

HCL Technologies

Estimate change	↔
TP change	↑
Rating change	↔

CMP: INR512 **TP: INR615 (+20%)** **Buy**

Good execution; Realistic outlook

Order book growth was encouraging

- HCLT's good execution despite the COVID-19 disruption in Mar'20 was impressive. Strong growth in Mode-2 (~7% QoQ, CC) and acquired IBM products reaching anticipated revenue run-rate (USD150-160m) were key positives. As expected, the company's near-term outlook was cautious given the heightened uncertainty around demand, pricing and payment terms due to COVID-19. However, it is encouraging to note the healthy increase in order book (+12% YoY) and that supply-side issues are largely under control. We plan to keenly monitor the impact of strong cloud adoption on the IMS segment (~37% of revenue) and discretionary spending patterns in ER&D.
- Our estimates remain largely the same over FY20-22E. Maintain **Buy** as we expect HCLT to better navigate the current crisis and emerge stronger on the back of expected increase in enterprise demand for digital services.

Minimal impact due to COVID-19 in Mar'20

- In 4QFY20, Revenue (USD) / EBIT (INR)/PAT increased 12%/28%/23% YoY (v/s est. 12%/21%/14% YoY). Organic/Inorganic revenue grew 6%/7.5% (YoY, CC) in the quarter.
- Strong growth in Mode-2 (+7.1% QoQ, CC) aided the company in reporting industry leading revenue growth during the quarter (0.8% QoQ, CC). Revenues from Mode-1 and Mode-3 were largely stable.
- Across geographies, revenue remained stable despite the COVID-19 crisis. Americas (+1.3% QoQ, CC) and RoW (+0.9% QoQ, CC) grew while Europe showed an insignificant decline.
- Across service lines, IT and Business services grew 1.6% QoQ, largely driven by digital offerings. Given constraints like accessibility of labs in a Work from Home (WFH) situation, ER&D declined 1.8% QoQ.
- EBIT margin at 20.9% (expansion of ~60bp QoQ) was ~100bp higher than our expectations. Key movers were (a) one-off impact in Mode-2, (b) increase in amortization, (c) currency, and (d) productivity in IT services.

Cautious outlook and commentary

- In line with our expectations, the company suspended the practice of providing revenue growth/EBIT margin guidance amidst the heightened uncertainty. Management does expect near-term impact due to COVID-19.
- The company expects some impact on volume-based billing as few clients have shut plants and put employees on furlough. Some deferral of discretionary spends in B2B clients and delay in decision making on new projects is anticipated.
- Management has indicated that order booking in Mar'20 was the strongest in FY20. Comparatively, order book increased 12% YoY at the beginning of FY21. Deal pipeline is healthier now (v/s end-Dec'19). Digital and IT Services continue to see traction in transformation, cloud adoption, workplace, security, etc.

Bloomberg	HCLT IN
Equity Shares (m)	2,721
M.Cap.(INRb)/(USDb)	1388.9 / 18.6
52-Week Range (INR)	624 / 376
1, 6, 12 Rel. Per (%)	9/12/9
12M Avg Val (INR M)	2223

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	707	732	831
EBIT Margin (%)	19.6	18.6	19.6
PAT	111	109	130
EPS (INR)	41.0	40.5	48.3
EPS Gr. (%)	11.3	(1.1)	19.1
BV/Sh. (INR)	179	222	264

Ratios

RoE (%)	24.5	20.2	19.8
RoCE (%)	18.7	14.7	15.1
Payout (%)	19.5	19.7	16.6

Valuations

P/E (x)	12.5	12.6	10.6
P/BV (x)	2.9	2.3	1.9
EV/EBITDA (x)	7.7	7.4	5.7
Div Yield (%)	1.6	1.6	1.6

Shareholding pattern (%)

As On	Dec-19	Sep-19	Dec-18
Promoter	60.0	60.0	60.0
DII	8.5	8.6	8.2
FII	27.7	28.0	28.3
Others	3.9	3.4	3.5

FII Includes depository receipts

- HCLT expects ER&D segment to witness a dip in the coming quarters due to weakness in Auto and Industrial Aero segments.
- Management expects the impact of COVID-19 to be relatively lower on the products and platforms segment (v/s services business).
- Industrial, Auto, Aero, Entertainment and non-essential Retail have witnessed heavy impact due to COVID-19. While BFSI and Telecom verticals saw lower impact, Technology Services and Life Sciences segments have been fairly insulated and witnessed strong traction. Management has also indicated that there are pockets of strong demand in weak verticals and weak demand in verticals that are perceived to be strong.

