

Result in-line, commentary comforting across biz., Order Book reassures

- HCLT reported 0.8% QoQ growth in CC terms (our estimate: 1.4%) led by 7.1% QoQ growth in Mode 2 covering up for 0.4%/1% QoQ decline in Mode 1/Mode 3. OPM improved by 60bps to 20.9% (DE: 20.3%) driven by one-off margins gains in Mode 2 (Q4:18.1% up ~290bps QoQ)
- HCLT didn't offer guidance for FY21 due to uncertainty in environment despite 12% order book growth YoY (Order pipeline soften in April but reviving now). HCLT expects growth to come in H2 as ramp up of deals (14 transformational deals wins in Q4) will begin only in Q2.
- ER&D segment de-grew 1.8% QoQ in CC terms as it could not access client labs due to COVID led restrictions but most of these concerns are resolved by May'20. Product & Platform continues to perform well (IBM IP quarterly run rate at US\$160mn) with expectations of limited impact as it is experiencing sustainability in renewals and strong demand momentum for its offerings in Digital Commerce and Security.
- With strong lead indicators and expectations of performance revival in H2, we largely retain our estimates building in CC revenue and EPS CAGR of ~5%/5% over FY20-22E. We have an Accumulate rating on the stock with TP of ₹560 valued at 12.5x PER on FY22E EPS (10% disc. to Infy).

Strong Order Book to provide support stability in Q2 and recovery in H2

HCLT reported 14 transformational deals wins (order book up 12% in FY20) which were largely won in Jan/Feb with slowed momentum in March. Business uncertainty remains as pipeline was weak in March and April first half, but has revived since then in last 3 weeks (pipeline consists 3-4 consolidation deals). Clients have requested delays in ramp-up but discretionary spends have not been deferred (barring in few EN deals). Certain Clients have requested for temporary price cuts, furloughs for on-site and extended payment terms. Supply challenges (1.5% of workforce) have been largely solved in May. Thus, we broadly subscribe to its commentary for stability by Q2 (decline in Q1) and then revival in H2FY21.

OPM largely to remain stable, no wage related actions initiated

OPM margin improved 60bps QoQ largely driven by ~50bps impact from Currency, negative 12bps from increased amortisation and 22bps from productivity. Profitability in Mode2/Mode3 expected to be neutralized given planned investments in innovation/amortisation respectively. We expect 40bps decline YoY in OPM at 19.2% in FY21.

Q4FY20 Result (₹ Mn)

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Revenue	185,900	159,900	16.3	181,350	2.5
Total Expense	138,700	123,930	11.9	136,650	1.5
EBITDA	47,200	35,970	31.2	44,700	5.6
Depreciation	8,390	5,580	50.4	8,000	4.9
EBIT	38,810	30,390	27.7	36,700	5.7
Other Income	(130)	1,520	(108.6)	670	(119.4)
Interest	0	0		0	
EBT	38,680	31,910	21.2	37,370	3.5
Tax	7,070	6,150	15.0	6,910	2.3
RPAT	31,530	25,680	22.8	30,380	3.8
APAT	31,530	25,680	22.8	30,380	3.8
			(bps)		(bps)
Gross Margin (%)	38.3	34.8	342	36.5	172
EBITDA Margin (%)	25.4	22.5	289	24.6	74
NPM (%)	17.0	16.1	90	16.8	21
Tax Rate (%)	18.3	19.3	(99)	18.5	(21)
EBIT Margin (%)	20.9	19.0	187	20.2	64

CMP	₹ 512
Target / Upside	₹ 560 / 10%
BSE Sensex	31,505
NSE Nifty	9,271

Scrip Details

Equity / FV	₹ 5,430mn / ₹ 2
Market Cap	₹ 1,389bn
	US\$ 18bn
52-week High/Low	₹ 624/₹ 375
Avg. Volume (no)	6,041,370
NSE Symbol	HCLTECH
Bloomberg Code	HCLT IN

Shareholding Pattern Mar'20(%)

Promoters	60.0
MF/Banks/FIs	8.4
FII	27.7
Public / Others	4.0

Valuation (x)

