

HCL Tech

Refer to important disclosures at the end of this report

Well-crafted strategy in place to drive growth

- At its analyst day event, HCLT outlined its growth and profitability priorities. The company believes that it will continue to see good traction in its services business (14.9% YoY CC in FY22) and that it has a well-crafted strategy in place to deliver superior growth.
- The Digital business led the bulk of growth in FY22 (50% of incremental growth) and HCLT expects to sustain the growth momentum in coming years as well. The ER&D business also saw a healthy recovery after Covid in FY22 (19% of incremental revenue) and the company expects growth to accelerate, driven by increased traction in digital engineering.
- HCLT has guided for 12-14% CC revenue growth in FY23 on the back of continued traction in the services business, healthy deal intake and deal pipeline. It has guided for 18-20% EBITM for FY23, considering supply-side challenges and planned investments in Mode 2 capabilities.
- We have a Buy rating on HCLT with a TP of Rs1,400 at 22x Mar'24E EPS, considering healthy revenue growth momentum in the services business, steady cash generation and attractive valuations (~4% dividend yield; ~6% FCF yield).

Revenue growth momentum to sustain in Services business: HCLT believes that the emerging demand drivers of Cloud and digital transformation bode well for growth momentum over the medium term and that it is well placed to capture these demand trends. It has identified five growth priorities in line with the recent demand trends to drive superior performance: 1) increased focus on cloud (since cloud being at the core of all propositions - digital business, digital foundation, digital operations and digital engineering); 2) strategic programs to deepen engagement with clients with big spend potential (F500/G500, Global 100 R&D spenders); 3) increased investments in Focus & New Frontier markets through dedicated GTM teams; 4) nurturing partner ecosystem to drive growth; and 5) leveraging cross-sell opportunities across ITBS, ERS and P&P clients. HCLT's unique strength in integrating and transforming Application and Infrastructure Services and experience in complex journeys of the Business & IT operating model change differentiates HCLT's digital business from its peers. HCLT expects to sustain revenue growth momentum in the Digital business (50% incremental growth in FY22) in coming years. The Digital foundation business grew 2x of market growth in the past 3 years and HCLT believes it can potentially grow by 2x-3x of market growth in the next 3-4 years on the back of expansion in existing clients, 40-50% potential growth in focused countries and New frontiers, ~USD100bn of addressable renewal opportunities over the next 3 years, strong partnerships with Hyperscalers and technology providers, and consolidation of USD70-80bn potential market with first-time outsourcers. HCLT's ER&D business bounced back in FY22 (16.8% YoY growth) from Covid-led disruptions, led by traction in digital engineering (34% YoY growth). It believes there is significant headroom for growth with global sourcing set to increase from 9% to 12%, long standing relationships with Top R&D spending customers, investments in global new vista locations for talent access and high propensity of customers to buy HCL ERS Next Gen Digital transformation Services. The company has laid down a 6-point strategy to drive growth in the P&P business: 1) differentiated execution by product mix, 2) increased renewal focus, 3) shift to XaaS model and subscription pricing, 4) increased focus on indirect channels – resellers, SI, MSP, OEM and Hyperscalers, 5) increasing profitability for IP partnership products, and 6) leveraging the P&P installed base for services expansion.

FY23 margins to be in 18-20% range: HCLT expects EBITM to be in the 18-20% range in FY23, considering supply-side challenges and planned investments in Mode 2 capabilities and markets. To offset potential margin headwinds like salary inflation and increase in travel and other back-to-office related costs, HCLT has identified margin levers of revenue growth leverage, price improvement for both traditional and digital work, improved utilization, automation, higher offshoring and right shoring, pyramid optimization and improved productivity.

Please see our sector model portfolio (Emkay Alpha Portfolio): [Information Technology \(Page 10\)](#)

Financial Snapshot (Consolidated)

(Rs mn)	FY20	FY21	FY22	FY23E	FY24E
Revenue	706,780	753,790	856,510	988,124	1,115,105
EBITDA	166,930	207,750	205,300	226,301	255,653
EBITDA Margin (%)	23.6	27.6	24.0	22.9	22.9
APAT	110,620	111,440	134,990	147,600	171,665
EPS (Rs)	40.8	41.1	49.7	54.4	63.3
EPS (% chg)	9.2	0.7	21.1	9.3	16.3
ROE (%)	23.4	19.9	22.2	23.2	25.5
P/E (x)	26.0	25.8	21.3	19.5	16.8
EV/EBITDA (x)	16.8	13.2	13.3	11.8	10.2
P/BV (x)	5.5	4.8	4.6	4.4	4.1