Valuation and view – Subdued multiples offer margin of safety

- HCLT's exposure to deeply troubled verticals (e.g. Energy, Travel, Transportation, Hospitality, Retail, etc.) is lower than peers. In addition, higher exposure to IMS (~37% of revenue) comprising larger share of non-discretionary spends offers better resilience to its portfolio in the current context. Besides, the company has higher exposure to Financial Services, Technology Services and Manufacturing where we anticipate an uptick in IT spends in a post COVID-19 world.
- However, the company's high exposure to ER&D (~16% of revenue) is a key monitorable. The discretionary nature of projects and supply-side challenges make us cautious on this segment. In addition, we would keenly monitor the impact of strong cloud adoption on IMS (~37% of revenue).
- We expect HCLT to better navigate the current crisis and emerge stronger on back of expected increase in enterprise demand for digital services. Our confidence partly stems from the historical track record of the company in adapting to multiple business challenges and technology change cycles. The stock is currently trading at ~12x on depressed FY21E earnings. Our target price is based on ~13x FY22E EPS.

Quarterly Performance

Y/E March	FY19				FY20				FY19	FY20	(INR b)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			Est.	Var.
											4QFY20	(% / bp)
Revenue (USD m)	2,055	2,099	2,202	2,278	2,364	2,486	2,543	2,543	8,632	9,936	2,558	-0.6
QoQ (%)	0.8	2.1	4.9	3.5	3.8	5.2	2.3	0.0	10.1	15.1	0.6	-60bp
Revenue (INR b)	139	149	157	160	164	175	181	186	605	707	184	0.9
YoY (%)	14.1	19.5	22.9	21.3	18.5	18.0	15.1	16.3	19.5	16.9	15.2	105bp
GPM (%)	34.4	35.4	35.3	34.8	33.5	36.9	38.4	40.1	35.0	37.3	36.3	381bp
SGA (%)	11.1	12.0	12.1	12.3	12.8	13.5	13.7	14.7	11.9	13.7	11.9	280bp
EBIT	27	30	31	30	28	35	37	39	118	138	37	5.8
EBIT Margin (%)	19.7	19.9	19.6	18.9	17.1	20.0	20.2	20.9	19.5	19.6	19.9	97bp
Other income	3	2	1	2	1	0	1	0	8	2	1	-120.4
ETR (%)	20.6	21.2	17.7	19.3	24.0	23.9	18.4	18.2	19.7	20.9	22.0	-377bp
Adjusted PAT	24	25	26	26	22	27	31	32	101	111	29	8.5
QoQ (%)	7.8	5.2	4.2	-2.2	-13.0	19.2	14.4	3.8			-4.3	806bp
YoY (%)	10.6	15.4	20.1	15.5	-6.8	5.7	16.1	23.1	15.4	9.7	13.5	967bp
EPS	8.6	9.0	9.7	9.5	8.2	9.8	11.3	11.7	36.8	41.0	10.8	8.5

Key Performance Indicators

Y/E March	FY19				FY20				FY19	FY20
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenue (QoQ CC %)	2.7	3.0	5.6	3.3	4.2	6.0	2.1	0.8	11.9	16.7
Costs (% of revenue)										
COGS	65.6	64.6	64.7	65.2	66.5	63.1	61.6	59.9	65.0	62.7
SGA	11.1	12.0	12.1	12.3	12.8	13.5	13.7	14.7	11.9	13.7
Margins										
Gross Margin	34.4	35.4	35.3	34.8	33.5	36.9	38.4	40.1	35.0	37.3
EBIT Margin	19.7	19.9	19.6	18.9	17.1	20.0	20.2	20.9	19.5	19.6
Net Margin	17.3	17.0	16.7	16.1	13.6	15.2	16.9	17.0	16.8	15.7
Operating metrics										
Headcount (k)	124	128	132	138	144	147	149	150	138	150
Attrition (%)	16.3	17.1	17.8	17.7	17.3	16.9	16.8	16.3	17.7	16.3
Fixed Price	62.0	61.8	63.3	63.7	63.5	66.5	67.8	68.3	62.7	66.5
Key Verticals (YoY %)										
BFSI	4.2	0.1	-2.7	-5.7	-1.9	15.4	15.5	14.1	-1.1	11.1
Manufacturing	14.0	11.3	10.5	12.4	22.3	15.2	14.2	34.3	12.0	33.9
Key Geographies (YoY%)										
North America	13.6	14.8	12.8	14.1	19.1	15.9	12.6	13.1	13.7	15.8
Europe	11.8	0.2	8.8	10.7	6.1	24.6	19.6	11.9	7.9	18.3

