

# HCL Technologies

## BUY

### Margins to improve gradually

#### Summary

HCL Technologies (HCLT) revenue and profitability was above our estimates led by healthy growth in services & products revenues. The company's IT services revenues (87% of revenues) increased 5.3% QoQ and products revenues increased 24.5% QoQ. Going forward, we expect the company to report healthy growth in IT services revenues mainly led by healthy deal wins. This coupled with strong client addition and net addition of 10,143 bodes well for revenue growth. In addition, we believe that with improvement in product business we expect margins to improve in coming quarters. Further, the company's aim to increase payout to 75% of net income for next 5 years is key positives. Hence, we upgrade the stock from HOLD to BUY with a target price of Rs 1,545 (PE of 24x on FY24 EPS).

#### Key Highlights and Investment Rationale

##### ■ Improvement in product business & robust IT services growth key positives

HCL's overall net new TCV (product + services) is up 64% YoY to US\$2135 mn. This coupled with the company's aim to expand IT services into newer geographies, traction in cloud and improvement in ER&D bodes well for IT revenue growth. HCL is also expected to witness improvement in products led by lower matured products and higher contribution from high growth products. HCLT is seeing acceleration in multi-year deal, cloud, cloud consulting, cloud migration, app modernization. Hence, we expect 14.3% CAGR growth over FY21-FY24E.

##### ■ Operating margins to improve gradually

HCL has guided for double digit revenue growth for revenues and margins at lower end of 19-21% for FY22E. We believe this is temporary aberration and we expect margins to improve gradually led by higher contribution of products business, automation, pyramid rationalization and revenue growth.

<b>TP</b>	<b>Rs1,545</b>
<b>CMP</b>	<b>Rs1,338</b>
Potential upside/downside	16%
Previous Rating	HOLD

#### Price Performance (%)

	-1m	-3m	-12m
Absolute	15.1	6.9	30.1
Rel to Sensex	9.8	7.1	6.7

#### V/s Consensus

EPS (Rs)	FY22E	FY23E	FY24E
IDBI Capital	48.6	56.2	64.4
Consensus	49.4	56.7	63.9
% difference	(1.6)	(0.9)	0.8

#### Key Stock Data

Bloomberg/Reuters	HCLT IN/ HCLT.BO
Sector	IT Services
Shares o/s (mn)	2,714
Market cap. (Rs mn)	3,629,663
3-m daily avg Trd value (Rs mn)	387.4
52-week high / low	Rs1,377 / 890
Sensex / Nifty	61,223 / 18,256

#### Shareholding Pattern (%)

Promoters	60.3
FII	22.3
DII	12.3
Public	5.1

#### Financial snapshot

(Rs mn)

Year	FY20	FY21	FY22E	FY23E	FY24E
Revenue	6,04,280	7,53,790	8,60,418	9,98,089	11,26,965
Change (yoy, %)	19	7	14	16	13
EBITDA	1,39,690	1,93,280	2,00,797	2,35,214	2,69,523
Change (yoy, %)	22	16	4	17	15
EBITDA Margin (%)	23.1	25.6	23.3	23.6	23.9
Adj. PAT	1,01,230	1,24,340	1,31,861	1,52,435	1,74,748
EPS (Rs)	37.3	45.8	48.6	56.2	64.4
Change (yoy, %)	18	14	6	16	15
PE(x)	36	29	28	24	21
Dividend Yield (%)	0	2	3	3	4
EV/EBITDA (x)	26	18	17	15	13
RoE (%)	26.0	22.4	21.4	23.4	25.2
RoCE (%)	29	24	23	26	28

Source: IDBI Capital Research;