	FY20A	FY21E	FY22E
P/E	12.5	12.2	11.4
EV/EBITDA	8.4	7.5	6.3
ROE (%)	23.8	20.3	18.6
RoACE (%)	21.3	18.0	16.9

Estimates (₹ mn)

	FY20A	FY21E	FY22E
Revenue	706,780	760,004	821,932
EBITDA	166,930	182,575	200,958
PAT	111,451	113,466	121,910
EPS (₹)	41.0	41.8	44.9

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Exhibit 1: Quarterly performance versus estimates

(in ₹ mn)	Actual	Estimates		% Variation		Comment
		Dolat	Consensus	Dolat	Consensus	
Revenues (in US\$ mn)	2,544	2,567	2,416	(0.9)	5.3	USD Revenues below estimate due to one-time COVID impact in loss of billing of about ~50bps
Sales	185,900	185,752	184,729	0.1	0.6	
EBIT	38,810	37,744	36,349	2.8	6.8	EBIT Margin above estimate due to one-time high margin in Mode 2.
EBIT Margin (%)	20.9	20.3	19.7	60 bps	120 bps	
PAT	31,530	29,626	28,844	6.4	9.3	PAT above estimates, beat was partially offset by Fx loss.

Source: Company, DART

Change in estimates

Factoring the near term caution and gradual recovery only by H2FY21 with revised USD/INR rate of Rs74/75, we have curtailed our revenue growth estimates marginally by 1.5% and 0.4% respectively for FY21/22E. However, given the strong Q4 OPM performance and stable performance in P&P business (32%+ Segment OPM) we have revised up our OPM estimates by 30bps for FY21/22E. We believe favourable mix and superior Fx realisations would cover up for lower growth and increased near term cost pressures (lower utilization and fresher intake).

Exhibit 2: Change in estimates

(₹ mn)	FY20			FY21E			FY22E		
	Old	Actual	% change	Old	New	% change	Old	New	% Change
Revenues (US\$ mn)	9,959	9,936	(0.2)	10,566	10,270	(2.8)	11,301	10,959	(3.0)
YoY growth (%)	15.4%	15.1%		6.1%	3.4%		7.0%	6.7%	
Revenues	706,632	706,780	0.0	771,296	760,004	(1.5)	825,006	821,932	(0.4)
YoY growth (%)	16.9	17.0		9.2	7.5		7.0	8.1	
EBIT	137,464	138,530	0.8	145,881	145,959	0.1	156,012	157,434	0.9
EBIT Margin (%)	19.5	19.6		18.9	19.2		18.9	19.2	
Net profits	109,036	111,451	2.2	113,399	113,466	0.1	121,930	121,910	0.0
EPS (₹)	40.2	41.0	2.0	41.8	41.8	(0.1)	45.0	44.9	(0.2)

Source: Company, DART

Exhibit 3: Key assumptions in our estimates

Metrics	FY21E	FY22E
USD Revenue growth (%)	3.4	6.7
USD/INR	74.0	75.0
INR Revenue growth (%)	7.5	8.1
EBIT Margins (%)	19.2	19.2
EPS growth (%)	1.8	7.4

Source: Company, DART

Exhibit 4: Key Revenue growth matrix (% YoY)

YoY Growth	FY19	FY20	Q1FY20	Q2FY20	Q3FY20	Q4FY20
CC Growth	11.8	16.7	17.0	20.5	16.4	13.5
USD Growth	10.1	15.1	15.0	18.4	15.5	11.7
INR Growth	19.5	17.0	18.4	17.9	15.5	16.3