Management commentary highlights

- In line with our expectations, the company has suspended the practice of providing revenue growth/EBIT margin guidance amidst the heightened uncertainty. Management does expect near-term impact due to COVID-19.
- The company expects some impact on volume-based billing as few clients have shut plants and put employees on furlough. Some deferral of discretionary spends in B2B clients and delay in decision making on new projects is anticipated.
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- HCLT expects ER&D segment to witness a dip in the coming quarters due to weakness in Auto and Industrial Aero segments.
- Management expects the impact of COVID-19 to be relatively lower on the products and platforms segment (v/s services business).
- Industrial, Auto, Aero, Entertainment and non-essential Retail have witnessed heavy impact due to COVID-19. While BFSI and Telecom verticals saw lower impact, Technology Services and Life Sciences segments have been fairly insulated and are witnessing strong traction. Management also indicated that there are pockets of strong demand in weak verticals and weak demand in verticals that are perceived to be strong.

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- Across geographies, revenue remained stable despite the COVID-19 crisis. Americas (+1.3% QoQ, CC) and RoW (+0.9% QoQ, CC) grew while Europe showed an insignificant decline.
- Across service lines, IT and Business services grew 1.6% QoQ, largely driven by digital offerings. Given constraints like accessibility of labs in a Work from Home (WFH) situation, ER&D declined 1.8% QoQ.
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Exhibit 1: Americas and ROW showed slight growth uptick while Europe remained flat

Geographies	Contr. To rev. (%)	CC YoY (%) (prior acquisition method)	CC QoQ Gr. (%)	CC YoY Gr. (%)
Americas	63.4	20.4	1.3	13.1
Europe	28.7	2.4	-0.1	11.9
ROW	7.8	-1.3	0.9	23.3

Source: MOFSL, Company

Exhibit 2: Technology led growth amongst verticals while Telecom MP&E dragged

Verticals	Contr. To rev. (%)	CC YoY (%) (prior acquisition method)	CC QoQ Gr. (%)	CC YoY Gr. (%)
Financial Services	21.1	1.5	-1.1	14.1
Manufacturing	20.7	26.7	-0.2	34.3
Technology	16.2	38.7	7.2	-3
Life Sciences & Healthcare	12.5	3.4	2.3	7.6
Telecom MP&E	8.3	6	-6.6	10.8
Retail & CPG	10.2	4.1	0.3	15.3
Public Services	11.1	-1.3	2.9	14.6

Source: MOFSL, Company

Exhibit 3: Engineering and R&D services reported sequential decline

Segments	Contr. To rev. (%)	CC YoY (%) (prior acquisition method)	CC QoQ Gr. (%)	CC YoY Gr. (%)
IT and Business Services	70.6	6.2	1.6	6.2
Engineering and R&D Services	16.3	10.2	-1.8	10.2
Products and Platforms	13.1	94	-0.1	94

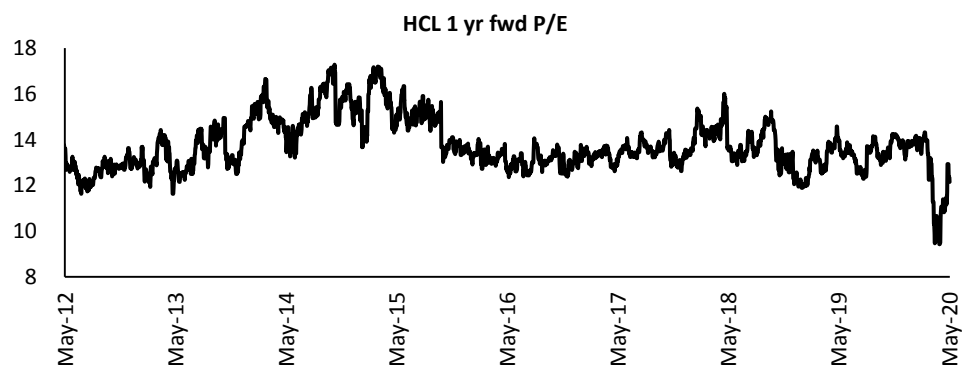
Source: MOFSL, Company

Valuation view

- HCLT's exposure to deeply troubled verticals (e.g. Energy, Travel, Transportation, Hospitality, Retail, etc.) is lower than peers. In addition, higher exposure to IMS (~37% of revenue) comprising larger share of non-discretionary spends offers better resilience to its portfolio in the current context. Besides, the company has higher exposure to Financial Services, Technology Services and Manufacturing where we anticipate an uptick in IT spends in a post COVID-19 world.
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Exhibit 4: Over long term, one-year forward P/E multiple averaged to ~14x