### Concall Highlights

- Engineering and R&D led the momentum with 8.3%/19.7% QoQ/YoY growth in CC; IT and Business services delivered 4.7% QoQ CC
- Mode 2 continues to lead the growth momentum growing at 6%/30.2% QoQ/YoY in Constant Currency.
- During the qtr company signed 8 net new large services deals and 8 new products deals
- Net new bookings remained strong at US\$2.1bn which is +64% YoY
- Pipeline continues to remain strong across all geos and verticals and balanced across sized deals.
- Cloud is the important theme which is driving lot of growth.
- Witnessing lot of momentum in engineering and R&D business led by IOT and industry 4.0 semiconductor and telecom sector transformation.
- Investments in new 48 countries are continuing and are getting into structure with right sized sales, sales support and delivery organisation.
- Campus placement in US is on track with target of hiring 2000 fresh graduates in 2-3years.
- Client mining: +1 to US\$50mn+ and +11 YoY; ETR for this Qtr was 22.5%.
- Margins: services margin has dropped by 190bps from 18.9% to 17% in Q3FY22; salary increment -80bps; seasonal leave -65bps; investment -40bps; retention & attrition, cost supply side issue -85bps; +60 bps operating leverage SGNA expense and Depreciation & Amortisation ; +20 exchange currency.
- OCF US\$584mn +100 QoQ; FCF was US\$521mn; gross Cash of 2.7bn and net of US\$2.14bn after 3 cash payouts.
- HCL is acquiring 100% stake in Starschema, a limited liability company incorporated in Hungary for total cash consideration of US\$ 42.5 mn (EV/sales of 3x). With this acquisition, HCL would enhance its capabilities and solutions in Data Engineering which will accelerate the growth of Mode 2 services in Digital Engineering, Near-shore Eastern European presence and ability to scale. The transaction is expected to be closed by March 2022.

Q3FY22 revenue growth of 7.6%/15%, QoQ/YoY in CC was better than our forecast.

EBIT margin of 19% was flat QoQ and at the lower end of the guided band.

**Exhibit 1: Financial snapshot**

(Rs mn)

Year-end: March	Q3FY22	Q2FY22	QoQ (%)	Q3FY21	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>2,978</b>	<b>2,791</b>	<b>6.7</b>	<b>2,617</b>	<b>13.8</b>
<b>Revenues</b>	<b>2,23,310</b>	<b>2,06,550</b>	<b>8.1</b>	<b>1,93,020</b>	<b>15.7</b>
COGS	1,43,090	1,31,270	9.0	1,15,510	23.9
Gross profit	80,220	75,280	6.6	77,510	3.5
SG&A	27,800	26,900	3.3	23,090	20.4
<b>EBITDA</b>	<b>52,420</b>	<b>48,380</b>	<b>8.4</b>	<b>54,420</b>	<b>(3.7)</b>
Depreciation & amortization	9,910	9,220	7.5	10,270	(3.5)
<b>EBIT</b>	<b>42,510</b>	<b>39,160</b>	<b>8.6</b>	<b>44,150</b>	<b>(3.7)</b>
Other income	2,030	2,070	(1.9)	1,260	61.1
PBT	44,540	41,230	8.0	45,410	(1.9)
Tax	9,970	8,460	17.8	5,440	83.3
Minority interest	140	130	7.7	150	n.m.
<b>Reported net profit</b>	<b>34,430</b>	<b>32,640</b>	<b>5.5</b>	<b>39,820</b>	<b>(13.5)</b>
<b>Diluted EPS (Rs)</b>	<b>12.7</b>	<b>12.0</b>	<b>5.5</b>	<b>14.7</b>	<b>(13.5)</b>
<b>As % of net revenue</b>					
Gross profit	35.9	36.4		40.2	
SG&A	12.4	13.0		12.0	
EBITDA	23.5	23.4		28.2	
EBIT	19.0	19.0		22.9	
Reported net profit	15.4	15.8		20.6	
Tax rate	22.4	20.5		12.0	