Source: Company, DART

Exhibit 5: Quarterly and Full Year Performance Trends

₹ mn	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	YoY (%)	QoQ (%)	FY19	FY20	YoY (%)
Revenues(US\$ mn)	2,277.8	2,363.6	2,485.4	2,543.0	2,544.0	11.7	0.0	8,632.4	9,936.0	15.1
Revenue	159,900	164,250	175,280	181,350	185,900	16.3	2.5	604,280	706,780	17.0
Operating Exp.	123,930	130,250	134,250	136,650	138,700	11.9	1.5	464,590	539,850	16.2
Cost of revenues	104,210	109,200	113,860	115,100	114,790	10.2	(0.3)	392,680	452,950	15.3
<i>as % of sales</i>	<i>65.2</i>	<i>66.5</i>	<i>65.0</i>	<i>63.5</i>	<i>61.7</i>			<i>65.0</i>	<i>64.1</i>	
SG&A expenses	19,720	21,050	20,390	21,550	23,910	21.2	11.0	71,910	86,900	20.8
<i>as % of sales</i>	<i>12.3</i>	<i>12.8</i>	<i>11.6</i>	<i>11.9</i>	<i>12.9</i>			<i>11.9</i>	<i>12.3</i>	
EBITDA	35,970	34,000	41,030	44,700	47,200	31.2	5.6	139,690	166,930	19.5
Depreciation	5,580	5,950	6,060	8,000	8,390			21,480	28,400	32.2
EBIT	30,390	28,050	34,970	36,700	38,810	27.7	5.7	118,210	138,530	17.2
Other Income	1,520	1,280	(30)	670	(130)			8,050	1,790	(77.8)
PBT	31,910	29,330	34,940	37,370	38,680	21.2	3.5	126,260	140,320	11.1
Total Tax	6,150	7,050	8,350	6,910	7,070			24,810	29,380	18.4
Adjusted PAT	25,760	22,280	26,590	30,460	31,610	22.7	3.8	101,450	110,940	9.4
APAT after MI	25,840	22,360	26,670	30,540	31,690	22.6	3.8	101,670	111,260	9.4
Reported EPS	9.5	8.2	9.8	11.2	11.6	22.8	3.8	36.8	40.8	10.8
Margins (%)						(bps)	(bps)			
EBIDTA	22.5	20.7	23.4	24.6	25.4	289	74	23.1	23.6	50
EBIT	19.0	17.1	20.0	20.2	20.9	187	64	19.6	19.6	4
EBT	20.0	17.9	19.9	20.6	20.8	85	20	20.9	19.9	(104)
PAT	16.2	13.6	15.2	16.8	17.0	89	21	16.8	15.7	(108)
Effective Tax rate	19.3	24.0	23.9	18.5	18.3	(99)	(21)	19.6	20.9	129

Source: DART, Company

What to expect next Quarter

We expect revenue decline of about 2.6% QoQ (much lower than other Tier I peers) and OPM decline of about 207bps to 18.8%. Better-than-peer's revenue expectations confidence is emanating from the fact that the impact in Q4 was minimal and pipeline and supply side pains have already started getting negated and just had impact for only one month.

Exhibit 6: What to expect next Quarter

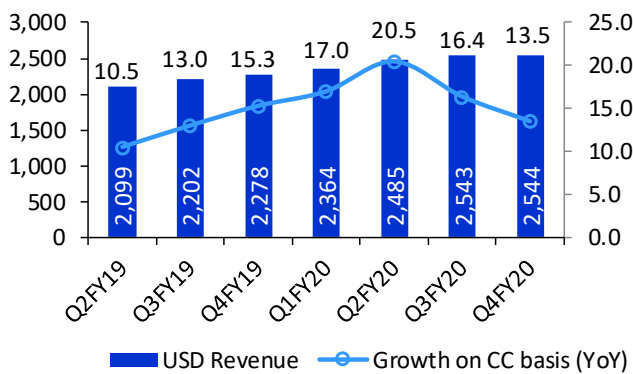
(₹ Mn)	Q1FY21E	Q4FY20	Q1FY20	YoY (%)	QoQ (%)
Sales (US\$ mn)	2,478	2,544	2,364	4.9	(2.6)
Sales	183,408	185,900	164,250	11.7	(1.3)
EBIT	34,496	38,810	28,050	23.0	(11.1)
PAT	26,909	31,530	22,200	21.2	(14.7)
EPS (₹)	9.9	11.6	8.2	21.2	(14.7)
EBIT Margin (%)	18.8	20.9	17.1	173 bps	(207 bps)

