

BUY

TP: Rs 980 | ▲ 18%

HCL TECHNOLOGIES

| IT Services

| 16 October 2020

Guidance raised on robust, broad-based performance

HCL Tech (HCLT) reported 6.4% QoQ USD growth coming from mid-high single digit recovery across verticals. Margins stood strong at 21.6%. Given the upgraded FY21 margin and growth guidance, we raise FY22/FY23 EPS by 9%/8% and keep FY21 EPS unchanged. Rolling valuations over, we have Sep'21 TP of Rs 980 (vs. Rs 920). Company's strong software business, healthy deal wins, traction in mode-2, 3 and cloud/infrastructure expertise offer good midterm growth visibility. Reiterate BUY.

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Robust operational performance: HCLT's broad-based USD revenue growth of 6.4% QoQ outperformed estimated growth of 5.2%. Life sciences, media and retail showed the highest recovery among verticals. Mode-2 delivered the best growth of 9.5% QoQ and the software business increased at a strong 7.3%. HCLT continues to enhance partnerships with cloud hyperscalers, i.e. IBM cloud, Google cloud, AWS and Microsoft Azure. EBIT margin at 21.6% – a 22-quarter high – grew 110bps QoQ and exceeded our estimate by 80bps. Salary hikes are planned from Q3 and have been factored into the new guidance.

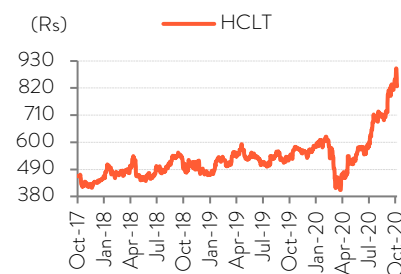
Improved deal signings: HCLT signed 15 transformational deals in Q2 vs. 11 in Q1, led by key industry verticals including life sciences, healthcare, energy & utilities and manufacturing. Most deals revolve around modernisation and digital transformation. The pipeline remains strong, growing 20% QoQ on the back of market share gains from vendor consolidation.

Guidance raised: HCLT updated its revenue growth guidance for Q3 and Q4FY21 to a range of 1.5-2.5% QoQ CC and expects FY21 growth to be positive (vs. 2.3-0.8% YoY CC revenue decline before). EBIT margin guidance for the year has been upgraded from 19.5-20.5% to 20-21%. Positive seasonality from products business is expected to moderate slightly in Q3.

Ticker/Price	HCLT IN/Rs 827
Market cap	US\$ 30.6bn
Shares o/s	2,713mn
3M ADV	US\$ 102.2mn
52wk high/low	Rs 911/Rs 375
Promoter/FPI/DII	60%/27%/13%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	604,280	706,780	761,595	871,156	953,334
EBITDA (Rs mn)	140,020	166,930	199,470	233,720	257,680
Adj. net profit (Rs mn)	99,757	110,940	124,883	147,851	166,274
Adj. EPS (Rs)	36.7	40.9	46.0	54.5	61.3
Adj. EPS growth (%)	16.3	11.5	12.6	18.4	12.5
Adj. ROAE (%)	25.2	23.5	22.5	23.6	23.5
Adj. P/E (x)	22.6	20.2	18.0	15.2	13.5
EV/EBITDA (x)	16.0	13.3	11.2	9.5	8.2

