

Estimate change



TP change



Rating change


CMP: INR623
TP: INR765 (+23%)
Buy

Margin beat; Encouraging guidance

Motilal Oswal values your support in the Asiamoney Brokers Poll 2020 for India Research, Sales and Trading team. We request your ballot.



	HCLT IN
Bloomberg	
Equity Shares (m)	2,714
M.Cap.(INRb)/(USD\$b)	1691.8 / 22.7
52-Week Range (INR)	652 / 376
1, 6, 12 Rel. Per (%)	-2/16/25
12M Avg Val (INR M)	2407

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	707	742	828
EBIT Margin (%)	19.6	20.2	20.5
PAT	111	121	139
EPS (INR)	40.7	44.4	51.0
EPS Gr. (%)	11.1	9.0	14.8
BV/Sh. (INR)	179	230	275

Ratios

RoE (%)	24.3	21.7	20.2
RoCE (%)	18.7	16.1	15.7
Payout (%)	19.6	18.0	15.7

Valuations

P/E (x)	15.3	14.1	12.3
P/BV (x)	3.5	2.7	2.3
EV/EBITDA (x)	9.6	8.1	6.7
Div Yield (%)	1.3	1.3	1.3

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	60.3	60.3	60.0
DII	10.1	9.2	8.0
FII	25.6	26.4	28.6
Others	4.0	4.1	3.4

FII Includes depository receipts

Valuations are the icing on the cake

- HCL Technologies (HCLT) reported EBITDA margin expansion (+20bp QoQ) despite the COVID-19 disruption, which is impressive. Notably, it had reported margin expansion even in 4QFY20, when most other large companies had witnessed contraction. A decent increase in net new deal wins and a robust deal pipeline (+40% QoQ) comfort us. HCLT surprised us by reinstating revenue growth (+1.5–2.5% CQGR, CC) and EBIT margin guidance (19.5–20.5%). Besides bringing back performance visibility, it further hinted that the worst was behind.
- We upgrade our FY21/FY22E EPS by 12–14%. Maintain **Buy**, as we expect HCLT to better navigate the current crisis and emerge stronger on the back of an expected increase in enterprise demand for Digital Services.

In-line revenue; Strong beat on margins

- HCLT reported revenue (CC) / EBIT / PAT growth of 1%/30%/32% YoY v/s our estimate of 1%/17%/19% YoY.
- Revenue decline was in-line with estimates. As expected, Engineering Services (-9% QoQ, CC) was the biggest overhang on revenue this quarter. While the IT & Business Services segment declined ~8% QoQ (CC), the Products & Platforms business remained resilient (-2% QoQ, CC).
- Across geographies, revenue decline was more or less broad-based.
- Across verticals, BFSI (-1.7% QoQ, CC) remained resilient. Manufacturing (-19% QoQ, CC), Telecom (-16% QoQ, CC), and Retail (-9% QoQ, CC) were the most impacted.
- The EBIT margin was ~200bp ahead of our estimate. Margins across segments (Mode-1, Mode-2, & Mode-3) remained resilient.
- Operationally, while margins expanded ~20bp QoQ to 25.6%, an increase in the D&A run-rate translated to EBIT margin contraction.

Key highlights from management commentary

- The business impact in 1QFY21 was lower than management initially feared. Revenue decline was led by a) COVID-19 and b) offshoring in large deals, which were ramped-up in FY20.
- A third of the COVID-19 impact was witnessed due to supply-side issues.
- 1QFY21 witnessed cases of deal ramp-downs, volume reductions, and requests for price cuts by clients. However, demand-side challenges have now stabilized, with management indicating the worst is behind.
- HCLT signed 11 transformational deals in 1QFY21 and gained wallet share in some of the consolidation opportunities.
- While renewals have been robust in 1QFY21, net new deal wins have also grown (YoY).
- The deal pipeline is robust (+40% QoQ). Digital and IMS are witnessing significant traction in transformation, cloud adoption, security, etc.

