

BUY**TP: Rs 1,610 | ▲ 20%****HCL TECHNOLOGIES**

Technology & Internet

14 January 2022

Major growth beat; mode-3 drives momentum

- HCL Tech (HCLT) reported stellar growth of 6.7% QoQ USD, beating our estimate of 3.5%
- FY22 double digit growth guidance intact. FY22 EBIT margin guidance stands at 19-21%
- Factoring Q3FY22 numbers, we raise FY23/24 EPS by 1%/4%; maintain BUY with a revised TP of Rs1,610.

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Significant growth beat: HCLT reported growth of 6.7% QoQ USD, outperforming our estimate of 3.5%. This growth is the highest yet among the four results announced. The growth was led by traction in mode-3 services which grew 20.3% QoQ USD (best growth in last 9 quarters). Products and platforms growth was driven by both renewals and new licenses. Mode-1 and 2 showed moderate growth of 4-5.5%. The growth was broad based geography wise. Within verticals, BFSI grew 5.7% while retail, media and entertainment and technology services grew roughly by double digits each. HCLT is seeing a lot of traction in ER&D services (driven by IoT) and cloud. It has guided for double digit revenue growth for full year.

Margin miss: EBIT margin stood at 19%, up 10bps QoQ, underperformed our estimate of 19.7%. SG&A expenses and employee costs both increased QoQ. Services margin dropped by 190bps, which was offset by P&P margins. 190 bps impact included: (1) 80bps from salary increments (2) 65bps from seasonal leaves (3) 40 bps impact from investments (4) 85bps retention and attrition costs.; offset by tailwinds of 60bps from operational efficiency, 20bps from cross currency.

TCV robust: TCV at USD2.13bn was flattish QoQ, up 64% YoY and a total of 16 new transformational deals were signed. Bookings and pipeline continue to be strong. The deal cycles have become shorter due to faster digital transformation adoption. Cloud has become one of the key deal win drivers for HCLT and AWS offerings have been expanded.

Attrition goes up: Attrition stood at 19.8% in Q3, up 410bps QoQ. Company hired ~10,000 employees in Q3. HCLT continues to invest in training to prepare itself for future demand. Management is leaning towards hiring more freshers and is planning to double its fresher hiring in FY23. It has set the campus hiring target for FY22 at 20,000.

Maintain BUY: Factoring in Q3 performance, we maintain BUY with a modest FY23/24 EPS upgrade of 1.4%/3.7% due to lukewarm margin commentary. We revise TP to Rs 1,610 (vs. Rs 1,560 earlier).

Key changes

Target	Rating
▲	◀ ▶

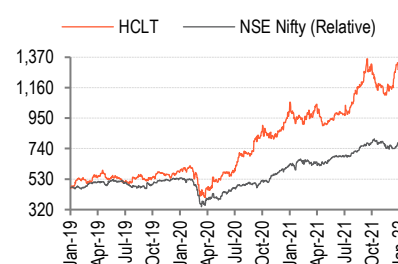
Ticker/Price	HCLT IN/Rs 1,337
Market cap	US\$ 49.0bn
Free float	38%
3M ADV	US\$ 69.2mn
52wk high/low	Rs 1,378/Rs 891
Promoter/FPI/DII	60%/27%/13%

Source: NSE | Price as of 14 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	753,790	858,319	981,214
EBITDA (Rs mn)	200,560	203,408	244,272
Adj. net profit (Rs mn)	130,660	133,013	152,610
Adj. EPS (Rs)	48.1	49.0	56.2
Consensus EPS (Rs)	48.1	49.8	56.7
Adj. ROAE (%)	22.9	20.3	20.9
Adj. P/E (x)	27.8	27.3	23.8
EV/EBITDA (x)	18.0	17.8	14.5
Adj. EPS growth (%)	17.8	1.8	14.7

