

Healthy deal wins, guidance key positives...

HCL Tech's results were below our expectations. However, the company won 19 transformational deals across industry verticals. New deal TCV in this quarter increased 49% YoY at US\$3.1 billion and 18% YoY to US\$7.3 billion in FY21. Further, in terms of guidance, HCL expects to grow in double digits in constant currency for FY22E and expects EBIT margin to be between 19.0% and 21.0% for FY22E. The company has declared a dividend of ₹ 6/share. Also, the board has declared a special dividend of ₹ 10/share.

Revenue trajectory to improve in coming years

The company plans to tap the US\$300 billion cloud opportunity by 2023; considering the company's expertise in Infrastructure Management Services (IMS) & app modernisation and focus on integrated deals. The company expects healthy double digit growth in revenues in FY22E mainly led by improved growth in IT & business services and ER&D (the company believes it has bottomed out and will see growth from here on). In terms of products & platforms HCL expects 75% of products to grow at a healthy pace but the company expects 25% of product to grow at single digit. This, coupled with improvement in large deal wins, expansion in other geographies, investment in sales & capabilities, inorganic growth and opportunities in captive carve outs make us positive on the company's revenue trajectory in the long term. Hence, we expect dollar revenues to increase at a CAGR of 11.7% in FY21-23E.

Despite investment we expect margins to expand

EBITDA margins in Q4FY21 declined 517 bps QoQ mainly led by wage impact for senior members of team ~60 bps, seasonal decline in product and platforms, impairment & increased investment in sales in product & platforms ~73 bps and lower utilisation ~61 bps, forex ~21 bps and rest due to one-time bonus. Going forward, the company plans to invest in expanding geographies, investment in sales, product engineering, invest in talent and wage hikes. Despite considering these headwinds, we expect the company to easily surpass the top end of guided margins in FY22E due to rupee depreciation, lower travel cost and operating leverage due to revenue growth. Hence, we expect margins to increase 100 bps in FY21-23E.

Valuation & Outlook

The company witnessed healthy new deal wins (up 18% YoY to US\$7.3 billion in FY21). This, coupled with traction in cloud & cloud related services, expansion in other geographies, investment in sales, inorganic growth and opportunities in captive carve outs makes us positive on HCL's revenue trajectory in the long term. Hence, we maintain **BUY** on the stock with a target price of ₹ 1,110 (18x PE on FY23E EPS) (earlier target price ₹ 1150).



Particulars

Particular	Amount
Market Cap (₹ Crore)	2,59,371.0
Total Debt (₹ Crore)	3,828.0
Cash & Equivalents (₹ Crore)	15,661.0
EV (₹ Crore)	2,47,538.0
52 week H/L	1073 / 463
Equity capital	543.0
Face value	₹ 2

Key Risk

- The recently acquired products from IBM require higher investment. If the company is unable to scale up these business adequately it will adversely impact its revenues
- We assume that acceleration in digital technologies will drive revenue growth of IT companies. However, a slower than expected pace of growth in digital technologies will impact HCL Tech's revenue growth.

Research Analyst

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Key Financial Summary

Key Financials	FY19	FY20	FY21	FY22E	FY23E	CAGR FY(21-23E)
Net Sales	60,427	70,678	75,379	85,467	96,567	13.2%
EBITDA	13,968	16,694	19,482	21,965	24,914	13.1%
Margins (%)	23.1	23.6	25.8	25.7	25.8	
Net Profit	10,122	11,062	12,435	14,188	16,540	15.3%
EPS (₹)	37.3	40.8	45.8	52.3	60.9	
P/E	25.6	23.4	20.9	18.3	15.7	
RoNW (%)	24.5	21.6	20.8	21.0	21.2	
RoCE (%)	26.9	23.0	23.5	24.7	25.5	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q4FY21	Q4FY21E	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	Comments
Revenue	19,642	19,838	18,590	5.7	19,302	1.8	Dollar revenues increased 2.5% QoQ (in cc terms) mainly led by financial services (up 3.3% QoQ), lifescience & healthcare (up 6.6% QoQ) and public services (up 9.9% QoQ)
Cost of sales (including employee expenses)	12,650	12,705	11,479	10.2	11,551	9.5	
Gross Margin	6,992	7,133	7,111	-1.7	7,751	-9.8	
Gross margin (%)	35.6	36.0	38.3	-265 bps	40.2	-456 bps	
Selling & marketing costs	2,470	2,311	2,391	3.3	2,309	7.0	
EBITDA	4,522	4,822	4,720	-4.2	5,443	-16.9	
EBITDA Margin (%)	23.0	24.3	25.4	-237 bps	28.2	-517 bps	
Depreciation	1,117	1,027	839	33.1	1,027	8.8	
EBIT	3,405	3,795	3,881	-12.3	4,416	-22.9	
EBIT Margin (%)	17.3	19.1	20.9	-354 bps	22.9	-554 bps	Margin declined due to wage impact for senior members of team by ~60 bps, seasonal decline in product and platforms (US\$18 million), impairment (US\$16 million) & increased investment in sales in product & platforms (US\$6 million) ~73 bps and lower utilisation ~61 bps, forex ~21 bps and rest due to one-time bonus
Other income	190	122	-13	NA	126	50.8	
PBT	3,595	3,917	3,868	-7.1	4,542	-20.8	
Tax paid	1,191	842	707	68.5	544	118.9	
PAT	2,387	3,059	3,153	-24.3	3,982	-40.0	Higher tax expense (due to absence of tax reversal as witnessed in previous quarters) led to decline in PAT