Source: DART, Company

Revenue growth skewed; Deal Ramp-up Q2 onwards to drive recovery in H2

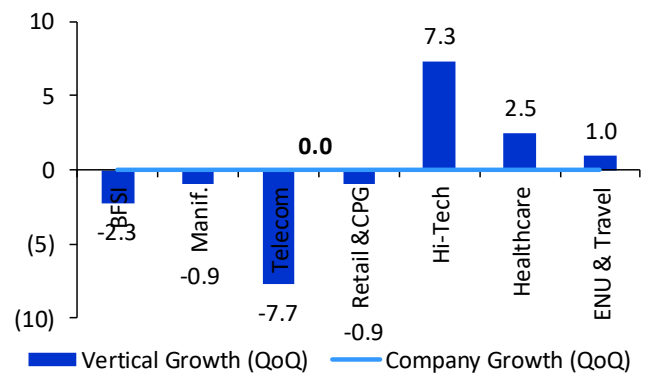
Revenue grew 0.8% QoQ and was led by strong performance in Mode 2 (up 7.1% QoQ). Revenue growth was skewed in terms of Verticals (Hi-tech grew 7.3% in USD terms) and Client Segment (revenues degrew for Top5/10/20 client's buckets). BFSI Vertical is expected to face limited impact as Banks intend to continue their Digitalization spends (towards digital banking and channels) amid crisis. Expect BFSI and Telecom vertical to witness lower impact. Tech is witnessing strong demand momentum and alongwith Healthcare segment is largely insulated to COVID related impact. Oil & Gas to witness some outsourcing demand led by vendor consolidation drive. Manufacturing (especially Auto/Aero), Non Grocery Retail is expected to underperform. IT Services and ER&D segment expected to see recovery by H2FY21 supported by 12% growth in order book in FY20. Products & Platform business is performing well with current full year run-rate of \$640mn. (v/s initial expectations of \$625mn) and is expected to do well as demand remains strong for Commerce/Security products and renewals are largely stable.

Exhibit 7: Revenue grew 13.5% YoY in CC terms



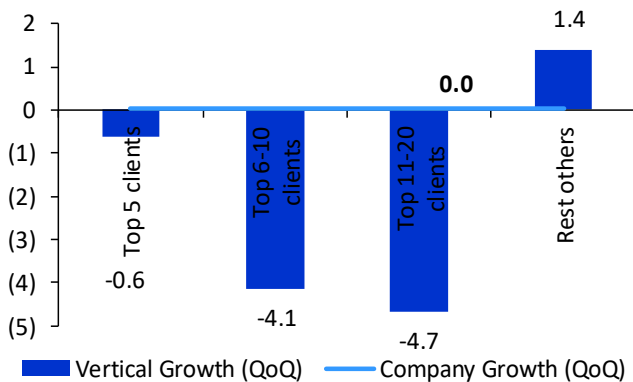
Source: Company, DART

Exhibit 8: Vertical-wise v/s Company (\$ growth)



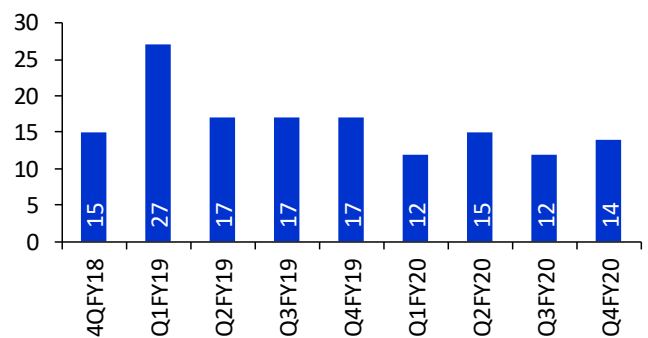
Source: Company, DART

Exhibit 9: Client buckets and Co. Growth (in \$ terms)