Source: Company, Emkay Research

CMP	Target Price
Rs 1,061 as of (May 11, 2022)	Rs 1,400 (■) 12 months
Rating	Upside
BUY (■)	32.0 %

Change in Estimates

EPS Chg FY23E/FY24E (%)	-/-
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

	EPS Estimates	
	FY23E	FY24E
Emkay	54.4	63.3
Consensus	54.1	61.9
Mean Consensus TP (12M)	Rs 1,310	

Stock Details

Bloomberg Code	HCLT IN
Face Value (Rs)	2
Shares outstanding (mn)	2,714
52 Week H/L	1,378 / 895
M Cap (Rs bn/USD bn)	2,879 / 37.27
Daily Avg Volume (nos.)	3,620,093
Daily Avg Turnover (US\$ mn)	53.4

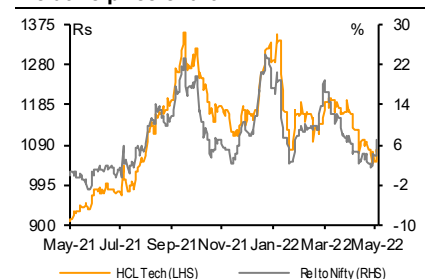
Shareholding Pattern Mar '22

Promoters	60.7%
FIIs	19.0%
DIIIs	14.7%
Public and Others	5.6%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(6)	(9)	(9)	17
Rel. to Nifty	2	(2)	1	7

Relative price chart



Source: Bloomberg

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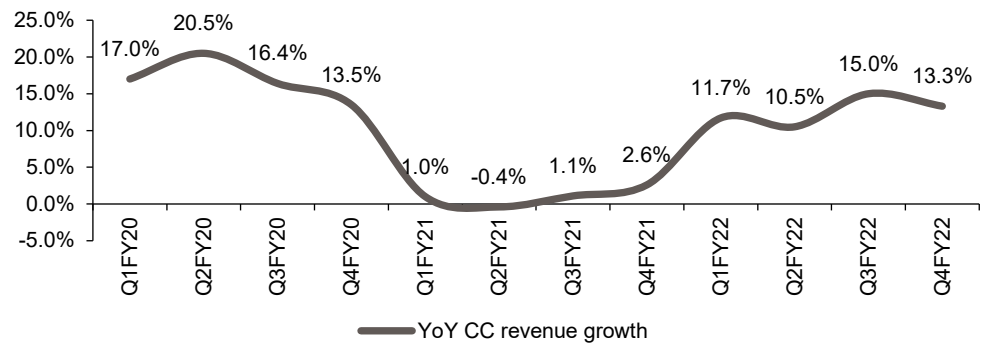
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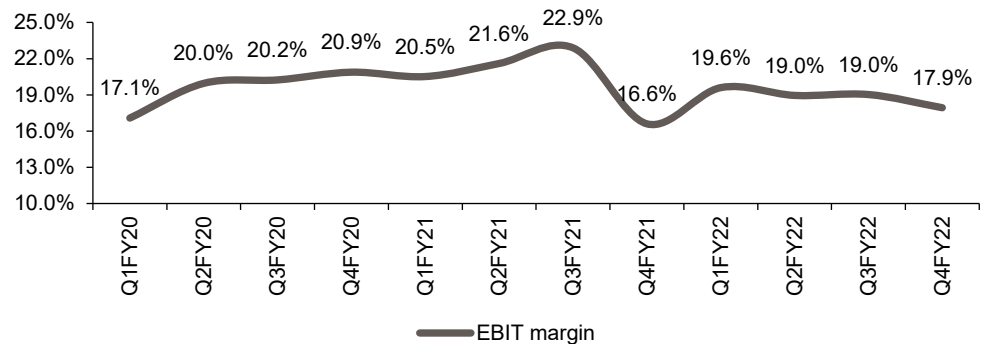
Story in Charts

