

BUY

TP: Rs 1,150 | ▲ 16%

HCL TECHNOLOGIES

| IT Services

| 15 January 2021

Growth streak continues; guidance raised

HCL Tech (HCLT) reported 4.4% QoQ dollar revenue growth in Q3FY21, outperforming our 3.2% estimate. EBIT margin stood strong at 22.9%, up 130bps QoQ. Management has upgraded FY21 margin and growth guidance, leading us to raise FY21/FY22/FY23 EPS by 8%/1%/3%. Rolling valuations over, we have a Dec'21 TP of Rs 1,150 (vs. Rs 980) based on an upgraded P/E of 18.8x. The company's strong software business, healthy deal wins, traction in mode-2/3 and cloud/infrastructure expertise offer good midterm growth visibility. BUY.

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Growth outperforms: Q3 revenue grew 4.4% USD/3.5% CC, beating our estimate of 3.2% USD/2.8% CC and exceeding the guided range of 1.5-2.5% CC. HCLT reached the US\$ 10bn milestone in CY20. Q3 growth was driven by a 13% QoQ increase in Mode-2 business. Mode-3 growth held strong at 7.7% while mode-1 was flat QoQ. Demand has risen for digital, cloud, products and platforms. Among verticals, media and entertainment led the momentum with a double-digit uptick. Five of seven verticals posted positive CC growth. EBIT margin was at a 22-quarter high of 22.9% (est. 20.1%), up 130bps QoQ, despite salary hikes (50bps QoQ impact) helped by lower SG&A costs.

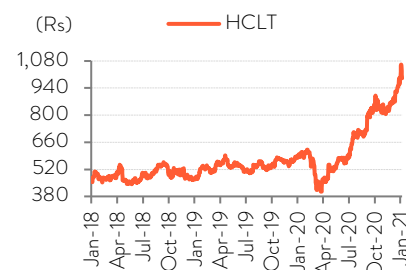
Healthy deal signings: HCLT won 13 transformational deals (vs. 15 in Q2FY21; 12 in Q3FY20) across industry verticals, including life sciences and healthcare, technology and financial services. TCV increased 13% YoY. The pipeline remains strong with triple-digit growth in new licenses in the software business.

Guidance raised: As anticipated, HCLT has slightly updated its revenue growth guidance for Q4FY21 to a range of 2-3% vs. 1.5-2.5% QoQ CC before and expects FY21 growth to be positive. Guidance includes DWS revenue and factors in the impact from product and platforms seasonality in Q4. EBIT margin guidance for the year has been raised from 20-21% to 21-21.5%.

Ticker/Price	HCLT IN/Rs 990
Market cap	US\$ 36.8bn
Shares o/s	2,713mn
3M ADV	US\$ 98.3mn
52wk high/low	Rs 1,067/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	759,502	866,906	967,129
EBITDA (Rs mn)	140,020	166,930	203,155	232,633	261,409
Adj. net profit (Rs mn)	99,757	110,940	134,698	149,993	171,473
Adj. EPS (Rs)	36.7	40.9	49.6	55.3	63.2
Adj. EPS growth (%)	16.3	11.5	21.4	11.4	14.3
Adj. ROAE (%)	25.2	23.5	24.2	23.8	24.0
Adj. P/E (x)	27.0	24.2	19.9	17.9	15.7
EV/EBITDA (x)	19.1	16.0	13.2	11.4	9.7