- While the Auto, Aero, and Energy verticals would take longer to recover, BFSI, Retail & CPG, Telecom, and Healthcare should do well going forward.
- The company has guided for a CQGR of 1.5–2.5% (CC) for the next three quarters, which translates to -2.3% to -0.8% YoY revenue growth (CC) for FY21.
- The EBIT margin was guided to be in the range of 19.5–20.5%, 100bp higher than its FY20 guidance.

Valuation and view – Subdued multiples offer margin of safety

- HCLT's exposure to deeply troubled verticals (e.g., Energy, Travel, Transportation, Hospitality, and Retail) is lower v/s peers. Additionally, higher exposure to IMS (~37% of revenue), comprising a larger share of non-discretionary spend, offers better resilience to its portfolio in the current context. Besides this, the company has higher exposure to Financial Services, Technology Services, and Manufacturing, wherein we anticipate an uptick in IT spends in the post-COVID-19 era.
- 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.
- We expect HCLT to better navigate the current crisis and emerge stronger on the back of an expected increase in enterprise demand for Digital Services. Our confidence partly stems from the company's historical track record of adapting to multiple business challenges and technology change cycles. The stock is currently trading at a modest ~12x on FY22E earnings and offers superior margin of safety. Our TP is based on ~15x FY22E EPS.

Quarterly Performance

Y/E March	FY20				FY21E				FY20	FY21E	(INR b)	
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			Est. 1QFY21	Var. (% / bp)
Revenue (USD m)	2,364	2,486	2,543	2,543	2,356	2,412	2,472	2,534	9,936	9,774	2,350	0.2
QoQ (%)	3.8	5.2	2.3	0.0	-7.4	2.4	2.5	2.5	15.1	-1.6	-7.6	21bp
Revenue (INR b)	164	175	181	186	178	183	188	193	707	742	179	-0.2
YoY (%)	18.5	18.0	15.1	16.3	8.5	4.6	3.7	3.6	16.9	5.0	8.7	-20bp
GPM (%)	33.5	36.9	38.4	40.1	39.9	39.4	39.4	39.4	37.3	39.5	36.5	338bp
SGA (%)	12.8	13.5	13.7	14.7	14.3	14.3	14.3	14.3	13.7	14.3	13.5	77bp
EBIT	28	35	37	39	37	37	38	39	138	150.3	33	11.0
EBIT Margin (%)	17.1	20.0	20.2	20.9	20.5	20.1	20.2	20.2	19.6	20.2	18.5	206bp
Other income	1	0	1	0	2	1	1	1	2	4	1	233.4
ETR (%)	24.0	23.9	18.4	18.2	24.0	21.0	21.0	21.0	20.9	21.8	21.0	303bp
Adjusted PAT	22	27	30	32	29	29	30	31	111	120	26	10.5
QoQ (%)	-13.1	19.3	14.5	3.8	-7.3	0.6	3.3	3.6			-16.1	881bp
YoY (%)	-7.4	5.1	16.7	23.3	31.5	10.8	-0.1	-0.2	9.5	9.0	19.0	1249bp
EPS	8.2	9.8	11.2	11.6	10.8	10.8	11.2	11.6	40.7	44.4	9.7	10.5

Key Performance Indicators

Y/E March	FY20				FY21				FY20	FY21
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenue (QoQ CC %)	4.2	6.0	2.1	0.8	-7.2				16.7	
Costs (% of revenue)										
COGS	66.5	63.1	61.6	59.9	60.1	60.6	60.6	60.6	62.7	60.5
SGA	12.8	13.5	13.7	14.7	14.3	14.3	14.3	14.3	13.7	14.3
Margins										
Gross Margin	33.5	36.9	38.4	40.1	39.9	39.4	39.4	39.4	37.3	39.5
EBIT Margin	17.1	20.0	20.2	20.9	20.5	20.1	20.2	20.2	19.6	20.2
Net Margin	13.5	15.1	16.8	17.0	16.4	16.0	16.2	16.3	15.6	16.2
Operating metrics										
Headcount (k)	144	147	149	150	150				150	
Attrition (%)	17.3	16.9	16.8	16.3	14.6				16.3	
Fixed Price	63.5	66.5	67.8	68.3	66.7				66.5	
Key Verticals (YoY CC %)										
BFSI	-1.9	15.4	15.5	14.1	11.7				11.1	
Manufacturing	22.3	15.2	14.2	34.3	-8.3				33.9	
Key Geographies (YoY CC %)										
North America	19.1	15.9	12.6	13.1	-5.8				15.8	
Europe	6.1	24.6	19.6	11.9	11.4				18.3	



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- Operationally, while margins expanded ~20bp QoQ to 25.6%, an increase in the D&A run-rate translated to EBIT margin contraction.

