adjusted ROAE	23.5	22.9	21.5	21.8	21.3

Ratio Analysis

Y/E 31 Mar	FY20A	FY21P	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	17.0	6.7	15.3	13.5	10.4
EBITDA	19.2	20.1	10.6	15.3	7.7
Adjusted EPS	11.5	17.8	8.3	13.1	9.4
Profitability & Return ratios (%)					
EBITDA margin	23.6	26.6	25.5	25.9	25.3
EBIT margin	19.6	21.3	20.8	20.9	20.6
Adjusted profit margin	15.7	17.3	16.3	16.2	16.1
Adjusted ROAE	23.5	22.9	21.5	21.8	21.3
ROCE	23.4	22.2	24.1	28.7	31.6
Working capital days (days)					
Receivables	84	85	82	85	86
Inventory	0	0	0	0	0
Payables	130	157	147	162	163
Ratios (x)					
Gross asset turnover	7.3	12.1	16.9	38.4	(213.6)
Current ratio	1.4	1.8	1.7	1.9	2.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.2)	(0.3)	(0.4)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

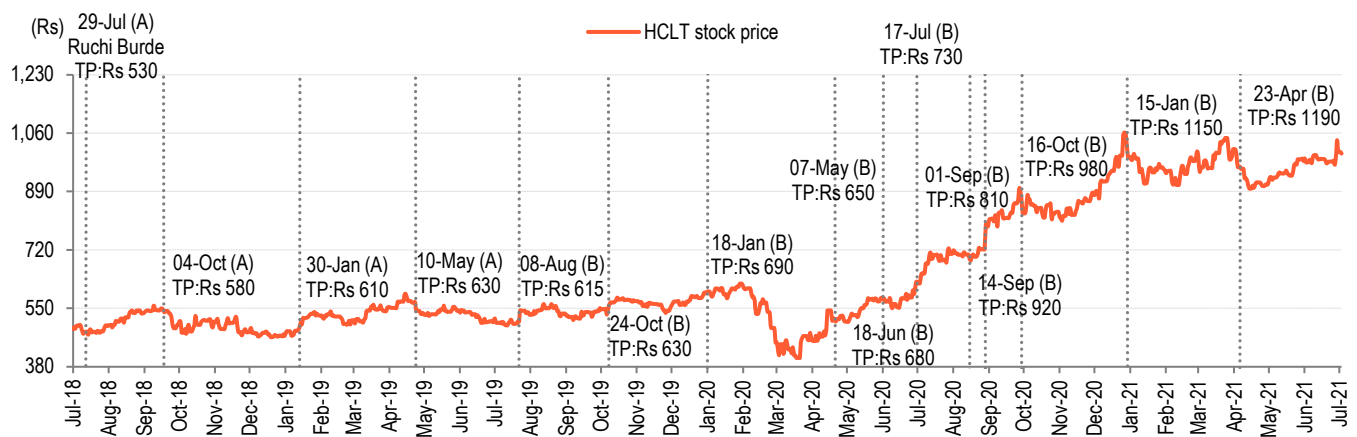
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HCL TECHNOLOGIES (HCLT IN)



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

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