Source: Bloomberg

Exhibit 5: Revision to our estimates

	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
INR/USD	76.0	77.0	73.5	73.5	3.4%	4.8%
USD Revenue - m	9,636	10,790	9,951	10,944	-3.2%	-1.4%
Growth (%)	(3.0)	12.0	0.0	10.0	-300bps	200bps
EBIT margin (%)	18.6	19.6	18.6	19.5	0bps	0bps
PAT (INR B)	110	131	115	133	-4.1%	-1.8%
EPS	40.5	48.3	42.2	49.2	-4.1%	-1.8%

Source: Company, MOFSL

Operating Metrics

Exhibit 6: Operating metrics

	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20
Service Line wise (%)								
IT and Business Services	74.9	73.8	74.0	75.8	75.3	71.4	70.2	70.6
Engineering and R&D Services	17.3	17.5	17.1	16.6	16.9	16.9	16.7	16.3
Products and Platform	7.8	8.7	8.9	7.6	7.8	11.7	13.1	13.1
Vertical wise (%)								
BFSI	23.8	23.0	21.6	22.3	23.8	22.4	21.6	21.1
Manufacturing	18.3	18.0	17.7	17.9	18.3	18.7	20.9	20.7
Technology & Services	18.2	18.2	18.7	18.5	18.2	16.5	15.1	16.2
Retail & CPG	9.1	10.0	10.2	9.9	9.1	10.0	10.3	10.2
Telecom MP&E	7.3	7.2	9.2	8.1	7.3	8.4	9.0	8.3
Life Sciences	12.8	12.9	13.0	12.9	12.8	12.9	12.2	12.5
Public Services	10.5	10.7	9.7	10.5	10.5	11.0	10.9	11.1
Geography wise (%)								
US	64.5	65.8	64.4	62.9	67.7	64.4	62.8	63.4
Europe	28.1	26.8	28.2	29.7	25.9	28.2	29.2	28.7
ROW	7.5	7.4	7.3	7.4	6.3	7.4	8.0	7.8
Client wise (%)								
Top 5 clients	17.0	17.3	17.4	17.0	16.6	16.5	15.2	15.1
Top 10 clients	24.6	24.8	24.8	24.1	23.9	24.0	22.4	22.0
Top 20 clients	34.2	34.2	34.1	33.4	34.2	34.6	33.0	32.1
QoQ Growth (%)								
Vertical wise (%)								
BFSI	(4.0)	(1.3)	(1.5)	6.8	10.7	(1.0)	(1.3)	(2.3)
Manufacturing	(3.9)	0.5	3.2	4.6	6.1	7.5	14.4	(1.0)
Technology & Services	9.2	2.1	7.8	2.4	2.1	(4.7)	(6.4)	7.3
Retail & CPG	(4.4)	12.2	7.0	0.4	(4.6)	15.6	5.4	(1.0)
Telecom MP&E	(0.6)	0.7	34.0	(8.9)	(6.5)	21.0	9.6	(7.8)
Life Sciences	12.2	2.9	5.7	2.7	3.0	6.0	(3.2)	2.5
Public Services	(0.1)	4.1	(4.9)	12.0	3.8	10.2	1.4	1.8
Geography wise (%)								
US	5.6	4.2	2.7	1.1	11.7	0.0	(0.2)	1.0
Europe	(5.6)	(2.6)	10.4	9.0	(9.5)	14.5	6.0	(1.7)
ROW	(11.1)	0.8	3.5	4.9	(11.7)	23.5	10.6	(2.5)
Client wise (%)								
Top 5 clients	5.1	3.9	5.5	1.1	1.3	4.5	(5.7)	(0.7)
Top 10 clients	4.2	3.0	4.9	0.5	2.9	5.6	(4.5)	(1.8)
Top 20 clients	2.3	2.1	4.6	1.3	6.3	6.4	(2.4)	(2.7)