Exhibit 1: YoY CC growth improved in H2FY22



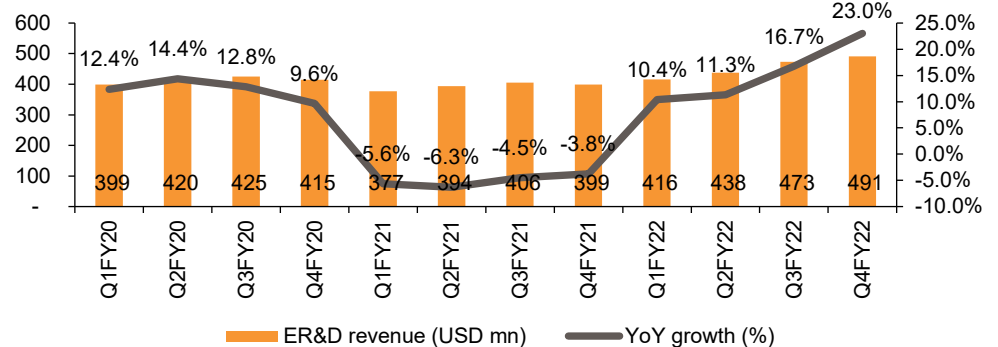
Source: Company, Emkay Research

Exhibit 2: EBITM came under pressure in FY22 due to supply side challenges; FY23 EBITM to be in 18-20% range