Source: Company; IDBI Capital Research

**Exhibit 2: Earnings Revision**

Year-end: March	FY22F			FY23F			FY24E
	New	Old	Chg (%)	New	Old	Chg (%)	Introduced
Revenue (US\$ mn)	11,553.5	11,364.1	1.7	13,307.9	12,519.0	6.3	15,026.2
Revenue (Rs bn)	860.4	839.7	2.5	998.1	926.4	7.7	1,127.0
EBIT (Rs bn)	162.6	153.5	5.9	194.2	162.9	19.2	223.6
<i>EBIT margin (%)</i>	<i>18.90</i>	<i>18.28</i>	<i>62 bps</i>	<i>19.46</i>	<i>17.58</i>	<i>187 bps</i>	<i>19.84</i>
EPS (Rs)	48.6	44.5	9.3	56.2	47.0	19.5	64.4

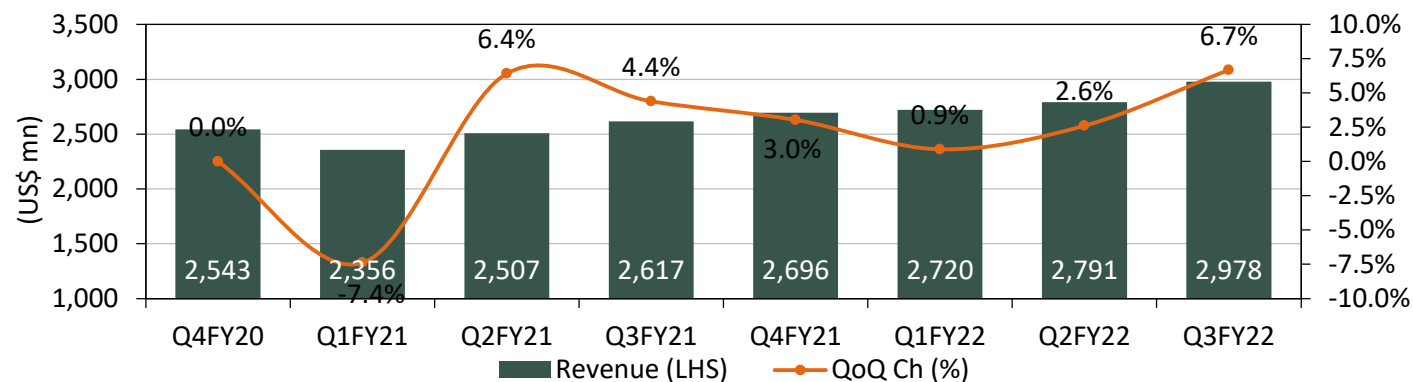
Source: Company; IDBI Capital Research

**Exhibit 3: Actual vs. estimates**

Year to March	Q3FY22	Q3FY22E	Variance (%)
Revenue (US\$ mn)	2,978	2,874	3.6
Revenue (Rs mn)	2,23,310	2,15,567	3.6
EBIT (Rs mn)	42,510	41,267	3.0
<i>EBIT margin (%)</i>	<i>19.0%</i>	<i>19.1%</i>	<i>(11)bps</i>
PAT (Rs mn)	34,430	31,795	8.3
<i>PAT margin (%)</i>	<i>15.4%</i>	<i>14.7%</i>	<i>67bps</i>
EPS (Rs)	12.7	11.7	8.3

Source: Company; IDBI Capital Research

**Exhibit 4: Q3FY22 revenue growth was below better than our forecast**



Source: Company; IDBI Capital Research

**Exhibit 5: Growth in large clients**

Year-end: March	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
US\$100m +	15	15	14	15	15	14	15	15
US\$50m +	30	29	29	31	35	37	41	42
US\$20m +	96	93	91	97	96	104	109	110
US\$10m +	171	173	172	173	178	178	190	198
US\$5m +	308	320	317	312	318	326	329	346
US\$1m +	791	848	865	814	809	817	836	864

