

HCL Technologies

Estimate change	↔
TP change	↑
Rating change	↔

Bloomberg	HCLT IN
Equity Shares (m)	2,714
M.Cap.(INRb)/(USDb)	2244.5 / 31.8
52-Week Range (INR)	911 / 376
1, 6, 12 Rel. Per (%)	3/49/47
12M Avg Val (INR M)	3846

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	707	757	857
EBIT Margin (%)	19.6	20.8	21.2
PAT	111	126	146
EPS (INR)	40.7	46.1	53.6
EPS Gr. (%)	11.1	13.1	16.3
BV/Sh. (INR)	190	220	253

Ratios

RoE (%)	24.3	22.6	21.7
RoCE (%)	18.7	17.0	17.1
Payout (%)	19.6	30.4	33.6

Valuations

P/E (x)	20.4	18.0	15.5
P/BV (x)	4.4	3.8	3.3
EV/EBITDA (x)	12.9	10.7	8.5
Div Yield (%)	1.0	1.7	2.2

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

CMP: INR827 **TP: INR1050 (+27%)** **Buy**

Cloud demand to boost FY22 growth

Broad-based recovery; margin guidance raised for FY21

- HCL Technologies (HCLT) delivered strong revenue growth (4.5% QoQ CC) on the back of broad-based recovery across geographies, verticals, and services.
- EBIT margin expansion (+110bp QoQ), driven by operating leverage, was better than expected. HCLT also revised its FY21 margin guidance upward (by 50bp to 20–21%) despite a potential wage hike in 3Q/4Q. This indicates its ability to sustain some amount of margin improvement, which is a positive.
- Strong new deal wins (+35% QoQ), good renewals, and a robust deal pipeline (+20% QoQ, all-time high) give us comfort. This, coupled with broad-based sequential growth across segments in 2Q, indicated an improved outlook.
- HCLT reported 15 transformational wins, all from new clients, exhibiting its ability to capture a larger share of client wallets. In our view, the company would continue to benefit from demand for digital services – especially in cloud migration (digital foundation) work – which should help it deliver 11% revenue growth in FY22.
- We marginally upgrade our EPS estimate for FY22 by 2%, while keeping it unchanged for FY21. Maintain **Buy**, as we expect HCLT to emerge stronger on the back of an expected increase in enterprise demand for digital and cloud services. Our TP implies 19.5x FY22 EPS (~30% discount to TCS).

Performance marginally ahead of estimates

- HCL reported revenue (USD) / EBIT / PAT growth of 1%/15%/18% YoY v/s our estimate of 0%/11%/17% YoY. For 1H, the company reported revenue (USD) / EBIT / PAT growth of 0%/22%/24% YoY.
- Revenue increased 4.5% QoQ CC (v/s est. 3.7% QoQ CC). 2Q saw a broad-based performance with all growth engines firing.
- Across geographies, excl. Europe (2.2% QoQ CC), the Americas (4.9% QoQ CC) and RoW (9% QoQ CC) reported above company average growth.
- Except for Public Services (0.2% QoQ CC), which came in flat, other verticals reported modest/strong growth during the quarter. Strong growth in Retail & CPG (8.4% QoQ CC) indicates faster-than-expected recovery.
- Broad-based growth across service lines is also a key positive.
- The EBIT margin expanded 110bp QoQ to 21.6%, moderately ahead of our est. of 21.0%. Key factors included (a) operational efficiency (increased utilization/ offshoring /automation): +157bp, (b) headwind from INR appreciation: -24bp (c) investment in P&P SGA: -32bp, and (d) lower depreciation/amortization: +7bp.
- Attrition in IT Services (LTM basis) at 12.2% contracted by 470 bps YoY.
- The company maintains its guidance for revenue growth of 1.5–2.5% QoQ CC for the remaining quarters of FY21. On the other hand, EBIT margin guidance was raised to 20–21% for FY21 from 19.5–20.5% earlier.
- FCF/PAT continued to be healthy at 136% in the quarter.
- The board declared dividend of INR4/share, marking the 71st consecutive quarter of dividend payout.