Source: Company, BOBCAPS Research

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Other highlights

- HCLT's software business continues to grow at a robust pace with triple-digit YoY growth (250%) in new license business TCV.
- Tax expense for the quarter was lower due to reversal of a provision for an uncertain tax position set up in prior years and reduction in tax liability due to a change in the method of calculating tax deductions. Effective tax rate going forward is expected to be within the 21-22% range.
- The board has announced a dividend of Rs 4/sh.
- LTM Attrition at 10.2% is at an all-time low.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenues (US\$ mn)	2,617	2,543	2.9	2,507	4.4
Revenue	193,020	181,350	6.4	185,940	3.8
Operating Expenditure	138,600	136,650	1.4	136,430	1.6
Cost of revenues	111,950	111,760	0.2	109,290	2.4
as % of sales	58.0	61.6	-	58.8	-
SG&A expenses	26,650	24,890	7.1	27,140	(1.8)
as % of sales	13.8	13.7	-	14.6	-
EBITDA	54,420	44,700	21.7	49,510	9.9
Depreciation	10,270	8,000	-	9,350	-
EBIT	44,150	36,700	20.3	40,160	9.9
Other Income	1,270	670	-	1,360	-
PBT	45,420	37,370	21.5	41,520	9.4
Total Tax	5,440	6,910	-	9,990	-
Adjusted PAT	39,980	30,460	31.3	31,530	26.8
(Profit)/loss from JV's/Ass/MI	(160)	(80)	-	(110)	-
APAT after MI	39,820	30,380	31.1	31,420	26.7
Extra ordinary items	0	0	-	0	-
Reported PAT	39,820	30,380	31.1	31,420	26.7
Reported EPS	14.7	11.2	31.1	11.6	26.7
Margins (%)			(bps)		(bps)
EBITDA	28.2	24.6	350	26.6	160
EBIT	22.9	20.2	260	21.6	130
EBT	23.5	20.6	290	22.3	120
PAT	20.6	16.8	390	16.9	370
Effective Tax rate	12.0	18.5	(650)	24.1	(1,210)

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

(in US\$ terms)	Q3FY21 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Business Segment			
Mode 1	61.0	0.6	(4.9)
Mode 2	22.7	13.4	28.3
Mode 3	16.3	7.7	6.2
Revenue by Geography			
US	62.5	3.4	2.4
Europe	29.5	8.4	4.0
Asia Pacific	8	(1.8)	2.9
Revenue by Service Offering			
IT and Business Services	70.4	3.8	3.2
Engineering and R&D Services	15.5	3.1	(4.5)
Products & Platforms	14.1	9.0	10.7
Revenues by Industry			
BFSI	21.4	1.1	1.9
Retail	10.5	5.4	4.9
Media, Publishing & Entertainment	8.3	12.5	(5.1)
Life Sciences	13.6	0.7	14.7
Energy Utilities - Public Sector	10.4	1.5	18.9
Manufacturing	18.1	6.7	(10.9)
Technology Services	17.8	7.4	21.3
Client Contribution			
Top 5	13.5	2.9	(8.9)
Top 10	21	4.9	(4.3)
Top 20	30.9	5.4	(3.5)
	Q3FY21	Q2FY21	Q3FY20
Quarterly Annualised Attrition (%)	14.9	14.7	25.5
Total Employees	159,682	153,085	149,173
Gross Addition	12,422	8,390	11,502
Net Addition	6,597	2,798	2,050
Revenues by Contract Type (%)			
Time & Material	31.6	32.6	32.2
Fixed Price	68.4	67.4	67.8

Source: BOBCAPS Research

Valuation methodology

We increase FY21/FY22/FY23 EPS estimates by 8%/1%/3% and roll over to a revised Dec'21 target price of Rs 1,150 (from Rs 980), set at a higher one-year forward P/E multiple of 18.8x (from 17x earlier). The revision in multiple comes on the back of four growth pillars:

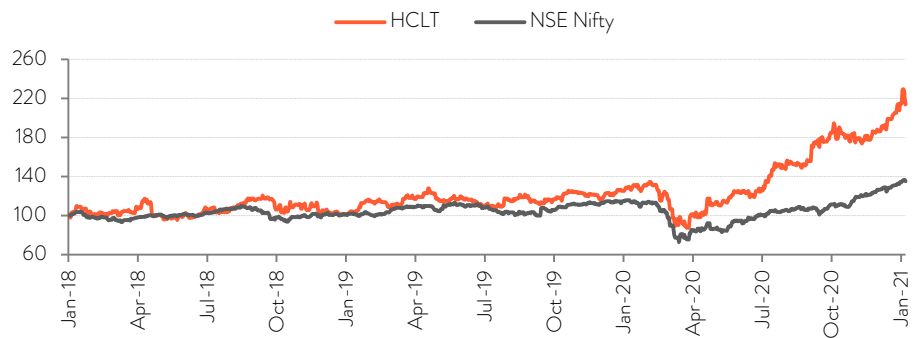
- strong demand environment aided by revival of pent-up demand from Covid-hit verticals such as manufacturing and retail
- demand acceleration in mode-2 services – HCLT has been able to capture the demand due to its ahead-of-the-curve investments, acquired IPs and separate business unit dedicated to hyperscalers.
- rapid product and platform growth with new license TCV up 250% YoY, aiding 9.3% CC revenue growth in Q3
- robust client relationships which helped secure deal renewals

