

CMP: ₹ 1251

Target: ₹ 1475 (18%)

Target Period: 12 months

October 18, 2021

BUY

Minimum 75% payout for FY22-26...

About the stock: HCL Technologies (HCLT) offers IT, ER&D and products to BFSI, retail, health, telecommunication, manufacturing, media & hi-tech verticals.

- HCL Tech has 250 Fortune 500 and 650 global 2000 clients
- HCL has grown organically and inorganically (14% CAGR over FY18-21)

Q2FY22 Results: HCLT reported strong IT services revenues.

- Revenue increased 3.5% QoQ in CC terms. IT services and ER&D revenues grew 5%+QoQ while P&P declined 8% QoQ
- EBIT margin declined 63 bps QoQ, 50 bps impact from lower P&P revenues
- P&P revenues are expected to be flat this year vs. earlier guidance of low single digit growth

What should investors do? HCLT share price has grown by ~3.5x over the past five years (from ~₹ 364 in October 2016 to ~₹ 1,259 levels in October 2021).

- We continue to remain positive and retain our BUY rating on the stock

Target Price and Valuation: We value HCLT at ₹ 1475 i.e. 24x P/E on FY23E EPS

Key triggers for future price performance:

- The company continues to win multiyear deals in Cloud transformation, cyber security, etc
- Expects healthy double digit growth in revenues in FY22E mainly led by improved growth in IT & business services and ER&D
- With improvement in large deal wins, expansion in geographies, investment in sales & capabilities, we expect HCLT to register 13.2% CAGR in FY21-23E

Alternate Stock Idea: Apart from HCLT, in our IT coverage we also like TechM.

- Key beneficiary of uptick communication spend
- BUY with target price of ₹ 1,611

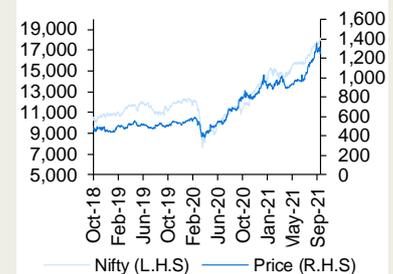
Particulars

Particular	Amount
Market Cap (₹ Crore)	339,452.4
Total Debt (₹ Crore)	3,828.0
Cash & Equivalents (₹ Crore)	15,661.0
EV (₹ Crore)	327,619.4
52 week H/L	1377 / 800.60
Equity capital	543.0
Face value	₹ 2

Shareholding pattern

	Sep-20	Dec-20	Mar-21	Jun-21
Promoters	60.3	60.3	60.3	60.3
FII	24.9	24.9	24.1	23.2
DII	10.6	10.3	10.5	11.0
Public	4.1	4.5	5.0	5.5

Price Chart



Recent Event & Key risks

- Double digit revenue growth in FY22E and EBIT margin of 19.0%-21.0%
- **Key Risk:** (i) Muted digital demand prospects, (ii) Inability to scale acquired business

Research Analyst

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Key Financial Summary

Key Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR FY(21-23E)
Net Sales	60,427	70,678	75,379	13.0%	85,467	96,567	13.2%
EBITDA	13,968	16,694	19,482	17.2%	21,367	24,914	13.1%
Margins (%)	23.1	23.6	25.8		25.0	25.8	
Net Profit	10,122	11,062	12,435	11.1%	13,736	16,540	15.3%
EPS (₹)	37.3	40.8	45.8		50.6	60.9	
P/E	33.5	30.7	27.3		24.7	20.5	
RoNW (%)	24.5	21.6	20.8		20.5	23.2	
RoCE (%)	26.9	23.0	23.5		24.1	27.6	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q2FY22 Earnings Conference Call highlights