Source: Company, DART

Exhibit 10: Trends in Transformational Deal wins

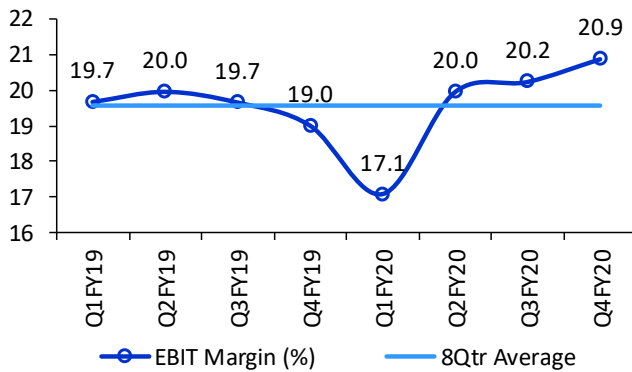


Source: Company, DART

OPM structurally resilient, no wage actions initiated

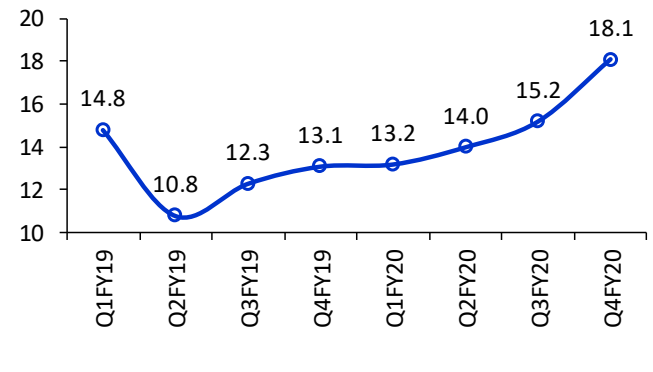
OPM margin improved 60bps QoQ largely driven by ~50bps gains from Currency, negative 12bps impact from increased amortisation and 22bps gains from increased productivity. HCLT do not plan to cut any wages and instead has already taken proactive measures by slowing down of hiring and changes in variable component to reflect business conditions. HCLT will honor (15,000) campus offers. OPM should broadly remain resilient on annualized basis. The gains in Mode 2 in Q4 would get neutralized going forwards as investments would continue here (GM in Mode 2 are high but investments (in talent/technology) would negate the gains at OPM levels). In P&P business, current profitability is about 32% but ideally should go down by ~200bps as there would be sustained investments towards sales & marketing and also increase in amortization for some more time as contracts in IBM deals would largely move to HCLT over FY20-FY21 leading to increased impairments (amortization to move up by 80mn\$ in FY21 over FY20 on IBM IPR).