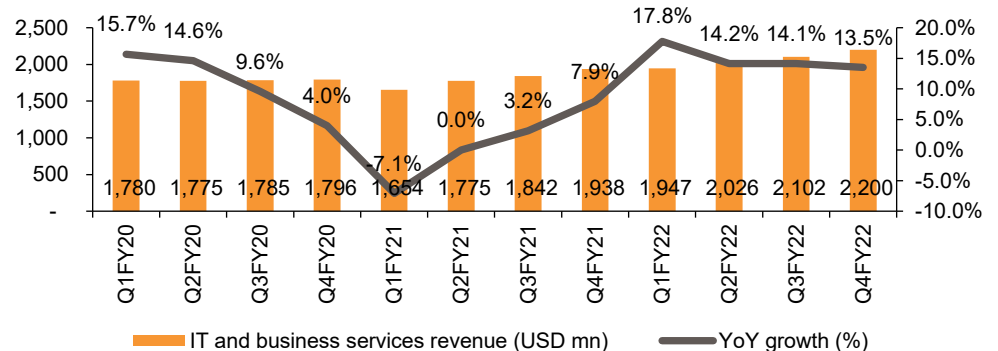
Source: Company, Emkay Research

Exhibit 3: ER&D revenue has seen healthy recovery post Covid led disruption



Source: Company, Emkay Research

Exhibit 4: Services business has seen healthy growth momentum in recent quarters



Source: Company, Emkay Research

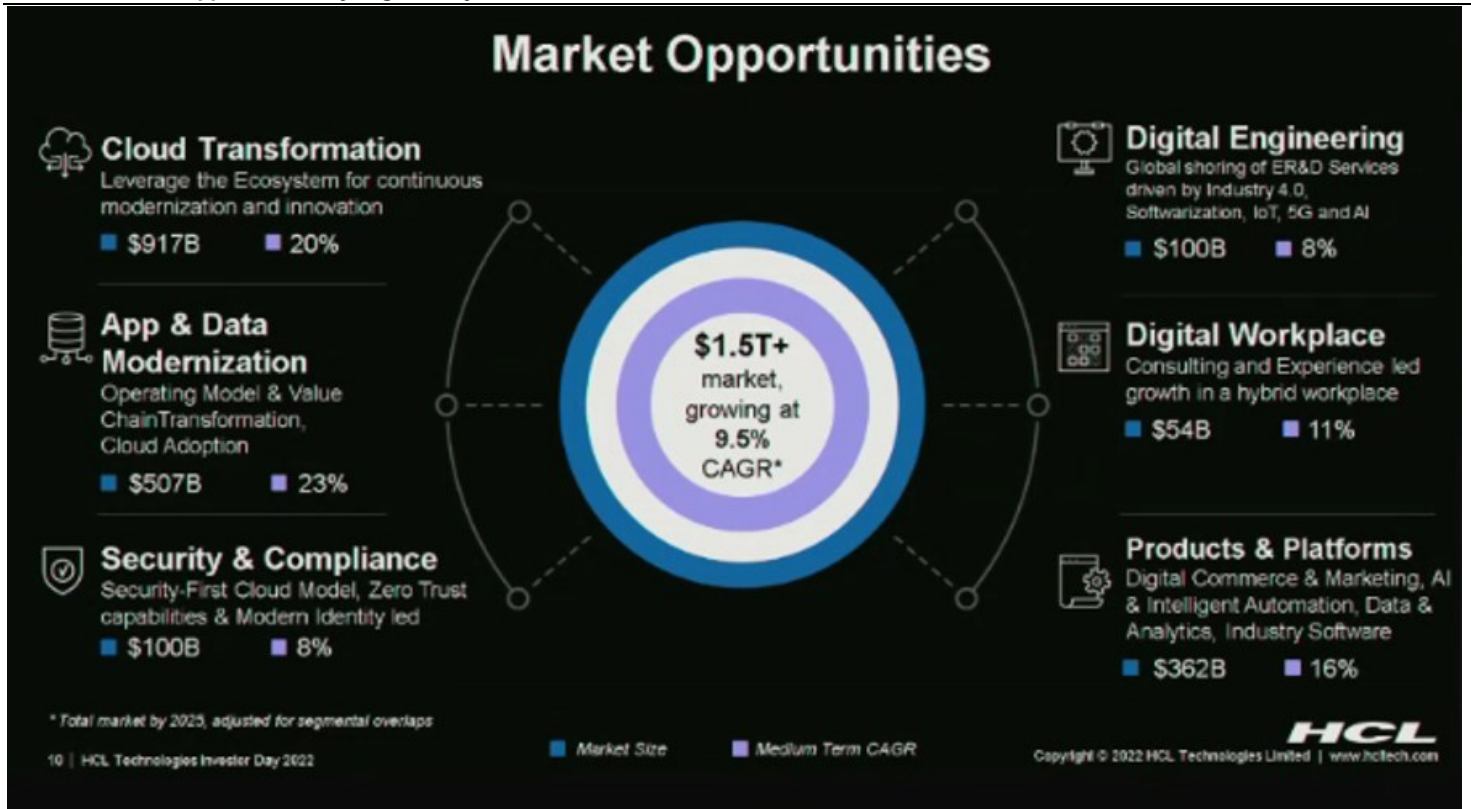
Other KTA's

- The emerging demand drivers are 1) shift from legacy/boutique vendors to scale digital vendors, 2) Cloud – 51% of global tech spends expected to be on cloud by 2025, 3) clients looking to leverage ecosystem for innovation and growth opportunities, 4) increased global sourcing of engineering and R&D services, and 5) increased acceptance of offshoring/near shoring. HCLT is well poised to benefit from these demand trends.
- **Digital business:** This segment has shown strong growth since 2020, which is reflected in 54+ notable customer renewals with enhanced scope for digital transformation and 66+ new customer wins.
- **ER&D business:**
 - The segment grew by 16.8% YoY in FY22 and HCLT has relationship with 61 of top 100 R&D spenders.
 - Digital engineering revenue mix grew from 25% in FY21 to 29% in FY22.
 - Telecom, industrial manufacturing and automotive verticals have recovered from their lows, while the Aerospace vertical has started to recover.
- **Digital Foundation:**
 - Clients are shifting toward Distributed, Multi-cloud, and Hybrid cloud. The business mix of Public Cloud has increased from 3% in FY18 to 19% in FY22 and is expected to reach 39% by FY25. The corresponding mix for Datacenter fell from 97% in FY18 to 81% in FY22 and will be 61% in FY25.
 - Experience-led digital workplace (DWP): The share of Consulting and experience services grew from 1% in FY18 to 16% in FY22 and is expected to reach 40% in FY25, with the share of EUC services declining from 99% in FY18 to 60% in FY25.
 - Growth drivers for Cyber security are Managed Identity and Access Management, Security of things, Cloud security and SASE and Application & data security. Growth drivers for Software defined Network services are distributed, multi cloud, hybrid cloud networking, Private 5G and WiFi6, SD-WAN & SASE and Network-as-a-Service.
- **Cloud business:**
 - Talent engine, end-to-end approach and Innovation are the three pillars leading the cloud transformation market for HCLT.
 - HCL's cloud business is well positioned to win in the Cloud segment on the back of Hyperscalers channel expansion, Cloud factory delivery model (faster time to revenue, improved margins by automation, from T&M to outcome based), upselling CloudSmart ecosystem offerings with ERS IOTWorks, Cloud Native & SaaS solutions and impactful investments for innovation.
- **P&P business:**
 - They currently have 6,800 global customers (with over USD10,000 annual revenue) in 132+ countries of which 66 are F100 companies, 223 F500 companies and 241 Global 500 companies. It has 75+ software products, which include AppScan, Bigfix, Commerce, Unica, etc.
 - The 4 key addressable markets include: 1) Digital transformation market with a TAM of \$17.4bn and is growing at a CAGR of 12.5%; 2) AI & Intelligent Automation market with a TAM of \$21.4bn and growing at a 16.5% CAGR; 3) Data & Analytics market with a TAM of \$34.1bn and growing at a 17.1% CAGR; and 4) Industry software market with a TAM of \$24.4bn and growing at a 16.7% CAGR.
 - The company has bifurcated its P&P products in Horizon 1 (Core products; 44% of revenue in FY22 and declined 12% YoY), Horizon 2 (growth products; 54% of revenue in FY22 and grew 9% YoY) and Horizon 3 (explore products; 2% of revenue in FY22 and grew 24% YoY).
 - FY22 revenue mix – 30% licenses, 67% subscription and support, and 3% services.
 - HCLT has invested a total of USD3.5bn in the P&P business since Jun'16. It recovered ~68% of investment so far and expects to recover the balance in the next couple of years. P&P investments yielded an ~18% post-tax IRR as per management.