- The management reiterated double digit revenue guidance for FY22 and 19-21% EBIT margin for FY22. The company lowered Product & Platforms (P&P) revenue guidance from earlier lower single digit growth in FY22 to flat revenues. P&P had US\$25 mn revenue slippage in Q2
- The company announced its dividend payout policy. HCLT is looking to distribute minimum 75% of the net income, for five years i.e. FY22-26. In line with the same, the company increased dividend for the quarter to ₹ 10 per share from ₹ 7 per share in the prior periods
- HCLT also made some changes in the long term incentive plan for the employees from earlier 100% cash to 70% cash + 30% restricted stock units (RSU). It will be offered as tenure based vesting till FY25
- The company continues to win large deals in cloud, digital, cybersecurity. Also some of the verticals like Retail CPG, Manufacturing saw deal wins in the quarter. Financial services had a muted quarter but the company is confident of coming back on the same in the subsequent quarters
- The company continue to hire freshers to cater to the increasing demand. It added 5,500 freshers in Q2 while addition of freshers for Q1 was 3,500. The company guided for 20,000 fresher's hiring in FY22
- The company received a favourable tax judgment in Q2FY22 (not quantified), due to which tax expense for the quarter were lower. Accordingly, the company revised downward ETR guidance for FY22 to 22-23% from 24-25%
- The sequential decline in P&P was due to delay in some of the deal signing at the end of the quarter. The management reiterated that it is not the loss of the business but the deal signing has been pushed to Q3
- HCLT saw an addition of 11,135 employees in Q2FY22, taking its overall full-time employee headcount to 187,634
- The company indicated that they are pushing for better pricing and some of the new/niche deals are coming with a better pricing. However, they maintained that pricing increase looks difficult for the existing deals

Exhibit 1: Variance Analysis

	Q2FY22	Q2FY22E	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	Comments
Revenue	20,655	20,942	18,594	11.1	20,068	2.9	Revenue was up 3.5% QoQ, led by IT services and ER&D grew by 5%+ while P&P declined 8% QoQ
Cost of sales (including employee expenses)	13,127	13,403	11,279	16.4	12,593	4.2	
Gross Margin	7,528	7,539	7,315	2.9	7,475	0.7	
Gross margin (%)	36.4	36.0	39.3	-289 bps	37.2	-80 bps	
Selling & marketing costs	2,690	2,681	2,364	13.8	2,567	4.8	
EBITDA	4,838	4,858	4,951	-2.3	4,908	-1.4	
EBITDA Margin (%)	23.4	23.2	26.6	-320 bps	24.5	-103 bps	
Depreciation	922	975	935	-1.4	977	-5.6	
EBIT	3,916	3,883	4,016	-2.5	3,931	-0.4	
EBIT Margin (%)	19.0	18.5	21.6	-264 bps	19.6	-63 bps	EBIT margin declined 63 bps QoQ, out of which 50 bps impact was due to lower P&P revenues
Other income	207	140	136	NA	194	6.7	
PBT	4,123	4,023	4,152	-0.7	4,125	0.0	
Tax paid	846	966	999	-15.3	894	-5.4	Favourable assessment led to lower tax for the quarter
PAT	3,264	3,042	3,142	3.9	3,215	1.5	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	85,467	85,467	0.0	96,567	96,567	0.0	We expect 13.2% CAGR revenue growth over FY21-23E
EBIT	17,563	17,563	0.0	20,905	20,905	0.0	
EBIT Margin (%)	20.5	20.5	0 bps	21.6	21.6	0 bps	We expect margins to stabilise at 21.6% in FY23E
PAT	13,736	13,736	0.0	16,540	16,540	0.0	
EPS (₹)	51	51	0.0	61	61	0.0	

Source: Company, ICICI Direct Research

Key Metrics

Exhibit 3: Geography wise break-up

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Revenue by geography (%)					
Americas	63.1	62.5	62.0	63.1	62.8
Europe	28.4	29.5	29.1	27.9	28.3
RoW	8.5	8.0	8.9	9.0	8.9
Growth QoQ (%) - Constant Currency					
Americas	4.9	3.2	2.0	2.6	2.4
Europe	2.2	6.3	0.7	-3.9	5.8
RoW	9.0	-4.5	13.3	2.4	4.0

Source: Company, ICICI Direct Research

Revenue growth was led by Europe & RoW

Exhibit 4: Industry wise break-up

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Revenue by verticals (%)					
Financial Services	22.1	21.4	21.6	22.1	21.3
Manufacturing	17.7	18.1	17.7	17.2	17.9
Lifesciences & Healthcare	14.1	13.6	14.1	14.7	15.3
Public Services	10.7	10.4	11.2	10.8	10.6
Retail & CPG	10.4	10.5	10.1	10.0	9.8
Telecommunications, Media, Publishing & Entertainment	7.7	8.3	8.1	7.9	7.9
Technology & Services	17.3	17.8	17.2	17.3	17.2
Growth QoQ (%) - Constant currency					
Financial Services	2.6	-0.4	3.3	2.9	0.4
Manufacturing	1.5	5.6	0.3	-2.2	8.1
Lifesciences & Healthcare	8.6	0.0	6.6	5.4	7.0
Public Services	0.2	0.5	9.9	-3.4	1.9
Retail & CPG	8.4	3.7	-0.9	-0.1	0.9
Telecommunications, Media, Publishing & Entertainment	6.1	12.1	-0.1	-1.9	3.0
Technology & Services	6.3	6.8	-0.6	1.6	2.6