Exhibit 11: Operating leverage driving OPM gains



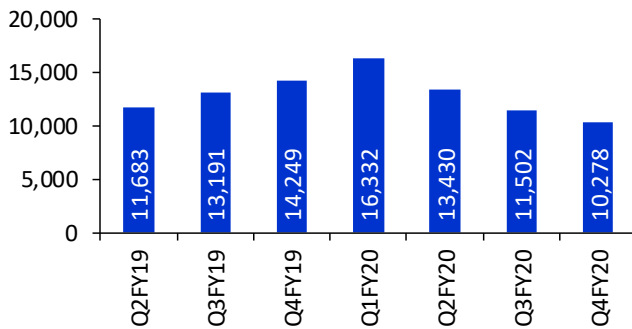
Source: Company, DART

Exhibit 12: Mode 2 OPM improved 290bps QoQ



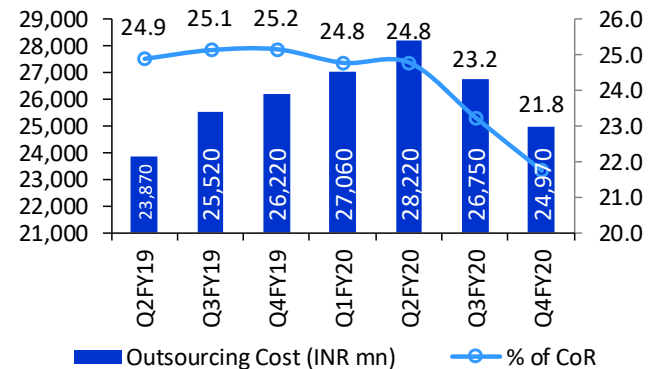
Source: Company, DART

Exhibit 13: Gross Addition Trends



Source: Company, DART

Exhibit 14: Outsourcing Cost under check



Source: Company, DART

Exhibit 15: Segment Breakup

Segment Breakup	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Segment Amount (\$ mn)								
Mode 1	1,506	1,511	1,562	1,606	1,662	1,665	1,679	1,656
Mode 2	321	336	377	431	444	455	462	488
Mode 3	226	250	263	241	258	365	402	400
Segment Growth YoY (%)								
Mode 1				2.9	10.3	10.2	7.5	3.1
Mode 2				43.7	38.6	35.5	22.5	13.4
Mode 3				36.2	14.0	46.3	53.1	65.7
Segment Growth CC QoQ (%)								
Mode 1	0.5	1.4	3.9	2.5	4.1	1.2	0.3	-0.4
Mode 2	8.2	5.3	13.1	14.3	3.6	3.0	1.1	7.1
Mode 3	11.7	10.4	6.2	(7.6)	6.5	42.0	11.1	-1.0
Segmental OPM (%)								
Mode 1	19.9	21.2	20.7	20.5	17.8	20.0	19.9	19.6
Mode 2	14.8	10.8	12.3	13.1	13.2	14.0	15.2	18.1
Mode 3	25.2	24.4	23.0	18.8	19.0	27.1	27.3	29.6

Source: DART, Company

Exhibit 16: P&P and other tech metrics update

Particulars	Key Highlights
AppScan Update	HCL announced new version of AppScan to be released in April. AppScan is a single solution for automated application security testing and management activities
Unica Version 12	HCL has announced version 12 of Unica to be available in April. The new version has over 200 enhancements, 25 new features, 90+ native reports, and a new UI/UX.
BigFix Version 10	HCL announced BigFix 10 to be available in April. BigFix 10 is the only endpoint management platform that enables IT/Security Operations to fully automate discovery, management and remediation.
DRYiCETM Gold BluePrint	HCL upgraded DRYiCETM Gold BluePrint to support the latest ServiceNow release of Orlando.
DRYiCETM OptiBot	HCL launched new version with a range of enhancements, including improved performance, new features, functionality, and improved security.
DRYiCETM iControl	HCL launched new version in Jan 2020