Key highlights from management commentary

- The company saw sharper and broad-based recovery across segments during the quarter. Hence, the management had increased its revenue and margin guidance for the quarter a month ago.
- (a) Increasing intensity of technology spend, (b) client stickiness (existing clients giving new deals), (c) an early lead in the Digital Foundation Business (Cloud, Security, Digital Workplace, Networks), (d) operational efficiency measures (offshoring, automation), and (e) employees have helped the company achieve growth/improvement.
- Margin expansion in the quarter was driven by increased utilization, offshoring, and automation. Revenue growth and margin expansion in Mode 2 is aiding overall performance.
- The company would offer wage hikes (similar to last year, but with a lag of a quarter – the best in the industry) and variable payouts similar to last year.
- 2QFY21 is seasonally weak for Products, but it saw decent growth on a sequential basis as some bookings were pulled forward from 3Q.
- HCLT signed 15 transformational deals in 2QFY21 (v/s 11 in the last quarter) and gained wallet share in some consolidation opportunities.
- While renewals have been good in 2QFY21, net new deal wins have also grown (+35% QoQ). The deal pipeline is robust (+20% QoQ) and at an all-time high. A good mix of deals is in the pipeline from across geographies (the US and Europe).
- Digital Foundation Services is witnessing significant traction in transformation, cloud adoption, security, etc.
- Strong momentum is seen in Life Sciences and Healthcare, Technology, BFSI, and Telecom. Manufacturing demand has improved, but some impact has been seen from increased offshoring in a large deal. Hence, this vertical would grow slower than others.
- Recovery in ER&D was largely driven by improved demand (new product engineering and product sustenance), which is expected to grow in the near term.
- FCF/PAT conversion continues to be strong due to (a) improved DSO and (b) higher non-cash expenses (depreciation & amortization; some part of tax).
- High localization in the US (two-thirds) helps. H1B visa regulatory changes would still have some impact as HCL needs to provide wage hikes in some cases.

Valuation and view – subdued multiples offer safety margin

- HCLT's exposure to deeply troubled verticals (e.g., Energy, Travel, Transportation, Hospitality, and Retail) is lower v/s peers. Moreover, the company has higher exposure in Financial Services, Technology Services, and Life Sciences, wherein we anticipate a better outlook.
- Additionally, higher exposure in IMS (~37% of revenue), comprising a larger share of non-discretionary spend, offers better resilience to its portfolio in the current context – with increased demand for cloud, network, security, and digital workplace services.
- Broad-based sequential growth, coupled with healthy deal wins and a robust pipeline, indicates an improved outlook. The upgrade in margin guidance is another positive and indicates its ability to sustain some amount of margin improvement.
- However, the company's high exposure to ER&D (~16% of revenue) is a key monitorable. While decent sequential growth was seen in this segment in 2Q, the growth outlook in the near term is comforting.

- Given its deep capabilities in the IMS space and strategic partnerships, investments in cloud, and digital capabilities, we expect HCLT to emerge stronger on the back of an expected increase in enterprise demand for these services. The stock is currently trading at a modest ~15x on FY22E earnings and offers a safety margin. Our TP is based on ~19.5x FY22E EPS (a 30% discount to TCS). Maintain Buy.

Quarterly Performance

(INR b)

Y/E March	FY20				FY21E				FY20	FY21E	Est.	Var. (% /
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QFY21	bp)
Revenue (USD m)	2,364	2,486	2,543	2,543	2,356	2,507	2,562	2,640	9,936	10,064	2,485	0.9
QoQ (%)	3.8	5.2	2.3	0.0	-7.4	6.4	2.2	3.0	15.1	1.3	5.5	91bp
Revenue (INR b)	164	175	181	186	178	186	193	199	707	757	185	0.2
YoY (%)	18.5	18.0	15.1	16.3	8.5	6.0	6.8	7.2	16.9	7.1	5.8	26bp
GPM (%)	33.5	36.9	38.4	40.1	39.9	41.2	39.7	40.3	37.3	40.3	40.1	112bp
SGA (%)	12.8	13.5	13.7	14.7	14.3	14.6	14.3	14.5	13.7	14.4	14.2	39bp
EBIT	28	35	37	39	37	40	39	41	138	157.7	39	3.3
EBIT Margin (%)	17.1	20.0	20.2	20.9	20.5	21.6	20.4	20.8	19.6	20.8	21.0	63bp
Other income	1	0	1	0	2	1	2	2	2	7	1	155.1
ETR (%)	24.0	23.9	18.4	18.2	24.0	24.0	24.0	24.0	20.9	24.0	21.0	302bp
Adjusted PAT	22	27	30	32	29	31	31	33	111	125	31	1.4
QoQ (%)	-13.1	19.3	14.5	3.8	-7.3	7.5	-0.3	5.2			6.1	145bp
YoY (%)	-7.4	5.1	16.7	23.3	31.5	18.5	3.2	4.6	9.5	13.2	16.9	160bp
EPS	8.2	9.8	11.2	11.6	10.8	11.6	11.5	12.2	40.7	46.1	11.4	1.4