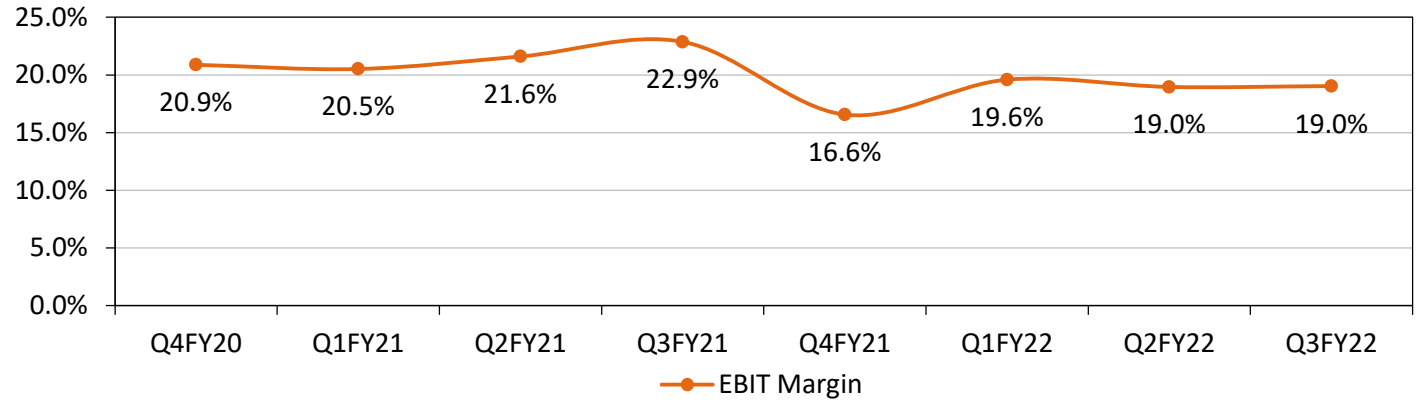
Source: Company; IDBI Capital Research

**Exhibit 6: Revenue growth across various segments (%)**

Parameters	% of revenue	QoQ CC growth	YoY CC growth
Overall revenue growth		7.6	15.0
<b>Geography</b>			
US	63.1	7.3	15.0
Europe	28.3	9.1	12.0
ROW	8.7	4.5	25.8
<b>Service-lines</b>			
IT and Business services	70.6	4.7	15.3
Engineering and R&D Services	15.9	8.3	19.7
Products and Platforms	13.5	24.5	8.2
<b>Verticals</b>			
Financial Services	21.1	6.3	13.5
Manufacturing	17.5	5.7	12.2
Technology & Services	18.4	14.0	18.1
Telecom & Media Publishing	8.1	11.3	12.4
Retail & CPG	10.1	11.5	11.5
Life science & Healthcare	14.4	0.9	21.3
Public Services	10.4	6.1	14.8
<b>Mode 1-2-3 solutions</b>			
Mode 1	59.5	5.1	11.7
Mode 2	25.5	6.1	30.2
Mode 3	15.0	21.6	6.2