Exhibit 1: Across geographies, revenue decline was broad-based

Geographies	Contr. To rev. (%)	CC YoY (%) (prior acquisition method)	CC QoQ Gr. (%)	CC YoY Gr. (%)
Americas	63.7	1.2	-6.9	-5.8
Europe	28.3	-0.3	-8.5	11.4
ROW	8	4	-5.1	31.2

Source: Company, MOFSL

Exhibit 2: Manufacturing, Telecom & Retail were the most impacted verticals

Verticals	Contr. To rev. (%)	CC YoY (%) (prior acquisition method)	CC QoQ Gr. (%)	CC YoY Gr. (%)
Financial Services	22.4	0	-1.7	11.7
Manufacturing	18.1	-15.5	-18.8	-8.3
Technology	17.2	31.1	-1.2	-8.8
Life Sciences & Healthcare	13.7	3.5	1.9	7.1
Telecom MP&E	7.6	-9.6	-15.5	-4.4
Retail & CPG	10	-5.4	-9	6.7
Public Services	11	-9.3	-7.1	7

Source: Company, MOFSL

Exhibit 3: Products & Platforms remained resilient during the quarter

Segments	Contr. To rev. (%)	CC YoY (%) (prior acquisition method)	CC QoQ Gr. (%)	CC YoY Gr. (%)
IT and Business Services	70.2	-5.6	-7.8	-5.6
Engineering and R&D Services	16	-5.1	-9	-5.1
Products and Platforms	13.8	77.7	-2.1	77.7

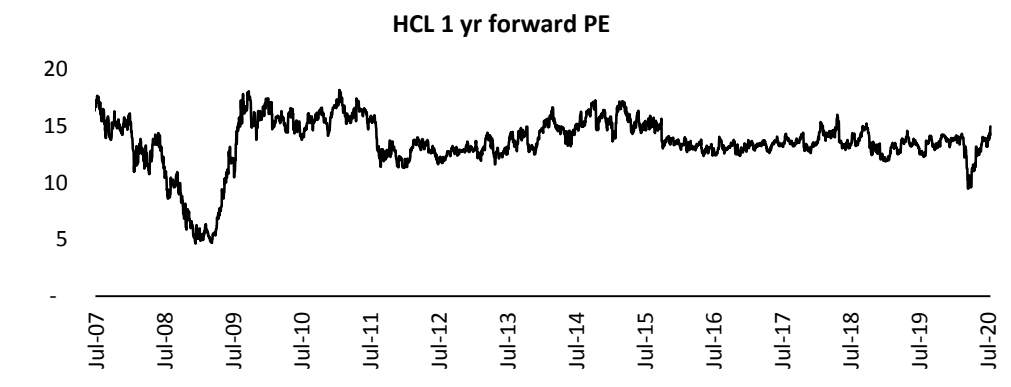
Source: Company, MOFSL

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Exhibit 4: Over the long term, the one-year forward P/E multiple averaged to ~14x



Source: Bloomberg, MOFSL

Exhibit 5: Revision to our estimates

	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
INR/USD	75.9	77.0	76.0	77.0	-0.1%	0.0%
USD Revenue - m	9,774	10,752	9,268	10,389	5.5%	3.5%
Growth (%)	(1.6)	10.0	(6.7)	12.1	510bps	-210bps
EBIT margin (%)	20.2	20.5	18.6	19.3	160bps	120bps
PAT (INR B)	120	138	105	124	14.4%	11.8%
EPS	44.4	51.0	38.8	45.6	14.4%	11.8%