Source: Company, Bloomberg, BOBCAPS Research

Stock performance

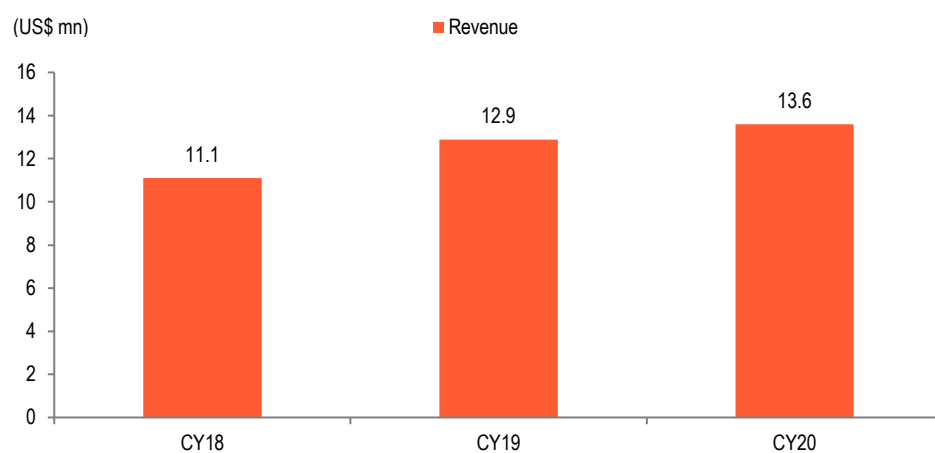
Source: NSE



Other highlights

- **Outlook:** HCLT maintains its products and platforms growth guidance of Q4FY22 at 0-1% due to seasonality. Double-digit overall revenue growth is expected for the full year-FY22. EBIT margin for FY22 is expected to reach 19%. ETR is expected to lie between 21.5%-22% in FY22. For Q4FY22, EBIT margin is expected to see 65bps impact due to seasonality from furloughs.
- Strong client addition was seen across all categories due to better account mining. On YoY basis, USD50 mn+ clients up by 11, USD20 mn+ clients up by 13, USD10 mn+ clients up by 25, and USD5 mn+ clients up by 34, USD1 mn+ clients up by 50.
- HCLT is pressing the peddle on its new vistas project under which it will expand in countries outside India. It has expanded in Sri Lanka, Costa Rica, Romania and US.
- HCLT acquired Hungarian data services company- Starschema, for a cash consideration of USD42.5mn. The transaction is expected to close by March. The company provides consulting, technology and managed services in data engineering to Global 2000 companies in the U.S. and Europe. The acquisition powers HCLT's mode-2 services and enhances its presence in Europe.

Fig 1 – Starschema revenue



Source: BOBCAPS Research, Company

- Board announced an interim dividend of Rs 10/sh.

Fig 2 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenues (US\$ mn)	2,978	2,617	13.8	2,791	6.7	8,488	7,479	13.5
Revenue	223,310	193,020	15.7	206,550	8.1	630,540	557,370	13.1
Operating Expenditure	170,890	138,600	23.3	158,170	8.0	480,660	407,780	17.9
Cost of revenues	139,280	111,950	24.4	127,580	9.2	388,830	328,520	18.4
as % of sales	62.4	58.0	-	61.8	-	61.7	58.9	-
SG&A expenses	31,610	26,650	18.6	30,590	3.3	91,830	79,260	15.9
as % of sales	14.2	13.8	-	14.8	-	14.6	14.2	-
EBITDA	52,420	54,420	(3.7)	48,380	8.4	149,880	149,590	0.2
Depreciation	9,910	10,270	-	9,220	-	28,900	28,680	0.8
EBIT	42,510	44,150	(3.7)	39,160	8.6	120,980	120,910	0.1
Other Income	2,030	1,270	-	2,070	-	6,040	4,680	29.1
PBT	44,540	45,420	(1.9)	41,230	8.0	127,020	125,590	1.1
Total Tax	9,970	5,440	-	8,460	-	27,370	24,720	10.7
Adjusted PAT	34,570	39,980	(13.5)	32,770	5.5	99,650	100,870	(1.2)
(Profit)/loss from JV's/Ass/MI	(140)	(160)	-	(130)	-	(430)	(400)	-
APAT after MI	34,430	39,820	(13.5)	32,640	5.5	99,220	100,470	(1.2)
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	34,430	39,820	(13.5)	32,640	5.5	99,220	100,470	(1.2)
Reported EPS	12.7	14.7	(13.5)	12.0	5.5	37	37	(1.2)
Margins (%)			(bps)		(bps)			(bps)
EBIDTA	23.5	28.2	(470)	23.4	10	23.8	26.8	(310)
EBIT	19.0	22.9	(380)	19.0	10	19.2	21.7	(250)
EBT	19.9	23.5	(360)	20.0	-	20.1	22.5	(240)
PAT	15.4	20.6	(520)	15.8	(40)	15.7	18.0	(230)
Effective Tax rate	22.4	12.0	1,040	20.5	190	21.5	19.7	190