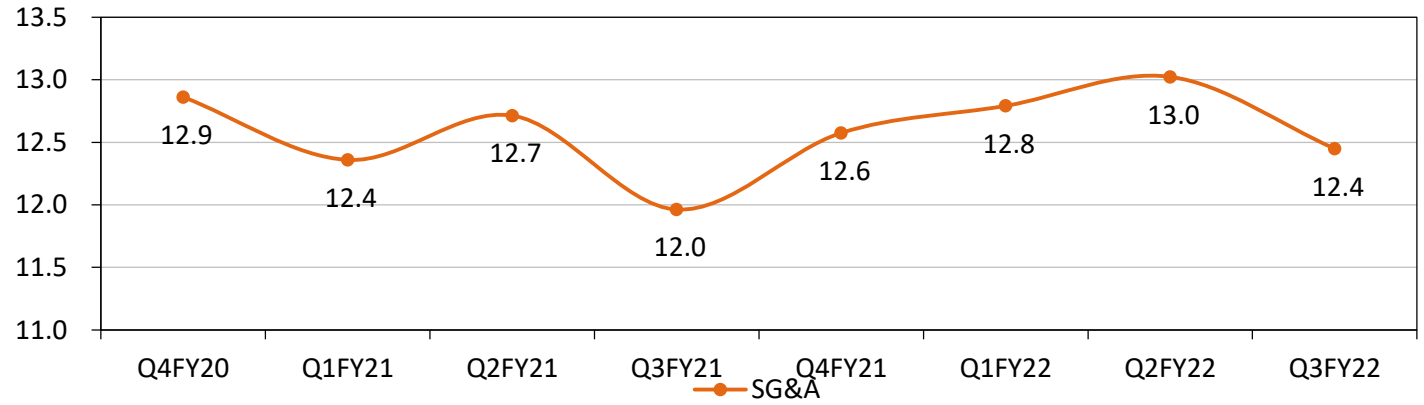
Source: Company; IDBI Capital Research

**Exhibit 7: Q3FY22 EBIT margin was at the lower end of guided band**



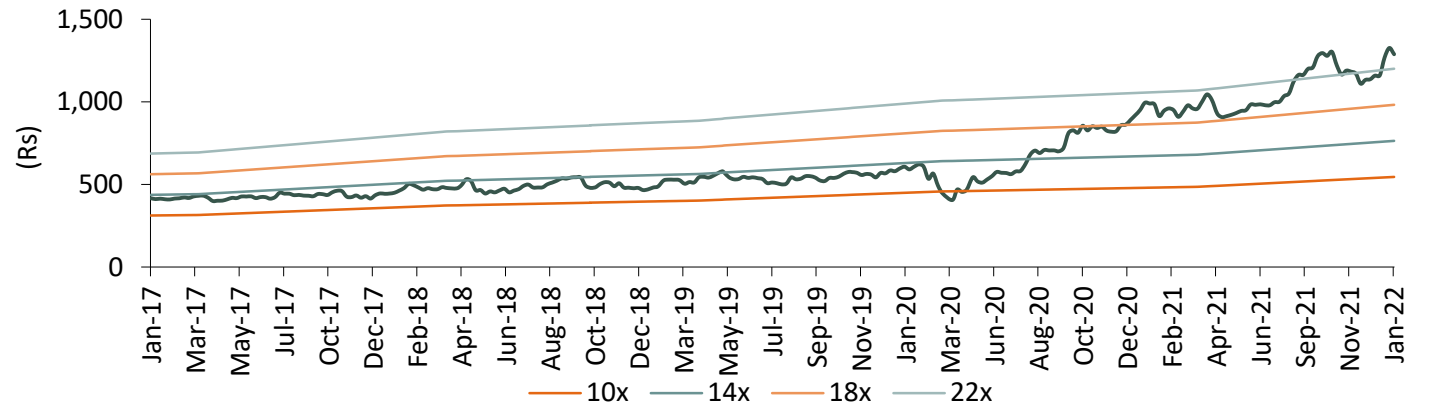
Source: Company; IDBI Capital Research

**Exhibit 8: SG&A saw a QoQ decline**



Source: Company; IDBI Capital Research

**Exhibit 9: One-year forward PER trend**



Source: Company; IDBI Capital Research



## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Net sales</b>	<b>5,05,700</b>	<b>6,04,280</b>	<b>7,53,790</b>	<b>8,60,418</b>	<b>9,98,089</b>	<b>11,26,965</b>
<i>Change (yoy, %)</i>	8	19	7	14	16	13
Operating expenses	(3,91,300)	(4,64,590)	(5,60,510)	(6,59,622)	(7,62,875)	(8,57,442)
<b>EBITDA</b>	<b>1,14,400</b>	<b>1,39,690</b>	<b>1,93,280</b>	<b>2,00,797</b>	<b>2,35,214</b>	<b>2,69,523</b>
<i>Change (yoy, %)</i>	11	22	16	4	17	15
<i>Margin (%)</i>	22.6	23.1	25.6	23.3	23.6	23.9
Depreciation	(14,520)	(21,480)	(39,850)	(38,187)	(40,997)	(45,947)
<b>EBIT</b>	<b>99,880</b>	<b>1,18,210</b>	<b>1,53,430</b>	<b>1,62,610</b>	<b>1,94,217</b>	<b>2,23,576</b>
Interest paid	-	-	-	-	-	-
Other income	11,110	8,050	6,570	7,340	7,408	7,408
<b>Pre-tax profit</b>	<b>1,10,990</b>	<b>1,26,260</b>	<b>1,60,000</b>	<b>1,69,950</b>	<b>2,01,625</b>	<b>2,30,984</b>
Tax	(23,160)	(24,810)	(35,100)	(37,459)	(48,390)	(55,436)
<i>Effective tax rate (%)</i>	20.9	19.6	21.9	22.0	24.0	24.0
Minority Interest	-	(220.0)	(560.0)	(630.0)	(800.0)	(800.0)
<b>Net profit</b>	<b>87,830</b>	<b>1,01,230</b>	<b>1,24,340</b>	<b>1,31,861</b>	<b>1,52,435</b>	<b>1,74,748</b>
Exceptional items	-	-	-	-	-	-
<b>Adjusted net profit</b>	<b>87,830</b>	<b>1,01,230</b>	<b>1,24,340</b>	<b>1,31,861</b>	<b>1,52,435</b>	<b>1,74,748</b>
<i>Change (yoy, %)</i>	4	15	14	6	16	15