Our target price revision also 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 stronger near-to-mid-term growth visibility for HCLT than peers on the back of its growing Mode-3 software business (which forms ~16% of revenue and is relatively immune to Covid-led volatility), healthy large deal wins (13 contracts won in Q3FY21), and IMS heritage that offers a 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)	10,106	10,174	0.7	11,169	11,330	1.4	12,222	12,399	1.4
YoY growth (%)	1.7	2.4	-	10.5	11.4	-	9.4	9.4	-
Revenues	761,595	759,502	(0.3)	871,156	866,906	(0.5)	953,334	967,129	1.4
EBITDA	199,470	203,155	1.8	233,720	232,633	(0.5)	257,680	261,409	1.4
EBITDA margins (%)	26.2	26.7	-	26.8	26.8	-	27.0	27.0	-
EBIT margins (%)	20.8	21.5	-	21.7	21.6	-	22.0	22.1	-
Net profits	124,883	134,698	7.9	147,851	149,993	1.4	166,274	171,473	3.1
EPS (Rs)	46.0	49.6	7.9	54.5	55.3	1.4	61.3	63.2	3.1

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, and
- adverse currency movement.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	604,280	706,780	759,502	866,906	967,129
EBITDA	140,020	166,930	203,155	232,633	261,409
Depreciation	21,480	28,400	39,735	44,960	47,736
EBIT	118,540	138,530	163,420	187,673	213,673
Net interest income/(expenses)	(1,693)	0	0	0	0
Other income/(expenses)	7,720	1,790	5,263	3,400	6,165
Exceptional items	0	0	0	0	0
EBT	124,567	140,320	168,683	191,074	219,838
Income taxes	24,810	29,380	33,985	41,081	48,364
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	99,757	110,940	134,698	149,993	171,473
Adjustments	0	0	0	0	0
Adjusted net profit	99,757	110,940	134,698	149,993	171,473

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	265,826	303,417	338,495
Provisions	0	0	15,190	17,338	19,343
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	583,929	661,746	750,706
Shareholders' fund	422,240	522,140	592,021	669,838	758,798
Total liabilities and equities	588,960	832,160	923,967	1,041,523	1,167,566
Cash and cash eq.	59,290	48,430	125,536	264,966	377,494
Accounts receivables	146,100	177,720	197,679	213,758	238,470
Inventories	0	0	0	0	0
Other current assets	37,160	79,030	91,140	86,691	96,713
Investments	58,520	105,680	105,680	105,680	105,680
Net fixed assets	132,396	62,440	41,367	15,536	(12,700)
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	68,355	60,683	67,699
Total assets	588,960	832,160	923,968	1,041,523	1,167,566

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	120,740	139,340	174,433	194,953	219,209
Interest expenses	(4,480)	(1,790)	(5,263)	(3,400)	(6,165)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(24,660)	47,020	(13,848)	35,782	(4,668)
Other operating cash flows	(1,936)	(40,905)	0	0	0
Cash flow from operations	89,664	143,665	155,322	227,334	208,376
Capital expenditures	(34,340)	(150,090)	(18,662)	(19,128)	(19,500)
Change in investments	5,200	47,160	0	0	0
Other investing cash flows	(3,604)	1,790	5,263	3,400	6,165
Cash flow from investing	(32,744)	(101,140)	(13,399)	(15,728)	(13,335)
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)	(64,817)	(72,177)	(82,513)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(14,620)	(53,384)	(64,817)	(72,177)	(82,513)
Changes in cash and cash eq.	42,300	(10,859)	77,106	139,430	112,528
Closing cash and cash eq.	59,290	48,430	125,536	264,966	377,494

