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Q1FY21 result review
and earnings revision

Technology

Target price: Rs720

Earnings revision

(%)	FY21E	FY22E
Sales	↑ 1.5	↑ 3.3
EBIT	↑ 8.0	↑ 8.7
EPS	↑ 12.5	↑ 12.4

Target price revision

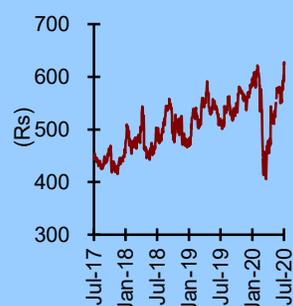
Rs720 from Rs590

Shareholding pattern

(%)	Dec '19	Mar '20	Jun '20
Promoters	60.0	60.3	60.3
Institutional			
Investors	36.1	35.5	35.6
MFs and other	5.6	5.5	5.9
Banks/FIs	0.9	0.9	1.9
Insurance Cos.	1.9	1.6	2.1
FIs	27.7	26.5	25.7
Others	3.9	4.2	4.1

Source: www.nseindia.com

Price chart



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INDIA

ICICI Securities

HCL Technologies

BUY

Maintained

Rs623

Better-than-expected recovery seen in FY21 guidance

HCL Technologies (HCLT) has reported a QoQ revenue decline of 7.2% in constant currency (CC) terms with IT & business services (IT&B) and ER&D segment declining by -7.8% and 9%, respectively. Organic revenue decline was 5.3% QoQ in Q1FY21. HCLT reinstated its guidance for FY21 with revenue expected to grow by 1.5-2.5% QoQ over the next three quarters with margins being in the range of 19.5-20.5% in FY21. As expected, the company is seeing increased traction in its technologies around digital workplace, cloud, collaboration and cybersecurity. The company signed 11 net transformational deals led by key industry verticals including telecommunication, financial services, manufacturing, life sciences and healthcare. The guidance is also supported by the fact that net-new booking is higher on a YoY basis during the quarter with robust renewals and a healthy pipeline. HCLT has also gained an increasing wallet share within its accounts in a tough environment by engaging with clients in their cost takeout initiatives and consolidation of vendors within its ecosystem. **Maintain BUY.**

- ▶ **Multiple hits impacted Q1FY21 revenue and FY21 guidance.** Revenue declined 7.2% QoQ in CC terms (growth of 1% on YoY basis) in Q1FY21, primarily on account of drop in volumes due to Covid-19 pandemic and right shoring within certain revenue profiles. Revenue is expected to grow in the range of 1.5-2.5% QoQ in CC terms in the next three quarters implying a revenue guidance of -2.3% to -0.8% in FY21.
- ▶ **Products and platform (P&P) performing well.** P&P segment revenue declined 2.1% QoQ in CC terms in Q1 (overall decline 7.2%). The segment performed relatively well primarily on account of presence across multiple verticals, relatively shorter deal cycles, mission critical products, new demand and used cases developing around ecommerce retail (retailers increasing spend on ecommerce), digital marketing and security services (WFH requiring additional security). Mode 1/Mode2/Mode 3 services witnessed QoQ decline in CC terms of 9.5%/1.6%/4.7%, respectively.
- ▶ **Margins surprised on the upside.** EBIT margin declined 36bps QoQ to 20.5% (I-Sec: 18.7%) with key tailwinds being rupee depreciation (76bps), SG&A cost, optimisation (40bps) and key headwinds being increasing R&D spend and drop in volumes (70bps). Management is expecting margins to be in the range of 19.5-20.5% in FY21.
- ▶ **Maintain BUY.** Pipeline was up 40% QoQ in Q1 with net new deal TCV intake also being up YoY and renewals remaining robust during the quarter driven by increased traction within lifescience, financial services, Hi-Tech, cloud and security offerings. HCLT is also seeing an increase in scope of vendor consolidation within stressed verticals such as Energy and Auto. Cash conversion was also healthy with FCF/EBITDA conversion at 125.5%. Net cash as of Q1FY21 stands at US\$1.3bn (post paying ~US\$800mn final tranche pertaining to acquisition of certain IBM assets) providing impetus in participating in complex deal structures around cost takeout initiatives and vendor consolidation. We retain BUY with a target price of Rs720 based on 15x Jun'22E EPS.