EPS	31.5	37.3	45.8	48.6	56.2	64.4
Dividend per sh	4	4	26	36	42	48
<i>Dividend Payout %</i>	15	13	57	74	75	75

## Balance Sheet

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Shareholders' funds</b>	<b>3,65,052</b>	<b>4,13,660</b>	<b>5,99,130</b>	<b>6,33,299</b>	<b>6,71,760</b>	<b>7,16,252</b>
Share capital	5,569	5,425	5,427	5,427	5,427	5,427
Reserves & surplus	3,59,483	4,08,235	5,93,703	6,27,872	6,66,333	7,10,825
<b>Total Debt</b>	<b>4,371</b>	<b>37,010</b>	<b>38,280</b>	<b>38,280</b>	<b>38,280</b>	<b>38,280</b>
Other liabilities	4,412	(6,250)	37,200	43,866	52,540	60,659
<b>Curr Liab &amp; prov</b>	<b>99,143</b>	<b>1,15,750</b>	<b>1,73,830</b>	<b>2,01,982</b>	<b>2,34,389</b>	<b>2,64,266</b>
Current liabilities	85,717	1,00,650	1,51,370	1,73,100	1,99,692	2,24,584
Provisions	13,426	15,100	22,460	28,881	34,697	39,682
<b>Total liabilities</b>	<b>1,07,926</b>	<b>1,46,510</b>	<b>2,49,310</b>	<b>2,84,128</b>	<b>3,25,208</b>	<b>3,63,205</b>
<b>Total equity &amp; liabilities</b>	<b>4,76,094</b>	<b>5,61,200</b>	<b>8,50,130</b>	<b>9,19,748</b>	<b>10,00,088</b>	<b>10,83,378</b>
Net fixed assets	1,95,904	2,31,230	3,50,470	3,41,163	3,35,166	3,34,219
Investments	268	850	890	890	890	890
Other non-curr assets	29,418	31,900	68,260	77,791	90,238	1,01,890
<b>Current assets</b>	<b>2,50,504</b>	<b>2,97,220</b>	<b>4,30,510</b>	<b>4,99,903</b>	<b>5,73,794</b>	<b>6,46,378</b>
Inventories	2,355	910	940	1,179	1,367	1,544
Sundry Debtors	96,394	1,17,060	1,36,630	1,55,582	1,91,414	2,16,130
Cash and Bank	1,02,731	1,00,920	1,56,610	1,85,202	1,92,332	2,15,662
Loans and advances	26,181	13,120	48,410	56,575	65,628	74,102
<b>Total assets</b>	<b>4,76,094</b>	<b>5,61,200</b>	<b>8,50,130</b>	<b>9,19,748</b>	<b>10,00,088</b>	<b>10,83,378</b>