E: MOSL Estimates

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	4.5			16.7	
Costs (% of revenue)										
COGS	66.5	63.1	61.6	59.9	60.1	58.8	60.3	59.7	62.7	59.7
SGA	12.8	13.5	13.7	14.7	14.3	14.6	14.3	14.5	13.7	14.4
Margins										
Gross Margin	33.5	36.9	38.4	40.1	39.9	41.2	39.7	40.3	37.3	40.3
EBIT Margin	17.1	20.0	20.2	20.9	20.5	21.6	20.4	20.8	19.6	20.8
Net Margin	13.5	15.1	16.8	17.0	16.4	16.9	16.2	16.5	15.6	16.5
Operating metrics										
Headcount (k)	144	147	149	150	150	153			150	
Attrition (%)	17.3	16.9	16.8	16.3	14.6	12.2			16.3	
Fixed Price	63.5	66.5	67.8	68.3	66.7	67.4			66.5	
Key Verticals (YoY CC %)										
BFSI	-1.9	15.4	15.5	14.1	11.7	-2.5			11.1	
Manufacturing	22.3	15.2	14.2	34.3	-8.3	-11.5			33.9	
Key Geographies (YoY CC %)										
North America	19.1	15.9	12.6	13.1	-5.8	-1.3			15.8	
Europe	6.1	24.6	19.6	11.9	11.4	-2.6			18.3	



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Exhibit 1: Recovery was broad-based across geographies

Geographies	Contr. To rev. (%)	CC QoQ Gr. (%)	CC YoY Gr. (%)
Americas	63.1	4.9	-1.3
Europe	28.4	2.2	-2.6
ROW	8.5	9.0	15.4

Source: Company, MOFSL

Exhibit 2: Public Services was flattish, while other verticals posted modest/strong growth

Verticals	Contr. To rev. (%)	CC QoQ Gr. (%)	CC YoY Gr. (%)
Financial Services	22.1	2.6	-2.5
Manufacturing	17.7	1.5	-11.5
Technology	17.3	6.3	12.8
Life Sciences & Healthcare	14.1	8.6	9.2
Telecom MP&E	7.7	6.1	-8.8
Retail & CPG	10.4	8.4	3.3
Public Services	10.7	0.2	-3.0

Source: Company, MOFSL

Exhibit 3: All service lines reported growth, with IT and Business Services leading the pack

Segments	Contr. To rev. (%)	CC QoQ Gr. (%)	CC YoY Gr. (%)
IT and Business Services	70.8	4.9	-1.6
Engineering and R&D Services	15.7	3.6	-6.8
Products and Platforms	13.5	3.1	16.2

Source: Company, MOFSL

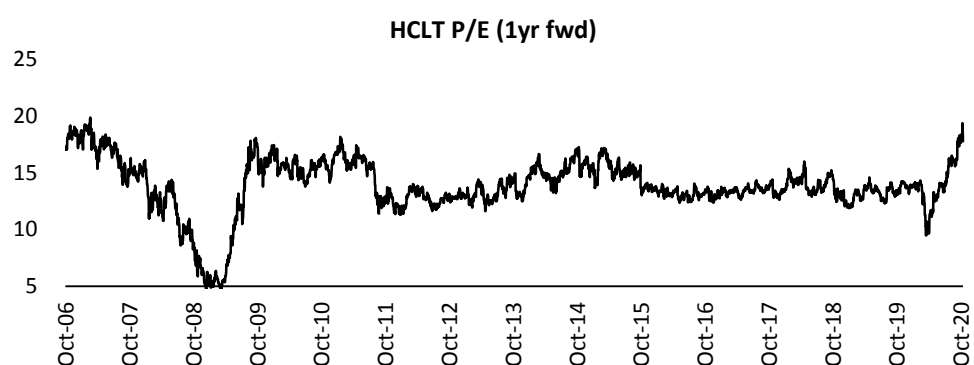
Valuation and view – subdued multiples offer safety margin

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Exhibit 4: Multiples offer safety margin



Source: Bloomberg, MOFSL

Exhibit 5: Revisions to our estimates

	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
INR/USD	75.2	76.5	75.3	76.5	-0.2%	0.0%
USD Revenue - m	10,064	11,206	9,999	11,078	0.7%	1.2%
Growth (%)	1.3	11.4	0.6	10.8	70bps	60bps
EBIT margin (%)	20.8	21.2	20.7	20.6	10bps	60bps
PAT (INR B)	125	145	125	142	0.1%	2.4%
EPS	46.1	53.6	46.1	52.3	0.0%	2.4%