Source: Company, BOBCAPS Research

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Other key highlights

- HCLT expects global tech spend to increase by low single digits in FY21 as demand for traditional areas is flat or shrinking but the spend on new technologies is likely to grow by double digits YoY. Primary addressable markets in the new normal include customer experience, supply chain transformation, e-commerce scale-up in retail CPG, application modernisation and partnership with hyperscalers. Offshoring is expected to be more pronounced, helping margins.
- The company's Q2 EBIT margin expanded 110bps QoQ to 21.6%, aided by operational efficiency (+167bps tailwind) that was driven by revenue growth especially from Mode-2 services but offset by forex headwinds (-24bps) and increased SG&A (-32bps).
- Combined revenue share from Mode-2 and 3 exceeded the company's 35% target, standing at ~37%.
- Retail recovered well. BFSI also registered broad-based growth across clients. Engineering and R&D services grew 4.4% QoQ while product and platforms increased by 4.1%.
- HCLT's software business completed one year this quarter. During the first year, the focus was on transitioning all customers (12,000+) from IBM which has been successfully completed.
- The DWS acquisition will enhance digital contribution from Australia (see our report [Acquisition spree on; DWS to expand footprint in Australia](#)).
- HCLT hired 8.4k employees in Q2.
- The board has announced interim dividend to Rs 4/sh, a 100% YoY increase.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenues (US\$ mn)	2,507	2,486	0.8	2,356	6.4
Revenue	185,940	175,280	6.1	178,410	4.2
Operating Expenditure	136,430	134,250	1.6	132,750	2.8
Cost of revenues	109,290	110,610	(1.2)	107,280	1.9
as % of sales	58.8	63.1	-	60.1	-
SG&A expenses	27,140	23,640	14.8	25,470	6.6
as % of sales	14.6	13.5	-	14.3	-
EBITDA	49,510	41,030	20.7	45,660	8.4
Depreciation	9,350	6,060	-	9,060	-
EBIT	40,160	34,970	14.8	36,600	9.7
Other Income	1,360	(30)	-	2,050	-
PBT	41,520	34,940	18.8	38,650	7.4
Total Tax	9,990	8,350	-	9,290	-
Adjusted PAT	31,530	26,590	18.6	29,360	7.4
(Profit)/loss from JV's/Ass/MI	(110)	(80)	-	(130)	-
APAT after MI	31,420	26,510	18.5	29,230	7.5
Extra ordinary items	0	0	-	0	-
Reported PAT	31,420	26,510	18.5	29,230	7.5
Reported EPS	11.6	9.8	18.5	10.8	7.5
Margins (%)			(bps)		(bps)
EBITDA	26.6	23.4	320	25.6	100
EBIT	21.6	20.0	160	20.5	110
EBT	22.3	19.9	240	21.7	70
PAT	16.9	15.1	180	16.4	50
Effective Tax rate	24.1	23.9	20	24.0	-

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

(in US\$ terms)	Q2FY21 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Business Segment			
Mode 1	63.3	6.2	(4.7)
Mode 2	20.9	9.5	15.2
Mode 3	15.8	3.8	8.4
Revenue by Geography			
US	63.1	5.4	(6.3)
Europe	28.4	6.8	11.4
Asia Pacific	8.5	13.0	33.9
Revenue by Service Offering			
IT and Business Services	70.8	7.3	0.0
Engineering and R&D Services	15.7	4.4	(6.3)
Products & Platforms	13.5	4.1	16.4
Revenue by Industry			
BFSI	22.1	5.0	9.2
Retail	10.4	10.6	15.3

(in US\$ terms)	Q2FY21 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Media, Publishing & Entertainment	7.7	7.8	(2.9)
Life Sciences	14.1	9.5	15.3
Energy Utilities - Public Sector	10.7	3.5	13.6
Manufacturing	17.7	4.0	(4.5)
Technology Services	17.3	7.0	(19.6)
Client Concentration			
Top 5	13.7	4.9	(11.4)
Top 10	20.9	6.4	(8.8)
Top 20	30.6	5.7	(8.4)
	Q2FY21	Q1FY21	Q2FY20
Quarterly Annualised attrition rate (%)	14.7	19.0	28.1
Total Employees	153,085	150,287	147,123
Gross Addition	8,390	7,005	13,430
Net Addition	2,798	(136)	3,223
Revenue by Contract Type (%)			
Time & material	32.6	33.3	33.5
Fixed Price	67.4	66.7	66.5

Source: BOBCAPS Research

Valuation methodology

We increase FY22/FY23 EPS estimates by 9%/8% and roll over to a revised Sep'21 target price of Rs 980 (from Rs 920), set at an unchanged one-year forward P/E multiple of 17x. Our target price revision factors in HCLT's strong margin guidance for FY21 and its commitment towards enhancing the Mode-2 & 3 portfolios (which command higher margins).