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- Fresher hiring has increased from 5,900 in FY19 to 22,850 in FY22 and the share of new vistas headcount has increased from 7.8% in FY19 to 15.8% in FY22.
- Management remains confident of delivering OCF/profit of over 120% for next few years. It expects RoC to be over 30% in FY23.
- Capital allocation: The company plans to return minimum 75% of net income over 5 years (FY22-26).

Exhibit 5: Market opportunities by segment by 2025



Source: Company, Emkay Research








Exhibit 6: HCLT's partner ecosystem



Source: Company, Emkay Research

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Exhibit 7: HCLT ER&D business growth by verticals

	VERTICAL	FY22 – FY24*		FY21 - FY22
		Global Sourcing Vertical Mix %	CAGR %	HCL ERS Revenue Growth YoY % vis-à-vis Industry
	Software & Internet	32%	12% - 13%	●●
	Telecom	8%	6% - 7%	●●
	Semiconductors	5%	7% - 8%	●●
	Medical Devices	3%	6% - 7%	●●●
	Industrial Mfg.	8%	3% - 4%	●●
	Transport: Auto	14%	4% - 5%	●
	Transport: Aero	5%	3% - 4%	●

*Source: *Everest Group, 2022*

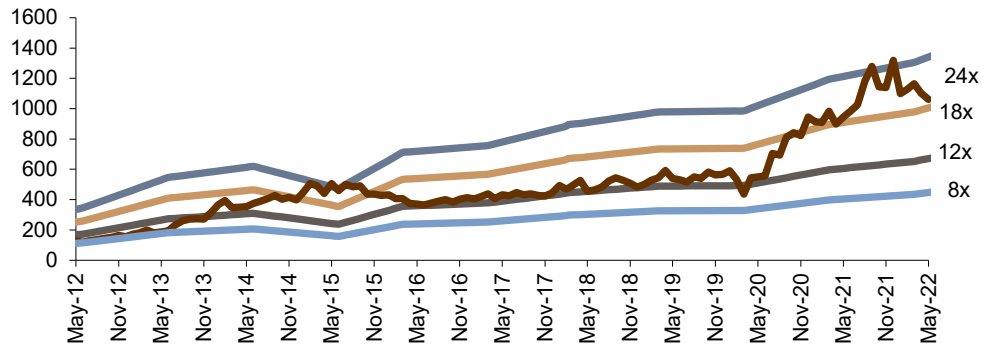
Source: Company, Emkay Research

Exhibit 8: Product and Platform business across horizon 1,2 and 3 and growth trajectory in FY22