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	36.7	40.9	49.6	55.3	63.2
Adjusted EPS	36.7	40.9	49.6	55.3	63.2
Dividend per share	14.7	16.4	19.9	22.1	25.3
Book value per share	155.2	192.4	218.2	246.8	279.6

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	4.4	3.8	3.5	3.1	2.6
EV/EBITDA	19.1	16.0	13.2	11.4	9.7
Adjusted P/E	27.0	24.2	19.9	17.9	15.7
P/BV	6.4	5.1	4.5	4.0	3.5

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	80.1	79.1	79.9	78.5	78.0
Interest burden (PBT/EBIT)	105.1	101.3	103.2	101.8	102.9
EBIT margin (EBIT/Revenue)	19.6	19.6	21.5	21.6	22.1
Asset turnover (Revenue/Avg TA)	112.6	99.5	86.5	88.2	87.6
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.6	1.6	1.5
Adjusted ROAE	25.2	23.5	24.2	23.8	24.0

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	7.5	14.1	11.6
EBITDA	22.4	19.2	21.7	14.5	12.4
Adjusted EPS	16.3	11.5	21.4	11.4	14.3
Profitability & Return ratios (%)					
EBITDA margin	23.2	23.6	26.7	26.8	27.0
EBIT margin	19.6	19.6	21.5	21.6	22.1
Adjusted profit margin	16.5	15.7	17.7	17.3	17.7
Adjusted ROAE	25.2	23.5	24.2	23.8	24.0
ROCE	24.9	23.4	24.8	30.0	37.1
Working capital days (days)					
Receivables	81	84	90	87	85
Inventory	0	0	0	0	0
Payables	92	130	172	164	166
Ratios (x)					
Gross asset turnover	4.8	7.3	14.6	30.5	682.2
Current ratio	2.3	1.4	1.7	2.0	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%

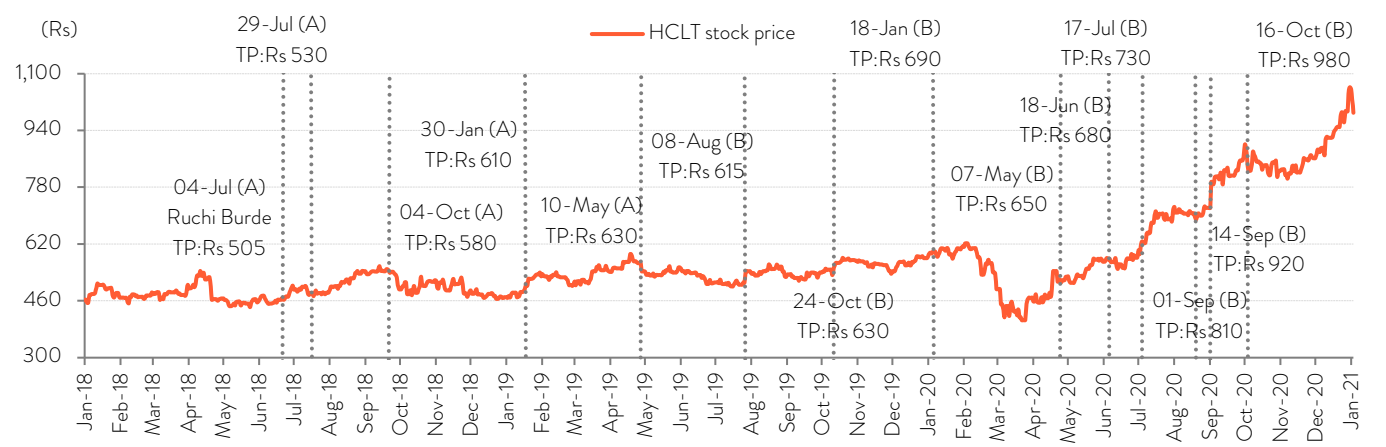
ADD – Expected return from >+5% to +15%

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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