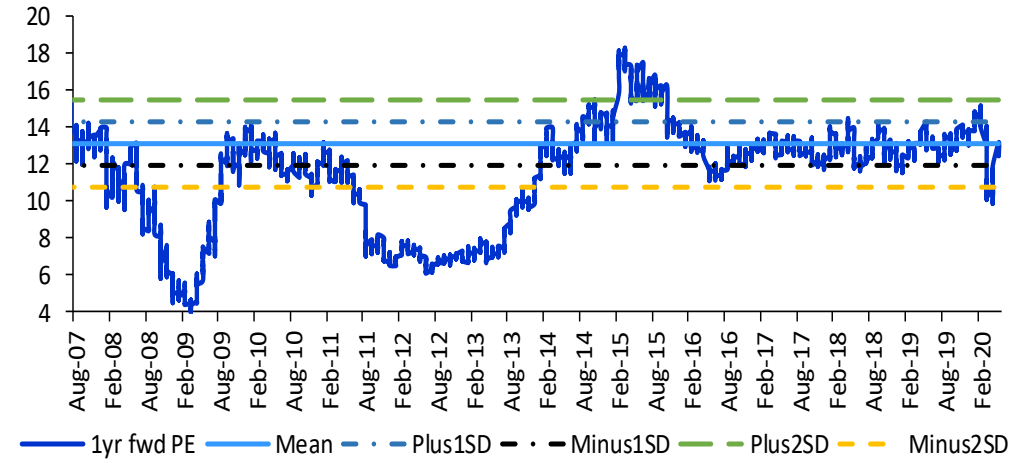
Source: DART, Company

Con-Call Takeaways

- **Demand side factors:** Certain clients have announced Furloughs for onsite resources given Stay-at-home drive. Discretionary spends have not been deferred as such but ramp-ups have delayed a bit in some of the EN deals. Some customers have requested for temporary price discounts mostly for 1 or 2 quarters and some payment terms extension from 30 days to 90 days in some cases. However, no major case of pricing renegotiations is observed.
- **Supply side factors:** HCL Tech has about 1.5% of its resources that that was not billed part of the last quarter and full of April (WFH is about 96% and WFO is nearly 2.5%). Significant part of this business billing loss is recovered in first week of May'20. Supply side challenges are largely resolved barring few issues related to access to labs (client site) or visa related factors.
- **ER&D (16% of revenues):** Business got impacted the most due to COVID as some of the work in this segment needs to be done on client's site. Vertical wise the business segments especially in Manufacturing vertical (especially clients in Auto/Aero) is getting impacted and rest other verticals continues to do well.
- **P&P business (13% of revenues):** Very limited impact due to COVID as customer base is very well distributed across markets/geographies. Experiencing strong velocity on renewals and new wins are coming in Security/Commerce product lines. Incremental revenues are tracking as was thought at the time of the acquisition (US\$160mn run rate for the quarter – ahead of \$156mn guided year ago).
- **Verticals wise:** Manufacturing (Auto/Aero) has biggest negative impact. O&G has opportunities in consolidation. Within Financial Services, Digital banking, digital channels are in good demand; VC is happening across clients. Telecom is very well insulated. Healthcare: some player may see some impact, but Pharma is also insulated, Healthcare Provider – profitability has been impacted as elective surgeries have been delayed. Tech Services is witnessing strong demand.
- **Order book:** Order book is up by 12% YoY for FY20 with Q4 being the best quarter in terms of signings - 14 new transformation deals was signed, just few in month of March. Pipeline was lower in Q4 compared to Q3, as second half of the quarter was impacted by COVID. However, after initial pause till first two weeks in April, pipeline has revived in the last three weeks and has started improving.
- **Recovery path in FY21:** HCLT expects revenues to decline in Q1 and then stabilize in Q2; with growth returning back in H2FY21. Some rebalancing by clients may happen over next few quarters both in terms of vendors' consolidation as well as captive programs (HCL proactively reaching out to captive centers of existing clients in India).
- **Profitability:** OPM should broadly remain resilient on annualized basis. The gains in Mode 2 in Q4 would get neutralize going forwards as investments would continue here (GM is high). In P&P business, current profitability is about 32% but ideally should go down by ~200bps as there would be investments towards sales & marketing and also increase in amortization for some more time.
- **Net cash as of Q4FY20 stands at US\$1.4bn** which is good enough to take care of US\$800mn required towards second tranche of payment towards IBM IP acquisition.

PE Performance

Exhibit 17: 1 year Fwd PER - Trading at 12.4x with its long term mean of ~13x.



Source: Company, DART

Profit and Loss Account

(₹ Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	604,280	706,780	760,004	821,932
Total Expense	464,590	539,850	577,430	620,974
COGS	392,680	452,950	478,388	521,931
Employees Cost	0	0	0	0
Other expenses	71,910	86,900	99,042	99,043
EBIDTA	139,690	166,930	182,575	200,958
Depreciation	21,480	28,400	36,616	43,524
EBIT	118,210	138,530	145,959	157,434
Interest	0	0	0	0
Other Income	8,050	2,301	1,901	3,503
Exc. / E.O. items	0	0	0	0
EBT	126,260	140,831	147,860	160,937
Tax	24,810	29,380	34,394	39,027
RPAT	101,450	111,451	113,466	121,910
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	101,450	111,451	113,466	121,910

Balance Sheet

(₹ Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	2,710	5,430	5,430	5,430
Minority Interest	0	0	0	0
Reserves & Surplus	419,530	508,780	600,526	698,000
Net Worth	422,240	514,210	605,956	703,431
Total Debt	39,860	68,720	68,720	68,720
Net Deferred Tax Liability	0	0	0	0
Total Capital Employed	462,100	582,930	674,676	772,151

Applications of Funds

Net Block	58,010	85,420	126,804	113,280
CWIP	0	0	0	0
Investments	88,900	67,240	67,240	67,240
Current Assets, Loans & Advances	442,050	676,400	739,261	858,510
Inventories	0	910	910	910
Receivables	117,060	141,310	163,810	182,710
Cash and Bank Balances	59,290	48,480	88,841	189,190
Loans and Advances	22,200	69,890	69,890	69,890
Other Current Assets	243,500	415,810	415,810	415,810
Less: Current Liabilities & Provisions	126,860	246,130	258,630	266,880
Payables	111,480	235,650	248,150	256,400
Other Current Liabilities	15,380	10,480	10,480	10,480
Net Current Assets	315,190	430,270	480,631	591,630
Total Assets	462,100	582,930	674,676	772,151