Source: Company, ICICI Direct Research

Manufacturing, Lifesciences drive growth for the quarter

Exhibit 5: Segment offering wise break-up

	% contribution to revenues Q2FY22	% contribution to revenues Q1FY22	CC Growth QoQ (%)	CC Growth YoY (%)
Revenue by verticals (%)				
IT and Business Services	72.6	71.6	5.2	13.2
Engineering and R&D Services	15.7	15.3	5.4	12.7
Products & Platforms	11.7	13.1	-8.0	-5.5

Source: Company, ICICI Direct Research

On QoQ basis, revenue growth was driven by IT Services and Engineering & R&D services

Exhibit 6: Client & human resource matrix

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Client metrics					
US\$1-5 million	548	502	491	491	507
US\$10-20 million	81	76	82	79	81
US\$50-100 million	15	16	20	23	26
US\$100 million+	14	15	15	14	15
Headcount, Utilization & Attrition					
Total Employees	153,085	159,682	168,977	176,499	187,634
Attrition - IT Services (LTM)	12.2	10.2	9.9	11.8	15.7

Source: Company, ICICI Direct Research

Attrition increased by 390 bps to 15.7 as witnessed for other IT players

Financial summary

Exhibit 7: Profit and loss statement				
	₹ crore			
	FY20	FY21	FY22E	FY23E
Total operating Income	70,678	75,379	85,467	96,567
Growth (%)	17.0	6.7	13.4	13.0
Direct costs	45,295	46,550	52,990	59,099
S,G&A expenses	8,690	9,348	11,111	12,554
Total Operating Expenditure	53,985	55,898	64,101	71,653
EBITDA	16,694	19,482	21,367	24,914
Growth (%)	19.5	16.7	9.7	16.6
Depreciation	2,841	3,985	3,804	4,009
Amortisation	-	-	-	-
Net Other Income	178	657	705	1,076
PBT	14,031	16,154	18,267	21,981
Forex adjustments	-	-	-	-
Total Tax	2,938	3,663	4,476	5,385
PAT	11,062	12,435	13,736	16,540
Growth (%)	9.3	12.4	10.5	20.4
EPS (₹)	40.8	45.8	50.6	60.9
Growth (%)	9.2	12.4	10.5	20.4

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
	FY20	FY21	FY22E	FY23E
PBT	14,031	16,154	18,267	21,981
Depreciation & Amortisation	3,420	4,611	3,804	4,009
(Inc)/dec in Current Assets	(3,162)	1,049	(3,666)	(4,033)
Inc/(dec) in CL and Provisions	1,602	1,992	2,505	2,756
Taxes paid	(2,558)	(3,445)	(4,476)	(5,385)
CF from operating activities	13,359	19,618	15,674	18,196
(Inc)/dec in Investments	(4,452)	(2,762)	705	1,076
(Inc)/dec in Fixed Assets	(7,922)	(1,753)	(1,709)	(1,709)
CF from investing activities	(12,374)	(5,742)	(1,005)	(634)
Issue/(Buy back) of Equity	-	-	-	-
Inc/(dec) in loan funds	(246)	(251)	(500)	(500)
Dividend paid & dividend tax	(1,625)	(3,256)	(6,511)	(12,405)
Inc/(dec) in debentures	-	-	-	-
Others	(1,297)	(1,155)	-	-
CF from financing activities	(3,168)	(11,180)	(7,011)	(12,905)
Net Cash flow	(2,183)	2,696	7,659	4,658
Exchange difference	42	65	-	-
Opening Cash	7,117	4,976	8,888	16,547
Bank bal + unclaimed dvd.	-	-	-	-
Cash & bank c/f to balance sheet	4,976	8,888	16,547	21,205