Source: BOBCAPS Research, Company

Fig 3 – Operating metrics

(US\$ terms)	Q3FY22 (% contri to revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue Breakup by business segment (in %)			
Mode 1	59.5	4.2	11.0
Mode 2	25.5	5.5	27.8
Mode 3	15.0	20.3	4.7
Revenue Breakup by Geography (in %)			
US	63.1	7.2	14.9
Europe	28.3	6.7	9.2
Asia Pacific	8.7	4.3	23.7
Revenue by Service Offering(in %)			
IT and Business Services	70.6	3.8	14.1
Engineering and R&D Services	15.9	8.1	16.7
Products & Platforms	13.5	23.1	9.0
Revenues by industry (in %)			
BFSI	21.1	5.7	12.2
Retail	10.1	10.0	9.5

(US\$ terms)	Q3FY22 (% contri to revenue)	Growth	
		QoQ (%)	YoY (%)
Media, Publishing & Entertainment	8.1	9.4	11.1
Life Sciences	14.4	0.4	19.6
Energy Utilities -Public Sector	10.4	4.7	13.8
Manufacturing	17.5	4.3	10.0
Technology Services	18.4	14.1	17.6
Client Contribution to revenues (in %)			
Top 5, %	12.2	2.5	2.8
Top 10, %	20.3	4.6	10.0
Top 20, %	29.4	4.9	8.3
	Dec'21	Sep'21	Dec'20
Total Employees	197,777	187,634	159,682
Net Addition	10,143	11,135	6,597
Attrition	19.8	15.7	10.2
Revenues by Contract Type (in %)			
Time & material	34.5	35.4	31.6
Fixed Price	65.5	64.6	68.4

Source: BOBCAPS Research, Company

Valuation methodology

HCLT management commentary has been upbeat regarding growth momentum. However, Q4FY22 is expected to see seasonal impact from 'product and platforms' business growth moderation and margin impact due to leaves. Factoring in Q3FY22 performance, we raise FY23/24 EPS by 1.4%/3.7%. The upward EPS revision has been limited due to possibility of growth moderation for mode-3 services and margin impact from investments in talent retention measures. We keep our one year forward target PE unchanged at 26x. Maintain BUY with a new TP of Rs1,610 (vs. Rs 1,560 earlier).

Fig 4 – Revised estimates

(Rs mn)	New			Old			Change		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	11,525	12,911	14,128	11,344	12,521	13,701	1.6	3.1	3.1
YoY Growth (%)	13.3	12.0	9.4	11.5	10.4	9.4	-	-	-
Revenues	858,319	981,214	1,073,707	843,828	951,573	1,041,272	1.7	3.1	3.1
EBITDA	203,408	244,272	269,747	206,636	241,493	261,598	(1.6)	1.2	3.1
EBITDA margin (%)	23.7	24.9	25.1	24.5	25.4	25.1	-	-	-
EBIT margin (%)	19.1	19.9	20.4	19.8	20.2	20.2	-	-	-
Net profits	133,013	152,610	172,221	133,419	150,521	166,044	(0.3)	1.4	3.7
EPS (Rs)	49.0	56.2	63.5	49.2	55.5	61.2	(0.3)	1.4	3.7

Source: BOBCAPS Research

Fig 5 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Services revenue (US\$ mn)	10,175	11,525	12,911	14,128
YoY Growth (%)	2.4	13.3	12.0	9.4
EBIT Margin (%)	21.3	19.1	19.9	20.4