Source: MOFSL

Operating metrics

Exhibit 6: Operating metrics

	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21
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	70.8
Engineering and R&D Services	17.3	17.5	17.1	16.6	16.9	16.9	16.7	16.3	16.0	15.7
Products and Platform	7.8	8.7	8.9	7.6	7.8	11.7	13.1	13.1	13.8	13.5
Vertical wise (%)										
BFSI	23.8	23.0	21.6	22.3	23.8	22.4	21.6	21.1	22.4	22.1
Manufacturing	18.3	18.0	17.7	17.9	18.3	18.7	20.9	20.7	18.1	17.7
Technology & Services	18.2	18.2	18.7	18.5	18.2	16.5	15.1	16.2	17.2	17.3
Retail & CPG	9.1	10.0	10.2	9.9	9.1	10.0	10.3	10.2	10.0	10.4
Telecom MP&E	7.3	7.2	9.2	8.1	7.3	8.4	9.0	8.3	7.6	7.7
Life Sciences	12.8	12.9	13.0	12.9	12.8	12.9	12.2	12.5	13.7	14.1
Public Services	10.5	10.7	9.7	10.5	10.5	11.0	10.9	11.1	11.0	10.7
Geography-wise (%)										
US	64.5	65.8	64.4	62.9	67.7	64.4	62.8	63.4	63.7	63.1
Europe	28.1	26.8	28.2	29.7	25.9	28.2	29.2	28.7	28.3	28.4
ROW	7.5	7.4	7.3	7.4	6.3	7.4	8.0	7.8	8.0	8.5
Client wise (%)										
Top 5 clients	17.0	17.3	17.4	17.0	16.6	16.5	15.2	15.1	13.9	13.7
Top 10 clients	24.6	24.8	24.8	24.1	23.9	24.0	22.4	22.0	20.9	20.9
Top 20 clients	34.2	34.2	34.1	33.4	34.2	34.6	33.0	32.1	30.8	30.6
QoQ Growth (%)										
Vertical wise (%)										
BFSI	(4.0)	(1.3)	(1.5)	6.8	10.7	(1.0)	(1.3)	(2.3)	(1.7)	5.0
Manufacturing	(3.9)	0.5	3.2	4.6	6.1	7.5	14.4	(1.0)	(19.0)	4.1
Technology & Services	9.2	2.1	7.8	2.4	2.1	(4.7)	(6.4)	7.3	(1.7)	7.0
Retail & CPG	(4.4)	12.2	7.0	0.4	(4.6)	15.6	5.4	(1.0)	(9.2)	10.7
Telecom MP&E	(0.6)	0.7	34.0	(8.9)	(6.5)	21.0	9.6	(7.8)	(15.2)	7.8
Life Sciences	12.2	2.9	5.7	2.7	3.0	6.0	(3.2)	2.5	1.5	9.5
Public Services	(0.1)	4.1	(4.9)	12.0	3.8	10.2	1.4	1.8	(8.2)	3.5
Geography wise (%)										
US	5.6	4.2	2.7	1.1	11.7	0.0	(0.2)	1.0	(6.9)	5.4
Europe	(5.6)	(2.6)	10.4	9.0	(9.5)	14.5	6.0	(1.7)	(8.7)	6.8
ROW	(11.1)	0.8	3.5	4.9	(11.7)	23.5	10.6	(2.5)	(5.0)	13.1
Client wise (%)										
Top 5 clients	5.1	3.9	5.5	1.1	1.3	4.5	(5.7)	(0.7)	(14.7)	4.9
Top 10 clients	4.2	3.0	4.9	0.5	2.9	5.6	(4.5)	(1.8)	(12.0)	6.4
Top 20 clients	2.3	2.1	4.6	1.3	6.3	6.4	(2.4)	(2.7)	(11.1)	5.7