**Cash Flow Statement**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Pre-tax profit	1,10,990	1,26,260	1,60,000	1,69,950	2,01,625	2,30,984
Depreciation	14,520	15,268	39,850	38,187	40,997	45,947
Tax paid	(23,160)	(38,843)	(23,140)	(37,459)	(48,390)	(55,436)
Chg in working capital	(25,398)	10,447	(54,560)	795	(12,666)	(3,489)
Other operating activities	(38,335)	(80,893)	32,445	(14,021)	(20,530)	(14,420)
<b>Cash flow from operations (a)</b>	<b>38,617</b>	<b>32,240</b>	<b>1,54,595</b>	<b>1,57,453</b>	<b>1,66,463</b>	<b>2,03,587</b>
Capital expenditure	(49,362)	(50,594)	(37,900)	(28,880)	(35,000)	(45,000)
Chg in investments	1,198	(582)	(120)	-	-	-
Other investing activities	-	-	-	-	-	-
<b>Cash flow from investing (b)</b>	<b>(48,164)</b>	<b>(51,176)</b>	<b>(38,020)</b>	<b>(28,880)</b>	<b>(35,000)</b>	<b>(45,000)</b>
Equity raised/(repaid)	(84)	(144)	-	-	-	-
Debt raised/(repaid)	(1,046)	32,639	(8,650)	-	-	-
Dividend (incl. tax)	(13,410)	(13,064)	(70,555)	(97,692)	(1,13,974)	(1,30,256)
Chg in minorities	-	(2,306)	(410)	-	-	-
Other financing activities	-	-	-	-	-	-
<b>Cash flow from financing (c)</b>	<b>(14,540)</b>	<b>17,125</b>	<b>(79,615)</b>	<b>(97,692)</b>	<b>(1,13,974)</b>	<b>(1,30,256)</b>
<b>Net chg in cash (a+b+c)</b>	<b>(24,087)</b>	<b>(1,811)</b>	<b>36,960</b>	<b>30,881</b>	<b>12,062</b>	<b>28,331</b>

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Book Value (Rs)	131	152	221	233	248	264
Adj EPS (Rs)	31.5	37.3	45.8	48.6	56.2	64.4
Adj EPS growth (%)	5	18	14	6	16	15
EBITDA margin (%)	23	23	26	23	24	24
Pre-tax margin (%)	22	21	21	20	20	20
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	28	29	24	23	26	28
ROE (%)	25.2	26.0	22.4	21.4	23.4	25.2
<b>DuPont Analysis</b>						
Asset turnover (x)	1.1	1.2	0.9	1.0	1.0	1.1
Leverage factor (x)	1.3	1.3	1.5	1.4	1.5	1.5
Net margin (%)	17.4	16.8	16.5	15.3	15.3	15.5
<b>Working Capital &amp; Liquidity ratio</b>						
Inventory days	1	0	0	1	1	1
Receivable days	70	71	66	66	70	70
Payable days	10	8	11	11	11	11

### Valuations

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
PER (x)	42.4	35.8	29.2	27.5	23.8	20.8
Price/Book value (x)	10.2	8.8	6.1	5.7	5.4	5.1
EV/Net sales (x)	7.2	5.9	4.7	4.0	3.5	3.1
EV/EBITDA (x)	32	26	18	17	15	13
Dividend Yield (%)	0	0	2	3	3	4

Source: Company; IDBI Capital Research



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**Key to Ratings Stocks:**

**BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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