Source: Company, BOBCAPS Research

Fig 6 – Peer comparison

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		RoE (%)		P/E (x)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	BUY	4,770	14.1	104.0	120.3	39.6	37.5	38.1	33.0
INFO IN	BUY	2,250	17.1	54.4	62.3	29.8	32.0	35.5	31.0
WPRO IN	BUY	850	18.2	22.6	26.9	20.5	21.6	28.3	23.8
HCLT IN	BUY	1,610	12.6	49.0	56.2	20.3	20.9	27.3	23.8
TECHM IN	BUY	1,970	16.1	65.5	81.1	21.5	23.6	26.5	21.4
LTI IN	BUY	8,270	21.4	132.0	162.5	29.0	30.1	53.6	43.5
MPHL IN	HOLD	3,650	17.0	76.6	95.0	21.1	24.2	42.6	34.4
MTCL IN	BUY	5,610	23.9	97.9	105.3	34.2	31.0	46.4	43.2
PSYS IN	HOLD	4,240	24.8	78.5	93.1	21.0	21.7	56.6	47.8
COFORGE IN	BUY	7,040	27.5	123.4	173.2	27.9	33.1	46.1	32.9
ECLX IN	BUY	3,690	22.9	125.8	143.6	27.0	28.4	22.7	19.9

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- Growth slowdown due to covid third wave.
- High attrition impacting margins

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Coforge	COFORGE IN	4.8	5,689	7,040	BUY
eClerx Services	ECLX IN	1.4	2,851	3,690	BUY
HCL Technologies	HCLT IN	49.0	1,337	1,610	BUY
Infosys	INFO IN	110.9	1,929	2,250	BUY
L&T Infotech	LTI IN	16.8	7,078	8,270	BUY
Mindtree	MTCL IN	10.1	4,548	5,610	BUY
Mphasis	MPHL IN	8.2	3,264	3,650	HOLD
Persistent Systems	PSYS IN	4.8	4,446	4,240	HOLD
Tata Consultancy Services	TCS IN	201.0	3,968	4,770	BUY
Tech Mahindra	TECHM IN	20.5	1,738	1,970	BUY
Wipro	WPRO IN	47.7	640	850	BUY

Source: BOBCAPS Research, NSE | Price as of 14 Jan 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	706,780	753,790	858,319	981,214	1,073,707
EBITDA	166,930	200,560	203,408	244,272	269,747
Depreciation	28,400	39,850	39,256	49,367	51,115
EBIT	138,530	160,710	164,152	194,905	218,632
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	1,790	6,580	6,767	5,898	7,974
Exceptional items	0	0	0	0	0
EBT	140,320	167,290	170,919	200,803	226,607
Income taxes	29,380	36,630	37,906	48,193	54,386
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	110,940	130,660	133,013	152,610	172,221
Adjustments	0	0	0	0	0
Adjusted net profit	110,940	130,660	133,013	152,610	172,221

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	259,090	217,050	300,412	343,425	375,798
Provisions	0	0	17,166	19,624	21,474
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	681,255	760,430	849,778
Shareholders' fund	522,140	620,910	689,917	769,092	858,440
Total liab. and equities	832,160	877,030	1,046,565	1,171,211	1,294,782
Cash and cash eq.	48,430	65,150	187,434	274,425	373,071
Accounts receivables	177,720	175,250	211,640	241,943	264,750
Inventories	0	0	0	0	0
Other current assets	79,030	74,290	85,832	98,121	107,371
Investments	105,680	140,220	168,264	185,090	203,599
Net fixed assets	62,440	62,450	41,813	11,446	(20,669)
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	60,082	68,685	75,160
Total assets	832,160	877,030	1,046,565	1,171,210	1,294,781

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	143,665	78,334	226,186	190,355	211,053
Capital expenditures	(150,090)	(39,860)	(18,618)	(19,000)	(19,000)
Change in investments	47,160	34,540	28,044	16,826	18,509
Other investing cash flows	1,790	6,580	(49,322)	(27,755)	(29,044)
Cash flow from investing	(101,140)	1,260	(39,896)	(29,929)	(29,535)
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)	(64,006)	(73,436)	(82,873)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(53,384)	(62,874)	(64,006)	(73,436)	(82,873)
Chg in cash & cash eq.	(10,859)	16,720	122,283	86,990	98,646
Closing cash & cash eq.	48,430	65,151	187,434	274,425	373,071