	Horizon 1 <i>Core Products</i>	Horizon 2 <i>Growth Products</i>	Horizon 3 <i>Explore Products</i>
Key Products	<ul style="list-style-type: none"> DX, Domino, Sametime, Connections OneDB, Versant Mainframe Suite, Service Orchestration 	<ul style="list-style-type: none"> CX, AppScan, VoltMX CAPS Quest Informatics Intelligent Automation Avalanche / Zen / Vector / ActianX 	<ul style="list-style-type: none"> Connected Data Platform MXGo, CX Studio AI/ops, SIAM/XaaS 5G / Industry 4.0 Offerings Business Observability
FY22 % Rev Share*	44%	54%	2%
FY22 YoY % Growth	-12%	9%	24%
Prominent Model – Go Forward	On-Premise	Cloud / SaaS / OEM	CloudNative / SaaS / Edge cloud
Strategic Driver	Modernising the Core and Improving Product Experience	Aligning to client adoption of Cloud/SaaS consumption models	Accelerators for Horizon 2 and predictable recurring revenue growth
Go Forward Strategy	Drive high renewal rate <ul style="list-style-type: none"> Pathway for pro-code/low-code Dev. environment for Domino customers Enabling CloudNative capabilities as part of roadmap for products Enabling Cloud Delivery options Bundled Offering and Consulting Services 	<ul style="list-style-type: none"> Supporting and accelerating growth momentum with bundled offerings Shift to XaaS model, Subscription pricing 	<ul style="list-style-type: none"> Investment orientation for future growth

Source: Company, Emkay Research

Exhibit 9: HCLT 1 year forward P/E chart



Source: Company, Emkay Research

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY20	FY21	FY22	FY23E	FY24E
Revenue	706,780	753,790	856,510	988,124	1,115,105
Expenditure	539,850	546,040	651,210	761,823	859,452
EBITDA	166,930	207,750	205,300	226,301	255,653
Depreciation	28,400	46,110	43,260	43,446	44,041
EBIT	138,530	161,640	162,040	182,855	211,613
Other Income	1,790	4,160	7,470	12,155	15,078
Interest expenses	0	0	0	0	0
PBT	140,320	165,800	169,510	195,010	226,690
Tax	29,380	54,120	34,280	46,802	54,406
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	(320)	(240)	(240)	(608)	(620)
Reported Net Income	110,620	111,440	134,990	147,600	171,665
Adjusted PAT	110,620	111,440	134,990	147,600	171,665

Balance Sheet

Y/E Mar (Rs mn)	FY20	FY21	FY22	FY23E	FY24E
Equity share capital	5,427	5,427	5,427	5,427	5,427
Reserves & surplus	516,339	593,703	613,713	647,339	688,747
Net worth	521,766	599,130	619,140	652,766	694,175
Minority Interest	384	1,690	920	920	920
Loan Funds	79,614	65,010	65,790	65,950	65,950
Net deferred tax liability	(21,946)	(10,328)	(10,641)	(10,260)	(10,260)
Total Liabilities	579,818	655,502	675,209	709,376	750,785
Net block	382,890	374,570	371,390	343,130	316,546
Investment	106,070	140,700	114,850	173,120	173,120
Current Assets	320,430	334,860	392,330	444,359	542,966
Cash & bank balance	48,430	65,210	105,100	104,350	159,471
Other Current Assets	93,370	93,460	78,910	113,702	128,313
Current liabilities & Provision	229,572	194,628	203,361	251,233	281,847
Net current assets	90,858	140,232	188,969	193,126	261,119
Misc. exp	0	0	0	0	0
Total Assets	579,818	655,502	675,209	709,376	750,785

Cash Flow

Y/E Mar (Rs mn)	FY20	FY21	FY22	FY23E	FY24E
PBT (Ex-Other income) (NI+Dep)	139,800	161,640	162,040	182,855	211,613
Other Non-Cash items	(7,970)	3,874	(4,371)	(3,730)	0
Chg in working cap	(19,120)	(4,149)	(39,913)	(4,526)	(12,872)
Operating Cashflow	123,774	203,390	169,127	186,520	202,833
Capital expenditure	(83,819)	(29,856)	(15,219)	(15,186)	(17,457)
Free Cash Flow	39,955	173,534	153,908	171,334	185,377
Investments	(45,930)	(27,559)	29,916	(58,270)	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(129,750)	(57,415)	14,697	(73,456)	(17,457)
Equity Capital Raised	1	0	0	0	0
Loans Taken / (Repaid)	9,242	(76,751)	(14,995)	160	0
Dividend paid (incl tax)	(16,231)	(32,595)	(122,051)	(113,974)	(130,256)
Other Financing Cash Flow	2,104	(8,238)	(6,888)	0	0
Financing Cashflow	(4,884)	(117,585)	(143,934)	(113,814)	(130,256)
Net chg in cash	(10,860)	28,390	39,890	(750)	55,121
Opening cash position	59,290	48,430	65,210	105,100	104,350
Closing cash position	48,430	76,820	105,100	104,350	159,471