Market Cap	Rs1691bn/US\$22.5bn	Year to March	2020	2021E	2022E	2023E
Reuters/Bloomberg	HCLT.BO/HCLT IN	Revenue (Rs mn)	706,780	731,762	790,118	855,235
Shares Outstanding (mn)	2,713.7	Net Income (Rs mn)	110,620	118,310	128,465	139,559
52-week Range (Rs)	628/406	EPS (Rs) after ESOP	40.8	43.6	47.3	51.4
Free Float (%)	39.7	% Chg YoY	10.8	7.0	8.6	8.6
FII (%)	25.7	P/E(x)	15.3	14.3	13.2	12.1
Daily Volume (US\$'000)	39,540	CEPS (Rs)	51.2	56.1	59.8	64.8
Absolute Return 3m (%)	36.9	EV/E(x)	9.5	8.7	8.2	7.6
Absolute Return 12m (%)	20.6	Dividend Yield	1.0	2.5	2.7	2.7
Sensex Return 3m (%)	17.8	RoCE (%)	19.1	17.0	17.5	17.3
Sensex Return 12m (%)	(4.4)	RoE (%)	23.7	21.3	20.4	19.7

Please refer to important disclosures at the end of this report

Table 1: Q1FY21 result review*(Rs mn, year ending March 31)*

	Q1FY21	Q4FY20	Q1FY20	% chg (QoQ)	% chg (YoY)
Revenues (US\$mn)	2,356	2,543	2,364	(7.4)	(0.3)
Re/\$ rate	75.7	73.1	69.5	3.6	9.0
Total Revenues	1,78,410	1,85,900	1,64,250	(4.0)	8.6
Direct costs	1,10,700	1,14,790	1,09,200	(3.6)	1.4
SG&A	22,050	23,910	21,050	(7.8)	4.8
EBIDTA	45,660	47,200	34,000	(3.3)	34.3
Depreciation & Amortisation	9,060	8,390	5,950	8.0	52.3
EBIT	36,600	38,810	28,050	(5.7)	30.5
Other income	2,070	240	1,090	762.5	89.9
Forex Gain/(Loss)	-	(360)	190	(100.0)	(100.0)
PBT	38,670	38,690	29,330	(0.1)	31.8
Less : Tax provision	9,290	7,070	7,050	31.4	31.8
PAT	29,380	31,620	22,280	(7.1)	31.9
Minority Interest	(130)	(80)	(80)	62.5	62.5
Net income	29,250	31,540	22,200	(7.3)	31.8
Recurring EPS (Rs.)	10.8	11.6	8.2	(7.3)	31.8
Ratios:					
EBITDA margin (%)	25.6	25.4	20.7		
EBIT Margin (%)	20.5	20.9	17.1		
Effective tax rate (%)	24.0	18.3	24.0		
Net margin (%)	16.4	17.0	13.5		

Source: Company data, I-Sec research

Valuation methodology and key risks

We maintain our **BUY** rating on HCL Tech with a revised target price of Rs720 (earlier: Rs590) based on 15x Jun'22E EPS (earlier: 14x Mar'22E EPS).

Key risks to our call: i) Higher than expected TCO pressure on renewals, ii) slower than expected ramp-up of deals, iii) structural slowdown in quarterly order intake, and iv) meaningful appreciation in INR/US\$ exchange rate.

Financial summary (US GAAP consolidated)

Table 2: Profit and loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Revenues (US\$mn)	9,936	9,724	10,535	11,403
Operating Revenues (Sales)	7,06,780	7,31,762	7,90,118	8,55,235
Operating Expenses	5,39,850	5,49,758	5,97,275	6,45,533
EBITDA	1,66,930	1,82,004	1,92,843	2,09,702
% margins	23.6	24.9	24.4	24.5
Depreciation/Amortisation	28,400	34,140	34,364	37,194
EBIT	1,38,530	1,47,864	1,58,479	1,72,508
% margins	19.6	20.2	20.1	20.2
Net other Income	1,790	6,300	10,012	10,544
Recurring PBT	1,40,320	1,54,164	1,68,490	1,83,051
Less: Taxes	29,380	35,854	40,025	43,492
Less: Minority Interest	320	0	0	0
Net Income	1,10,620	1,18,310	1,28,465	1,39,559