Source: MOFSL

Operating metrics

Exhibit 6: Operating metrics

	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21
Service Line wise (%)									
IT and Business Services	74.9	73.8	74.0	75.8	75.3	71.4	70.2	70.6	70.2
Engineering and R&D Services	17.3	17.5	17.1	16.6	16.9	16.9	16.7	16.3	16.0
Products and Platform	7.8	8.7	8.9	7.6	7.8	11.7	13.1	13.1	13.8
Vertical wise (%)									
BFSI	23.8	23.0	21.6	22.3	23.8	22.4	21.6	21.1	22.4
Manufacturing	18.3	18.0	17.7	17.9	18.3	18.7	20.9	20.7	18.1
Technology & Services	18.2	18.2	18.7	18.5	18.2	16.5	15.1	16.2	17.2
Retail & CPG	9.1	10.0	10.2	9.9	9.1	10.0	10.3	10.2	10.0
Telecom MP&E	7.3	7.2	9.2	8.1	7.3	8.4	9.0	8.3	7.6
Life Sciences	12.8	12.9	13.0	12.9	12.8	12.9	12.2	12.5	13.7
Public Services	10.5	10.7	9.7	10.5	10.5	11.0	10.9	11.1	11.0
Geography-wise (%)									
US	64.5	65.8	64.4	62.9	67.7	64.4	62.8	63.4	63.7
Europe	28.1	26.8	28.2	29.7	25.9	28.2	29.2	28.7	28.3
ROW	7.5	7.4	7.3	7.4	6.3	7.4	8.0	7.8	8.0
Client wise (%)									
Top 5 clients	17.0	17.3	17.4	17.0	16.6	16.5	15.2	15.1	13.9
Top 10 clients	24.6	24.8	24.8	24.1	23.9	24.0	22.4	22.0	20.9
Top 20 clients	34.2	34.2	34.1	33.4	34.2	34.6	33.0	32.1	30.8
QoQ Growth (%)									
Vertical wise (%)									
BFSI	(4.0)	(1.3)	(1.5)	6.8	10.7	(1.0)	(1.3)	(2.3)	(1.7)
Manufacturing	(3.9)	0.5	3.2	4.6	6.1	7.5	14.4	(1.0)	(19.0)
Technology & Services	9.2	2.1	7.8	2.4	2.1	(4.7)	(6.4)	7.3	(1.7)
Retail & CPG	(4.4)	12.2	7.0	0.4	(4.6)	15.6	5.4	(1.0)	(9.2)
Telecom MP&E	(0.6)	0.7	34.0	(8.9)	(6.5)	21.0	9.6	(7.8)	(15.2)
Life Sciences	12.2	2.9	5.7	2.7	3.0	6.0	(3.2)	2.5	1.5
Public Services	(0.1)	4.1	(4.9)	12.0	3.8	10.2	1.4	1.8	(8.2)
Geography wise (%)									
US	5.6	4.2	2.7	1.1	11.7	0.0	(0.2)	1.0	(6.9)
Europe	(5.6)	(2.6)	10.4	9.0	(9.5)	14.5	6.0	(1.7)	(8.7)
ROW	(11.1)	0.8	3.5	4.9	(11.7)	23.5	10.6	(2.5)	(5.0)
Client wise (%)									
Top 5 clients	5.1	3.9	5.5	1.1	1.3	4.5	(5.7)	(0.7)	(14.7)
Top 10 clients	4.2	3.0	4.9	0.5	2.9	5.6	(4.5)	(1.8)	(12.0)
Top 20 clients	2.3	2.1	4.6	1.3	6.3	6.4	(2.4)	(2.7)	(11.1)