Reiterate BUY as we see relatively higher near-to-mid-term growth visibility for HCLT than peers on the back of:

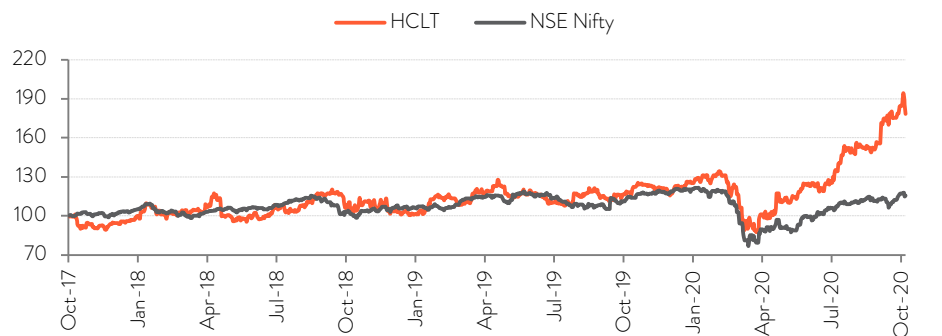
- its growing software (Mode-3) business which forms ~16% of revenue and is relatively immune to Covid-led volatility,
- healthy large deal wins (15 contracts won in Q2FY21), and
- its IMS heritage which offers unique positioning to leverage the cloud migration opportunity accelerated by the pandemic.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	9,865	10,106	2.4	10,801	11,169	3.4	11,820	12,222	3.4
YoY growth (%)	(0.7)	1.7	-	9.5	10.5	-	9.4	9.4	-
Revenues	752,867	761,595	1.2	842,502	871,156	3.4	921,977	953,334	3.4
EBITDA	196,347	199,470	1.6	217,607	233,720	7.4	241,057	257,680	6.9
EBITDA margins (%)	26.1	26.2	-	25.8	26.8	-	26.1	27.0	-
EBIT margins (%)	20.6	20.8	-	20.5	21.7	-	21.0	22.0	-
Net profits	124,938	124,883	0.0	135,450	147,851	9.2	153,388	166,274	8.4
EPS (Rs)	46.0	46.0	0.0	49.9	54.5	9.2	56.5	61.3	8.4

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

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

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	604,280	706,780	761,595	871,156	953,334
EBITDA	140,020	166,930	199,470	233,720	257,680
Depreciation	21,480	28,400	40,765	44,992	47,786
EBIT	118,540	138,530	158,705	188,727	209,894
Net interest income/(expenses)	(1,693)	0	0	0	0
Other income/(expenses)	7,720	1,790	4,572	3,287	6,047
Exceptional items	0	0	0	0	0
EBT	124,567	140,320	163,278	192,015	215,941
Income taxes	24,810	29,380	38,395	44,163	49,666
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	99,757	110,940	124,883	147,851	166,274
Adjustments	0	0	0	0	0
Adjusted net profit	99,757	110,940	124,883	147,851	166,274

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	266,558	304,905	333,667
Provisions	0	0	15,232	17,423	19,067
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	578,837	655,542	741,806
Shareholders' fund	422,240	522,140	586,929	663,634	749,898
Total liabilities and equities	588,960	832,160	919,649	1,036,892	1,153,561
Cash and cash eq.	59,290	48,430	121,086	259,077	369,799
Accounts receivables	146,100	177,720	198,223	214,806	235,069
Inventories	0	0	0	0	0
Other current assets	37,160	79,030	91,391	87,116	95,333
Investments	58,520	105,680	105,680	105,680	105,680
Net fixed assets	132,396	62,440	40,515	15,023	(13,263)
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	68,544	60,981	66,733
Total assets	588,960	832,160	919,650	1,036,893	1,153,561

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	120,740	139,340	165,647	192,844	214,061
Interest expenses	(4,480)	(1,790)	(4,572)	(3,287)	(6,047)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(24,660)	47,020	(14,058)	35,794	(3,827)
Other operating cash flows	(1,936)	(40,905)	0	0	0
Cash flow from operations	89,664	143,665	147,017	225,350	204,186
Capital expenditures	(34,340)	(150,090)	(18,840)	(19,500)	(19,500)
Change in investments	5,200	47,160	0	0	0
Other investing cash flows	(3,604)	1,790	4,572	3,287	6,047
Cash flow from investing	(32,744)	(101,140)	(14,268)	(16,213)	(13,453)
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)	(60,094)	(71,146)	(80,011)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(14,620)	(53,384)	(60,094)	(71,146)	(80,011)
Changes in cash and cash eq.	42,300	(10,859)	72,656	137,991	110,722
Closing cash and cash eq.	59,290	48,430	121,086	259,077	369,799