Source: Company data, I-Sec research

Table 3: Balance sheet

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Assets				
Total Current Assets	3,84,240	3,79,786	4,78,861	5,93,700
Total Current Liabilities & Provisions	2,08,890	1,42,343	1,53,694	1,66,361
Net Current Assets	1,75,350	2,37,443	3,25,167	4,27,339
Investments	380	380	380	380
Net Fixed Assets	3,82,890	3,99,840	3,85,229	3,69,416
Other Assets	64,650	62,410	62,410	62,410
Total Assets	6,23,270	7,00,074	7,73,186	8,59,545
Liabilities				
Borrowings	50,920	47,040	47,040	47,040
Other Liabilities	50,210	53,852	54,086	56,584
Minority Interest	5,280	5,190	5,190	5,190
Net Worth	5,16,860	5,93,991	6,66,870	7,50,731
Total Liabilities	6,23,270	7,00,074	7,73,186	8,59,545

Source: Company data, I-Sec research

Table 4: Quarterly trend

(Rs mn, year ending March 31)

	Sep-19	Dec-19	Mar-20	Jun-20
Net sales	1,75,280	1,81,350	1,85,900	1,78,410
% growth (YoY)	17.9	15.5	16.3	8.6
EBITDA	41,030	44,700	47,200	45,660
Margin (%)	23.4	24.6	25.4	25.6
Other income	-30	660	-120	2,070
Rec. Net Income after ESOP	26,510	30,370	31,540	29,250

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Op. CF before W.Cap changes	1,49,190	1,46,384	1,56,059	1,69,451
Work. Capital Inflow / (Outflow)	(15,600)	(14,924)	(26,262)	(35,477)
Capex / Acquisition	(79,570)	(52,081)	(19,753)	(21,381)
Free Cashflow	54,020	79,380	1,10,044	1,12,593
CF from other Invst Act	(44,170)	(30,239)	6,770	7,302
Incl/(Dec) in Equity/related item	-	9,902	0	(0)
Incl/(Dec) in Borrowings	(15,430)	(598)	233	2,498
Divided paid	(16,250)	(50,721)	(55,586)	(55,697)
Ince(Dec) in Cash	(21,830)	7,725	61,461	66,695

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Per Share Data (Rs)				
EPS(Basic Rec)	40.8	43.6	47.2	51.2
EPS (Dil. Rec.)	40.8	43.6	47.3	51.4
Recurring Cash EPS	40.8	43.6	47.3	51.4
Dividend per share (DPS)	51.2	56.1	59.8	64.8
Book Value per share (BV)	6.0	15.5	17.0	17.0
	190.5	218.7	245.1	275.3

Growth Ratios (%)

Operating Income (Sales) – US\$ terms	15.1	(2.1)	8.3	8.2
Operating Income (Sales)	17.0	3.5	8.0	8.2
EBITDA	19.5	9.0	6.0	8.7
Recurring Net Income (bef ESOP)	9.3	7.0	8.6	8.6
Diluted Recurring EPS	10.8	7.0	8.6	8.6
Diluted Recurring CEPS	13.3	9.7	6.3	8.0

Valuation Ratios (x)

P/E	15.3	14.3	13.2	12.1
P/CEPS	12.2	11.1	10.4	9.6
P/BV	3.3	2.8	2.5	2.3
EV / EBITDA	9.5	8.7	8.2	7.6
EV / Sales	2.2	2.2	1.9	1.7
EV / FCF	13.8	14.5	14.0	13.1

Operating Ratio

Software Dev. Expenses/Sales (%)	64.1	62.8	63.6	63.5
SG&A/Sales (%)	12.3	12.3	12.0	12.0
Other Income / PBT (%)	1.3	4.1	5.9	5.8
Effective Tax Rate (%)	20.9	23.3	23.8	23.8
NWC / Total Assets (%)	21.1	28.2	35.1	41.7
Fixed Asset Turnover (x) on avg	2.3	1.9	2.0	2.3
Receivables (days) INR	73	72	72	72
Debt Equity Ratio (x)	0.1	0.1	0.1	0.1

Return/Profitability Ratio (%)

Recurring Net Income Margins	15.7	16.2	16.3	16.3
RoC (Based on Avg)	20.5	18.6	19.1	18.7
RoCE (Based on Avg)	19.1	17.0	17.5	17.3
RoNW (Based on Avg)	23.7	21.3	20.4	19.7
Dividend Payout Ratio	17.7	42.8	43.3	39.9
Dividend Yield	1.0	2.5	2.7	2.7
EBITDA Margins	23.6	24.9	24.4	24.5

Source: Company data, I-Sec research

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