Source: Company, MOFSL

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	742	828
Change (%)	13.7	14.3	13.9	8.6	19.5	16.9	5.0	11.6
Cost of Goods Sold	227	270	309	332	393	443	449	502
Gross Profit	131	139	157	173	211	264	293	326
Selling & Admin Exp.	43	52	55	59	72	97	106	118
EBITDA	88	87	102	114	139	167	187	207
% of Net Sales	24.6	21.3	21.9	22.6	23.1	23.6	25.2	25.0
Depreciation	5	5	8	15	21	28	37	38
EBIT	83	82	94	100	118	138	150	170
% of Net Sales	23.3	20.1	20.3	19.7	19.5	19.6	20.2	20.5
Forex Gain	-1	1	2	5	2	0	0	0
Other Income	10	9	7	6	6	2	5	6
PBT	92	92	104	111	126	140	155	176
Tax	19	19	19	23	25	29	34	37
Rate (%)	20.3	20.4	18.8	20.9	19.7	20.9	21.8	21.0
PAT	73	73	84	88	101	111	121	139
EO Item (net)	0	0	0	0	0	0	0	0
Net Income	73	73	84	88	101	111	121	139
Change (%)	28.1	0.2	14.9	4.1	15.4	9.7	9.3	14.7

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	623	745
Net Worth	230	277	345	364	423	486	624	746
Loans	4	10	6	4	40	48	47	48
Other liabilities	14	13	13	13	20	52	60	61
Capital Employed	248	300	363	381	484	586	731	855
Gross Block	132	158	225	267	333	483	532	559
Less : Depreciation	46	51	59	73	95	123	160	198
Net Block	85	106	166	194	238	360	372	361
Other assets	29	38	38	37	54	61	63	64
Investments	0	2	2	5	4	0	0	0
Curr. Assets	215	247	272	243	301	361	444	594
Debtors	93	106	111	121	148	167	165	184
Cash & Bank Balance	97	117	131	97	115	145	235	361
Other Current Assets	25	24	31	25	38	50	44	49
Current Liab. & Prov	82	94	115	98	113	196	147	164
Net Current Assets	133	153	158	145	188	165	296	430
Application of Funds	248	300	363	381	484	586	731	855

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	36.7	40.7	44.4	51.0
Cash EPS	55.1	55.5	65.1	72.9	44.6	51.4	58.4	65.2
Book Value	162.7	196.4	244.0	259.6	153.7	179.0	230.0	274.9
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	21.8	19.6	18.0	15.7
Valuation (x)								
P/E	12.0	12.0	10.5	10.0	17.0	15.3	14.1	12.3
Cash P/E	11.3	11.3	9.6	8.6	14.0	12.1	10.7	9.6
EV/EBITDA	9.0	8.9	7.4	6.9	11.8	9.6	8.1	6.7
EV/Sales	2.2	1.9	1.6	1.6	2.7	2.3	2.0	1.7
Price/Book Value	3.8	3.2	2.6	2.4	4.1	3.5	2.7	2.3
Dividend Yield (%)	2.7	3.5	3.8	1.3	1.3	1.3	1.3	1.3
Profitability Ratios (%)								
RoE	35.4	28.9	27.1	24.8	25.6	24.3	21.7	20.2
RoCE	29.1	23.9	23.2	21.2	19.6	18.7	16.1	15.7
Turnover Ratios								
Debtors (Days)	95	95	87	88	89	86	81	81
Asset Turnover (x)	4.2	3.8	2.8	2.6	2.5	2.0	2.0	2.3

Cash Flow Statement

Y/E June	2015	2016	2017	2018	2019	2020	2021E	2022E
(INR b)								
CF from Operations	73	73	94	102	115	143	159	176
Chg. in Working Capital	-18	-2	0	-15	-21	-19	23	-6
Net Operating CF	55	71	94	87	94	124	182	170
Net Purchase of FA	-11	-10	-33	-13	-21	-10	-19	-22
Net Purchase of Invest.	-17	-33	-10	-14	-14	-108	-1	0
Net Cash from Inv.	-29	-43	-43	-27	-35	-118	-20	-22
Issue of shares/other adj	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	-4	5	-4	-36	1	6	-66	1
Dividend Payments	-25	-34	-41	-20	-13	-16	-19	-25
Net CF from Finan.	-29	-28	-44	-57	-12	-10	-85	-25
Free Cash Flow	44	61	61	74	72	114	163	148
Net Cash Flow	-2	0	6	3	47	-4	77	123
Opening Cash Balance	86	104	119	126	105	117	154	238
Closing CashBalance	97	117	131	97	115	145	235	361

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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