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	36.7	40.9	46.0	54.5	61.3
Adjusted EPS	36.7	40.9	46.0	54.5	61.3
Dividend per share	14.7	16.4	18.4	21.8	24.5
Book value per share	155.2	192.4	216.3	244.6	276.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.7	3.2	2.9	2.5	2.2
EV/EBITDA	16.0	13.3	11.2	9.5	8.2
Adjusted P/E	22.6	20.2	18.0	15.2	13.5
P/BV	5.3	4.3	3.8	3.4	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	80.1	79.1	76.5	77.0	77.0
Interest burden (PBT/EBIT)	105.1	101.3	102.9	101.7	102.9
EBIT margin (EBIT/Revenue)	19.6	19.6	20.8	21.7	22.0
Asset turnover (Revenue/Avg TA)	112.6	99.5	86.9	89.1	87.0
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.6	1.6	1.5
Adjusted ROAE	25.2	23.5	22.5	23.6	23.5

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	7.8	14.4	9.4
EBITDA	22.4	19.2	19.5	17.2	10.3
Adjusted EPS	16.3	11.5	12.6	18.4	12.5
Profitability & Return ratios (%)					
EBITDA margin	23.2	23.6	26.2	26.8	27.0
EBIT margin	19.6	19.6	20.8	21.7	22.0
Adjusted profit margin	16.5	15.7	16.4	17.0	17.4
Adjusted ROAE	25.2	23.5	22.5	23.6	23.5
ROCE	24.9	23.4	23.1	29.6	36.0
Working capital days (days)					
Receivables	81	84	90	87	86
Inventory	0	0	0	0	0
Payables	92	130	171	164	168
Ratios (x)					
Gross asset turnover	4.8	7.3	14.8	31.4	1,083.6
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

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

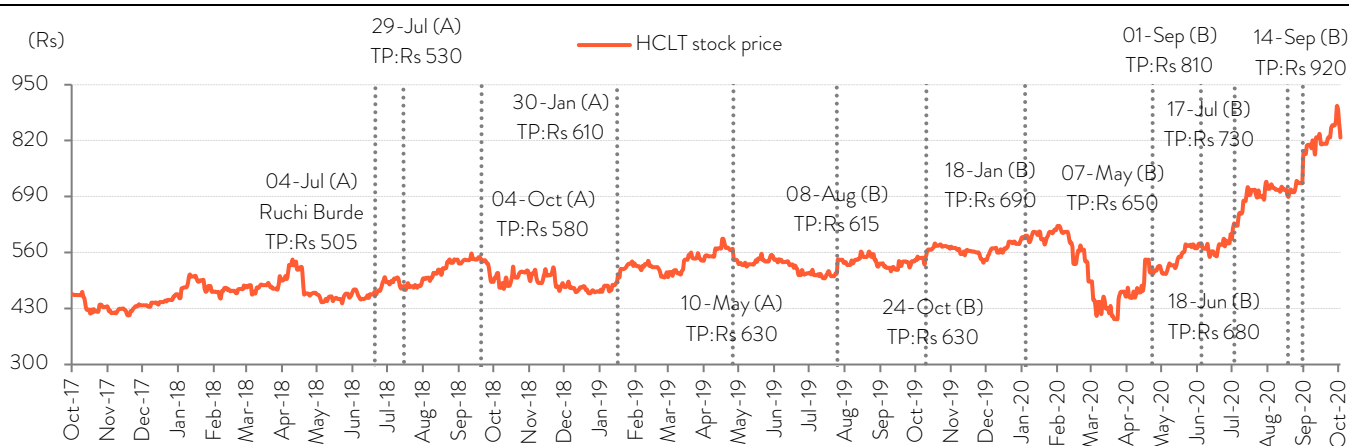
ADD – Expected return from >+5% to +15%

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

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