Source: Company, Emkay Research

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Key Ratios

Profitability (%)	FY20	FY21	FY22	FY23E	FY24E
EBITDA Margin	23.6	27.6	24.0	22.9	22.9
EBIT Margin	19.6	21.4	18.9	18.5	19.0
Effective Tax Rate	20.9	32.6	20.2	24.0	24.0
Net Margin	15.7	14.8	15.8	15.0	15.5
ROCE	27.5	26.8	25.5	28.2	31.1
ROE	23.4	19.9	22.2	23.2	25.5
RoIC	37.0	37.0	35.8	41.2	49.8

Per Share Data (Rs)	FY20	FY21	FY22	FY23E	FY24E
EPS	40.8	41.1	49.7	54.4	63.3
CEPS	51.2	58.1	65.7	70.4	79.5
BVPS	192.3	220.8	228.2	240.5	255.8
DPS	8.0	26.0	44.0	42.0	48.0

Valuations (x)	FY20	FY21	FY22	FY23E	FY24E
PER	26.0	25.8	21.3	19.5	16.8
P/CEPS	21.5	18.9	16.7	15.6	13.8
P/BV	5.5	4.8	4.6	4.4	4.1
EV / Sales	4.0	3.6	3.2	2.7	2.3
EV / EBITDA	16.8	13.2	13.3	11.8	10.2
Dividend Yield (%)	0.8	2.5	4.1	4.0	4.5

Gearing Ratio (x)	FY20	FY21	FY22	FY23E	FY24E
Net Debt/ Equity	(0.1)	(0.2)	(0.2)	(0.3)	(0.4)
Net Debt/EBIDTA	(0.4)	(0.7)	(0.8)	(0.9)	(1.0)
Working Cap Cycle (days)	21.9	36.3	35.7	32.8	33.3

Growth (%)	FY20	FY21	FY22	FY23E	FY24E
Revenue	17.0	6.7	13.6	15.4	12.9
EBITDA	19.5	24.5	(1.2)	10.2	13.0
EBIT	17.2	16.7	0.2	12.8	15.7
PAT	9.3	0.7	21.1	9.3	16.3

Quarterly (Rs mn)	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Revenue	196,410	200,680	206,550	223,310	225,970
EBITDA	52,760	49,080	48,380	53,930	50,530
EBITDA Margin (%)	26.9	24.5	23.4	24.2	22.4
PAT	11,200	32,150	32,640	34,540	36,060
EPS (Rs)	4.1	11.8	12.0	12.7	13.3

Source: Company, Emkay Research

Shareholding Pattern (%)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Promoters	60.3	60.3	60.3	60.3	60.7
FII	24.1	23.2	22.3	20.4	19.0
DII	10.5	11.3	12.5	13.7	14.7
Public and Others	5.0	5.1	4.9	5.5	5.6

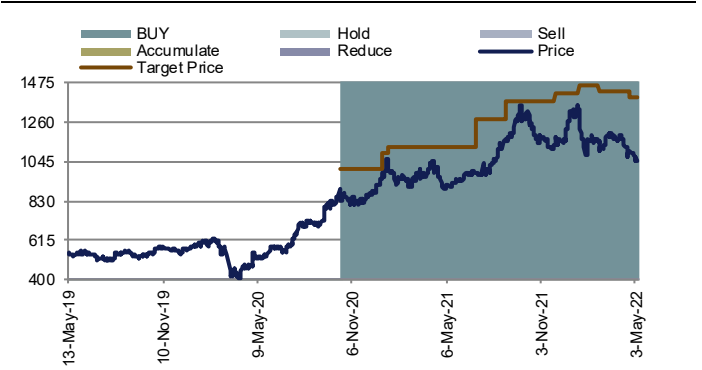
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
22-Apr-22	1,102	1,400	12m	Buy	Dipeshkumar Mehta
1-Apr-22	1,170	1,430	12m	Buy	Dipeshkumar Mehta
22-Feb-22	1,150	1,430	12m	Buy	Dipeshkumar Mehta
15-Jan-22	1,337	1,460	12m	Buy	Dipeshkumar Mehta
1-Jan-22	1,319	1,420	12m	Buy	Dipeshkumar Mehta
30-Nov-21	1,139	1,420	12m	Buy	Dipeshkumar Mehta
15-Oct-21	1,251	1,380	12m	Buy	Dipeshkumar Mehta
2-Oct-21	1,274	1,380	12m	Buy	Dipeshkumar Mehta
27-Aug-21	1,163	1,380	12m	Buy	Dipeshkumar Mehta
20-Jul-21	977	1,280	12m	Buy	Dipeshkumar Mehta
2-Jul-21	985	1,280	12m	Buy	Dipeshkumar Mehta
24-Apr-21	956	1,130	12m	Buy	Dipeshkumar Mehta
5-Apr-21	1,034	1,130	12m	Buy	Dipeshkumar Mehta
18-Mar-21	948	1,130	12m	Buy	Dipeshkumar Mehta
15-Jan-21	990	1,130	12m	Buy	Dipeshkumar Mehta
4-Jan-21	980	1,090	12m	Buy	Dipeshkumar Mehta
18-Dec-20	891	1,010	12m	Buy	Dipeshkumar Mehta
16-Oct-20	827	1,010	12m	Buy	Dipeshkumar Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – Information Technology