Source: MOFSL, Company

Financials and valuations

Income Statement								(INR b)
Y/E June	2015	2016	2017	2018	2019	2020	2021E	2022E
Sales	358	409	466	506	605	707	732	831
Change (%)	13.7	14.3	13.9	8.6	19.5	16.9	3.6	13.5
Cost of Goods Sold	227	270	309	332	393	443	470	529
Gross Profit	131	139	157	173	211	264	262	301
Selling & Admin Exp.	43	52	55	59	72	97	93	101
EBITDA	88	87	102	114	139	167	169	201
% of Net Sales	24.6	21.3	21.9	22.6	23.1	23.6	23.1	24.2
Depreciation	5	5	8	15	21	28	33	38
EBIT	83	82	94	100	118	138	136	162
% of Net Sales	23.3	20.1	20.3	19.7	19.5	19.6	18.6	19.6
Forex Gain	-1	1	2	5	2	0	0	1
Other Income	10	9	7	6	6	2	2	2
PBT	92	92	104	111	126	140	139	165
Tax	19	19	19	23	25	29	29	35
Rate (%)	20.3	20.4	18.8	20.9	19.7	20.9	21.0	21.0
PAT	73	73	84	88	101	111	110	131
EO Item (net)	0	0	0	0	0	0	0	0
Net Income	73	73	84	88	101	111	109	130
Change (%)	28.1	0.2	14.9	4.1	15.0	9.5	-1.1	19.2

Balance Sheet								(INR b)
Y/E June	2015	2016	2017	2018	2019	2020	2021E	2022E
Share Capital	1	1	1	1	1	1	1	1
Other Reserves	229	276	344	363	422	485	603	716
Net Worth	230	277	345	364	423	486	604	717
Loans	4	10	6	4	40	48	74	75
Other liabilities	14	13	13	13	20	52	55	56
Capital Employed	248	300	363	381	484	586	733	848
Gross Block	132	158	225	267	333	483	598	627
Less : Depreciation	46	51	59	73	95	123	157	195
Net Block	85	106	166	194	238	360	441	432
Other assets	29	38	38	37	54	61	65	66
Investments	0	2	2	5	4	0	0	0
Curr. Assets	215	247	272	243	301	361	430	581
Debtors	93	106	111	121	148	167	173	196
Cash & Bank Balance	97	117	131	97	115	145	205	326
Other Current Assets	25	24	31	25	38	50	51	58
Current Liab. & Prov	82	94	115	98	113	196	203	231
Net Current Assets	133	153	158	145	188	165	226	350
Application of Funds	248	300	363	381	484	586	733	848

Financials and valuations

Ratios								
Y/E June	2015	2016E	2017	2018	2019	2020	2021E	2022E
Diluted (INR)								
EPS	51.9	51.9	59.7	62.5	36.8	41.0	40.5	48.3
Cash EPS	55.1	55.5	65.1	72.9	44.5	51.2	52.5	62.1
Book Value	162.7	196.4	244.0	259.6	153.8	179.0	222.5	264.3
DPS	17.0	22.0	24.0	8.0	8.0	8.0	8.0	8.0
Payout %	32.8	42.4	40.2	12.8	21.7	19.5	19.7	16.6
Valuation (x)								
P/E	9.9	9.8	8.6	8.2	13.9	12.5	12.6	10.6
Cash P/E	9.3	9.2	7.8	7.0	11.5	10.0	9.7	8.2
EV/EBITDA	7.1	7.0	5.8	5.5	9.6	7.7	7.4	5.7
EV/Sales	1.8	1.5	1.3	1.2	2.2	1.8	1.7	1.4
Price/Book Value	3.1	2.6	2.1	2.0	3.3	2.9	2.3	1.9
Dividend Yield (%)	3.3	4.3	4.7	1.6	1.6	1.6	1.6	1.6
Profitability Ratios (%)								
RoE	35.4	28.9	27.1	24.8	25.7	24.5	20.2	19.8
RoCE	29.1	23.9	23.2	21.2	19.6	18.7	14.7	15.1
Turnover Ratios								
Debtors (Days)	95	95	87	88	89	86	86	86
Asset Turnover (x)	4.2	3.8	2.8	2.6	2.5	2.0	1.7	1.9

Cash Flow Statement								(INR b)
Y/E June	2015	2016	2017	2018	2019	2020	2021E	2022E
CF from Operations	73	73	94	102	115	143	143	169
Chg. in Working Capital	-18	-2	0	-15	-21	-19	1	-3
Net Operating CF	55	71	94	87	94	124	144	167
Net Purchase of FA	-11	-10	-33	-13	-21	-10	-20	-23
Net Purchase of Invest.	-17	-33	-10	-14	-14	-108	-70	0
Net Cash from Inv.	-29	-43	-43	-27	-35	-118	-90	-23
Issue of shares/other adj	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	-4	5	-4	-36	1	6	22	0
Dividend Payments	-25	-34	-41	-20	-13	-16	-25	-25
Net CF from Finan.	-29	-28	-44	-57	-12	-10	-3	-26
Free Cash Flow	44	61	61	74	72	114	124	144
Net Cash Flow	-2	0	6	3	47	-4	51	118
Opening Cash Balance	86	104	119	126	105	117	154	208
Closing CashBalance	97	117	131	97	115	145	205	326

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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