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	35.0	35.9	37.1	36.5
EBIDTA Margin	23.1	23.6	24.0	24.4
EBIT Margin	19.6	19.6	19.2	19.2
Tax rate	19.6	20.9	23.3	24.3
Net Profit Margin	16.8	15.8	14.9	14.8
(B) As Percentage of Net Sales (%)				
COGS	65.0	64.1	62.9	63.5
Employee	0.0	0.0	0.0	0.0
Other	11.9	12.3	13.0	12.1
(C) Measure of Financial Status				
Gross Debt / Equity	0.1	0.1	0.1	0.1
Interest Coverage				
Inventory days	0	0	0	0
Debtors days	71	73	79	81
Average Cost of Debt	0.0	0.0	0.0	0.0
Payable days	67	122	119	114
Working Capital days	190	222	231	263
FA T/O	10.4	8.3	6.0	7.3
(D) Measures of Investment				
AEPS (₹)	37.4	41.0	41.8	44.9
CEPS (₹)	45.4	51.5	55.3	60.9
DPS (₹)	4.9	6.0	8.0	9.0
Dividend Payout (%)	13.0	14.6	19.1	20.0
BVPS (₹)	155.8	189.4	223.2	259.1
RoANW (%)	25.7	23.8	20.3	18.6
RoACE (%)	24.3	21.3	18.0	16.9
RoAIC (%)	31.2	29.6	26.1	26.9
(E) Valuation Ratios				
CMP (₹)	512	512	512	512
P/E	13.7	12.5	12.2	11.4
Mcap (₹ Mn)	1,389,401	1,389,401	1,389,401	1,389,401
MCap/ Sales	2.3	2.0	1.8	1.7
EV	1,369,971	1,409,641	1,369,280	1,268,931
EV/Sales	2.3	2.0	1.8	1.5
EV/EBITDA	9.8	8.4	7.5	6.3
P/BV	3.3	2.7	2.3	2.0
Dividend Yield (%)	1.0	1.2	1.6	1.8
(F) Growth Rate (%)				
Revenue	19.5	17.0	7.5	8.1
EBITDA	22.1	19.5	9.4	10.1
EBIT	18.4	17.2	5.4	7.9
PBT	13.8	11.5	5.0	8.8
APAT	15.5	9.9	1.8	7.4
EPS	18.7	9.7	1.8	7.4
Cash Flow				
(₹ Mn)	FY19A	FY20A	FY21E	FY22E
CFO	89,710	133,590	140,081	154,784
CFI	(30,730)	(123,740)	(78,000)	(30,000)
CFF	(16,540)	(31,260)	(21,720)	(24,435)
FCFF	27,050	54,370	62,081	124,784
Opening Cash	16,570	59,010	26,720	45,321
Closing Cash	59,010	37,600	67,081	145,670

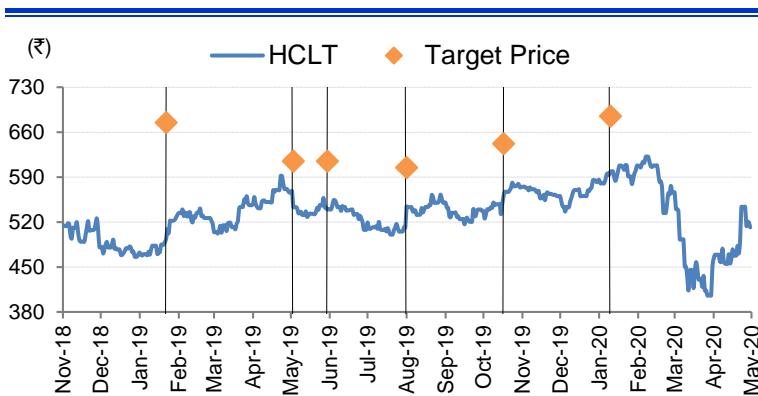
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)
Jan-19	Buy	675	494
May-19	Accumulate	615	543
Jun-19	Accumulate	615	540
Aug-19	Accumulate	605	544
Oct-19	Accumulate	642	560
Jan-20	Accumulate	685	599

*Price as on recommendation date

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