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	40.9	48.1	49.0	56.2	63.5
Adjusted EPS	40.9	48.1	49.0	56.2	63.5
Dividend per share	16.4	19.3	19.6	22.5	25.4
Book value per share	192.4	228.8	254.2	283.4	316.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	5.1	4.8	4.2	3.6	3.2
EV/EBITDA	21.6	18.0	17.8	14.5	12.7
Adjusted P/E	32.7	27.8	27.3	23.8	21.1
P/BV	6.9	5.8	5.3	4.7	4.2

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	79.1	78.1	77.8	76.0	76.0
Interest burden (PBT/EBIT)	101.3	104.1	104.1	103.0	103.6
EBIT margin (EBIT/Revenue)	19.6	21.3	19.1	19.9	20.4
Asset turnover (Rev./Avg TA)	99.5	88.2	89.2	88.5	87.1
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.5	1.5	1.5
Adjusted ROAE	23.5	22.9	20.3	20.9	21.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	17.0	6.7	13.9	14.3	9.4
EBITDA	19.2	20.1	1.4	20.1	10.4
Adjusted EPS	11.5	17.8	1.8	14.7	12.9
Profitability & Return ratios (%)					
EBITDA margin	23.6	26.6	23.7	24.9	25.1
EBIT margin	19.6	21.3	19.1	19.9	20.4
Adjusted profit margin	15.7	17.3	15.5	15.6	16.0
Adjusted ROAE	23.5	22.9	20.3	20.9	21.2
ROCE	23.4	22.2	22.3	27.3	31.1
Working capital days (days)					
Receivables	84	85	82	84	86
Inventory	0	0	0	0	0
Payables	130	157	144	159	163
Ratios (x)					
Gross asset turnover	7.3	12.1	16.5	36.8	(232.8)
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%

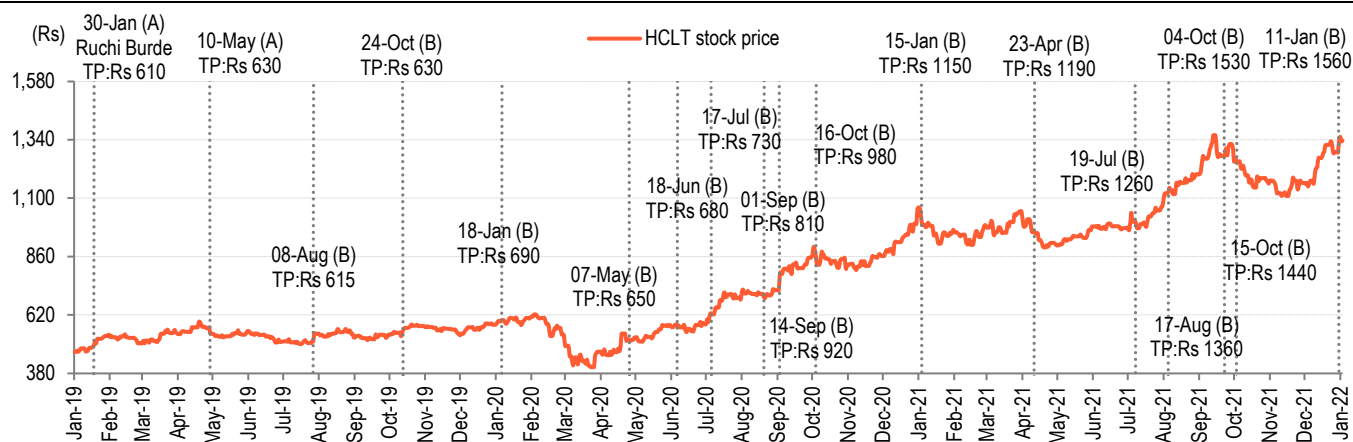
HOLD – Expected return from -6% to +15%

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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