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Sector

IT Services, ITeS and Software

Analyst bio

Dipesh is a seasoned Equities professional who has covered Technology sector for over 15 years. Dipesh has completed his B.E. in Information Technology from Sardar Patel University and MMS in Finance from Mumbai University.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight based on Current NAV	Change vs last published EAP (bps)
Information Technology	13.37	13.28	-1%	-9	100.00	
BirlaSoft	0.00	0.03	NA	3	0.23	0
Coforge	0.13	0.00	-100%	-13	0.00	0
Firstsource Solutions	0.00	0.03	NA	3	0.23	0
HCL Tech	1.23	1.24	1%	1	9.26	0
Infosys	5.99	6.04	1%	6	45.20	0
L&T Infotech	0.21	0.00	-100%	-21	0.00	0
Mindtree	0.20	0.21	8%	2	1.60	0
Mphasis	0.23	0.28	22%	5	2.10	0
Oracle Financial Services*	0.09	0.00	-100%	-9	0.00	0
Persistent Systems	0.00	0.18	NA	18	1.31	0
TCS	3.75	3.65	-3%	-10	27.30	0
Tech Mahindra	0.81	0.85	4%	3	6.34	0
Wipro	0.74	0.77	4%	3	5.77	0
Cash	0.00	0.09	NA	9	0.67	0

Source: Emkay Research

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

Sector portfolio NAV

	Base					Latest
	1-Apr-19	10-May-21	10-Nov-21	10-Feb-22	8-Apr-22	10-May-22
EAP - Information Technology	100.0	178.8	229.2	234.1	235.7	206.6
BSE200 Neutral Weighted Portfolio (ETF)	100.0	167.5	215.0	217.1	218.1	190.7

*Performance measurement base date 1st April 2019

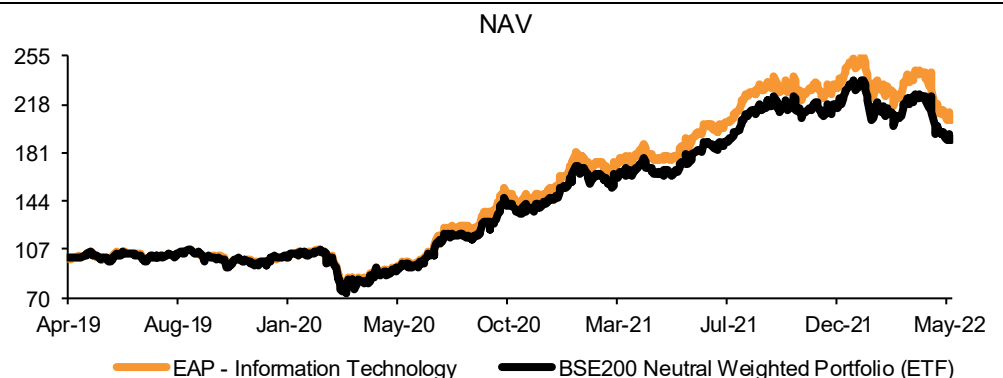
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - Information Technology	-12.3%	-11.7%	-9.9%	15.6%
BSE200 Neutral Weighted Portfolio (ETF)	-12.6%	-12.2%	-11.3%	13.9%

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 12 May 2022 03:21:24 (SGT)

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