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	757	857
Change (%)	13.7	14.3	13.9	8.6	19.5	16.9	7.1	13.3
Cost of Goods Sold	227	270	309	332	393	443	452	493
Gross Profit	131	139	157	173	211	264	305	364
Selling & Admin Exp.	43	52	55	59	72	97	109	123
EBITDA	88	87	102	114	139	167	196	241
% of Net Sales	24.6	21.3	21.9	22.6	23.1	23.6	25.9	28.1
Depreciation	5	5	8	15	21	28	38	59
EBIT	83	82	94	100	118	138	158	182
% of Net Sales	23.3	20.1	20.3	19.7	19.5	19.6	20.8	21.2
Forex Gain	-1	1	2	5	2	0	0	0
Other Income	10	9	7	6	6	2	8	11
PBT	92	92	104	111	126	140	165	192
Tax	19	19	19	23	25	29	40	46
Rate (%)	20.3	20.4	18.8	20.9	19.7	20.9	24.0	24.0
PAT	73	73	84	88	101	111	125	146
EO Item (net)	0	0	0	0	0	0	0	0
Net Income	73	73	84	88	101	111	126	146
Change (%)	28.1	0.2	14.9	4.1	15.4	9.7	13.2	16.4

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	247	279	334	367	421	516	596	684
Net Worth	248	280	335	368	422	517	598	685
Loans	5	10	5	4	40	51	51	51
Other liabilities	13	13	13	13	15	55	58	64
Capital Employed	265	303	353	385	477	623	706	800
Gross Block	136	159	220	269	330	506	567	652
Less : Depreciation	46	51	59	73	95	123	161	221
Net Block	90	107	161	196	235	383	405	431
Other assets	31	39	37	40	56	65	67	73
Investments	0	2	1	3	0	0	0	0
Curr. Assets	236	250	265	246	297	384	446	523
Debtors	95	107	108	123	146	178	185	208
Cash & Bank Balance	118	119	127	98	114	154	204	251
Other Current Assets	23	24	30	25	37	53	57	64
Current Liab. & Prov	92	95	111	99	111	209	212	228
Net Current Assets	144	155	153	146	186	175	234	295
Application of Funds	265	303	353	385	477	623	706	800

Financials and valuations

Ratios

Y/E June	2015	2016E	2017	2018	2019	2020	2021E	2022E
Diluted (INR)								
EPS	25.9	26.0	29.8	31.3	36.7	40.7	46.1	53.6
Cash EPS	27.6	27.8	32.6	36.4	44.6	51.4	60.3	75.8
Book Value	87.7	99.2	118.5	131.1	153.4	190.5	219.9	252.5
DPS	17.0	22.0	24.0	8.0	8.0	8.0	14.0	18.0
Payout %	65.6	84.7	80.4	25.6	21.8	19.6	30.4	33.6
Valuation (x)								
P/E	32.0	32.0	27.8	26.5	22.6	20.4	18.0	15.5
Cash P/E	30.1	29.9	25.5	22.8	18.6	16.1	13.8	11.0
EV/EBITDA	25.4	25.7	21.8	19.6	15.9	12.9	10.7	8.5
EV/Sales	6.2	5.5	4.8	4.4	3.7	3.0	2.8	2.4
Price/Book Value	9.5	8.4	7.0	6.3	5.4	4.4	3.8	3.3
Dividend Yield (%)	2.0	2.7	2.9	1.0	1.0	1.0	1.7	2.2
Profitability Ratios (%)								
RoE	35.4	28.9	27.1	24.8	25.6	24.3	22.6	21.7
RoCE	29.1	23.9	23.2	21.2	19.6	18.7	17.0	17.1
Turnover Ratios								
Debtors (Days)	97	96	85	88	88	92	89	89
Asset Turnover (x)	4.0	3.8	2.9	2.6	2.6	1.8	1.9	2.0

Cash Flow Statement

Y/E June	2015	2016	2017	2018	2019	2020	2021E	2022E
(INR b)								
CF from Operations	77	80	90	102	125	103	163	188
Chg. in Working Capital	-11	-8	5	-35	-34	31	-7	-15
Net Operating CF	66	72	95	68	90	134	156	173
Net Purchase of FA	-12	-11	-62	-49	-61	-176	-61	-69
Net Purchase of Invest.	-15	-7	-2	30	29	-51	0	0
Net Cash from Inv.	-26	-18	-64	-19	-32	-227	-61	-69
Issue of shares/other adj	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	-3	5	9	-1	35	104	0	0
Dividend Payments	-42	-31	-34	-17	-11	-22	-44	-58
Net CF from Finan.	-45	-26	-25	-18	24	82	-44	-58
Free Cash Flow	55	61	33	18	30	-43	95	104
Net Cash Flow	-5	29	6	30	83	-11	51	46
Opening Cash Balance	10	14	7	13	17	59	48	99
Closing CashBalance	14	7	13	17	59	48	99	146

NOTES

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

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