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
	₹ crore			
	FY20	FY21	FY22E	FY23E
Liabilities				
Equity Capital	543	543	543	543
Reserve and Surplus	50,724	59,370	66,595	70,730
Total Shareholders funds	51,267	59,913	67,138	71,273
Total Debt	4,693	3,828	3,328	2,828
Other liabilities + Provisions	4,907	4,901	5,079	5,276
Minority Interest / Others	154	169	169	169
Total Liabilities	61,021	68,811	75,714	79,546
Assets				
Net Block + CWIP	8,542	8,364	8,361	8,267
Intangible assets + Goodwill	29,348	29,093	27,001	24,796
Investments	77	89	89	89
Liquid investments	6,989	6,773	6,773	6,773
Inventory	91	94	107	120
Debtors	14,131	13,663	15,492	17,503
Loans and Advances	3,422	4,841	5,489	6,202
Other Current Assets	8,811	8,792	9,969	11,263
Cash	4,976	8,888	16,547	21,205
Total Current Assets	38,420	43,051	54,376	63,067
Total Current Liabilities	21,885	17,383	19,709	22,269
Net Current Assets	16,535	25,668	34,666	40,798
Other non current assets	6,519	5,597	5,597	5,597
Application of Funds	61,021	68,811	75,714	79,546

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
	₹ crore			
	FY20	FY21	FY22E	FY23E
Per share data (₹)				
EPS	40.8	45.8	50.6	60.9
Cash EPS	51.2	60.5	64.6	75.7
BV	189.0	220.8	247.4	262.6
DPS	9.5	24.3	24.0	45.7
Cash Per Share	18.3	32.8	61.0	78.1
Operating Ratios (%)				
EBIT Margin	19.6	20.6	20.5	21.6
PBT Margin	19.9	21.4	21.4	22.8
PAT Margin	15.7	16.5	16.1	17.1
Debtor days	73	66	66	66
Return Ratios (%)				
RoE	21.6	20.8	20.5	23.2
RoCE	23.0	23.5	24.1	27.6
RoIC	28.2	29.2	33.5	40.5
Valuation Ratios (x)				
P/E	30.7	27.3	24.7	20.5
EV / EBITDA	19.9	16.8	15.0	12.6
EV / Net Sales	4.7	4.3	3.7	3.3
Market Cap / Sales	4.8	4.5	4.0	3.5
Price to Book Value	6.6	5.7	5.1	4.8
Solvency Ratios				
Debt/EBITDA	0.3	0.2	0.2	0.1
Debt/EBITDA	0.3	0.2	0.2	0.1
Current Ratio	1.2	1.6	1.6	1.6
Quick Ratio	1.2	1.6	1.6	1.6

Source: Company, ICICI Direct Research

Exhibit 11: ICICI Direct coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
HCL Tech (HCLTEC)	1,251	1,475	BUY	339,452	45.8	50.6	60.9	27.3	24.7	20.5	23.5	24.1	27.6	20.8	20.5	23.2
Infosys (INFTEC)	1,716	2,060	BUY	729,276	45.5	54.8	64.3	37.7	31.3	26.7	31.7	34.0	37.0	25.2	27.8	30.3
TCS (TCS)	3,611	4,530	BUY	1,336,070	87.6	110.9	133.0	41.2	32.6	27.2	45.9	51.9	55.8	37.5	43.8	46.8
Tech M (TECMAH)	1,430	1,611	BUY	138,205	50.2	64.7	74.6	28.5	22.1	19.2	19.8	22.8	23.7	17.8	20.4	20.8
Wipro (WIPRO)	708	743	BUY	387,525	19.1	21.2	25.7	37.0	33.5	27.5	21.3	22.8	27.5	19.5	21.6	26.3
LTI (LTINFC)	6,098	6,599	BUY	107,055	111.0	126.2	146.4	54.9	48.3	41.6	31.9	30.9	30.6	26.5	25.7	25.4
Mindtree (MINCON)	4,693	4,915	HOLD	77,295	67.4	89.8	109.2	69.6	52.2	43.0	32.5	36.0	36.3	25.7	28.2	28.2
Coforge (NIITEC)	5,595	6,139	BUY	34,781	73.3	106.3	139.1	76.3	52.6	40.2	23.3	26.8	29.8	18.5	23.4	26.2
TeamLease (TEASER)	4,988	4,550	BUY	8,560	46.5	67.5	100.3	107.3	73.9	49.7	14.2	16.4	19.8	11.6	15.8	18.6
Infoedge (INFEDG)	7,010	6,270	BUY	90,824	20.9	37.1	51.0	335.2	189.0	137.6	7.7	13.1	16.7	6.0	9.9	12.6

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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