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	84,552	85,467	1.1	95,549.0	96,567	1.1	We revise our US\$ INR assumption upwards leading to upward revision in revenues
EBIT	18,537	18,161	-2.0	21,236.0	20,905	-1.6	
EBIT Margin (%)	21.9	21.2	-67 bps	22.2	21.6	-58 bps	We revise our margin estimates downwards due to impact of wage hike, investment in expanding geographies, talent and sales
PAT	14,729	14,188	-3.7	17,044.0	16,540	-3.0	Higher tax rate prompt us to revise EPS estimates downwards
EPS (₹)	54.3	52.3	-3.7	62.8	60.9	-3.0	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook** – The company expects healthy double digit growth in revenues in FY22E mainly led by improved growth in IT & business services and ER&D (the company believes it has bottomed out and will see growth from here on). In terms of products & platforms, HCL expects 75% of products to grow at a healthy pace but the company expects 25% of product to grow at single digit. HCL plans to tap the US\$300 billion cloud opportunity by 2023 by benefiting from leadership in cloud and providing an integrated deals of IT services+ Engineering services+ hyperscalers+ industry IP+ products & platforms. The company has already won 19 large deals of which four are integrated, one is large deal in ER&D and two are captive carve outs (UD trucks and a European utility). Out of the 19 deals, two were US\$250 million and quite a few were US\$100 mn plus and 50 million plus deal. Apart from healthy deal wins, the company plans to invest in Australia, Canada, France, Germany, Japan and emerging markets like Brazil, Mexico, South Korea and Spain, which, we believe, bodes well for medium term revenue growth. In addition, HCL plans to invest in sales team & product engineering to drive its long term revenue growth
- **Margin walk through** - On the margin front, the EBITDA margin declined 517 bps QoQ mainly led by wage impact for senior members of team ~60 bps, seasonal decline in product and platforms (US\$18 million), impairment (US\$16 million) & increased investment in sales in product & platforms (US\$6 million) ~73 bps and lower utilisation ~61 bps, forex ~21 bps and rest due to one-time bonus. Going forward, HCL plans to invest in expanding geographies, investment in sales, product engineering, investment in talent and wage hikes. Despite considering these headwinds, we expect the company to easily surpass top end of guided margins in FY22E due to rupee depreciation, lower travel cost and operating leverage due to cloud. Hence, we expect margins to increase 100 bps to 21.6% over FY21-23E
- **Mode 2, 3** - The IBM products acquisition is reflected in Mode 3 business. Mode 2 (digital business) and mode 3 (product business), which are into newer age technologies, together constituted ~39% of revenues. Mode 2 revenues increased 7.4% QoQ while Mode 3 revenues decreased 3.9% QoQ mainly due to product seasonality. In terms of margins, Mode 2 margins declined 140 bps QoQ to 20.6% and Mode 3 margins declined 950 bps QoQ to 20.2%
- **Acquisition** - The company has acquired DWS Ltd for A\$158.2 million and had a revenue of A\$167.9 million. HCL completed the acquisition on January 5, 2021. We believe this could add 1% to revenues
- **Employees** – HCL saw an addition of 9,295 employees in Q4FY21, taking its overall full-time employee headcount to 168,977. Localisation for FY21 in the US was at 70.4%. The company plans to hire 15000 freshers during the year spread across India, US, Europe, Australia, Sri Lanka and Vietnam

Key Metrics

Exhibit 3: Geography wise break-up

	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
Revenue by geography (%)					
Americas	63.4	63.7	63.1	62.5	62.0
Europe	28.7	28.3	28.4	29.5	29.1
RoW	7.8	8.0	8.5	8.0	8.9
Growth QoQ (%) - Constant Currency					
Americas	1.3	-6.9	4.9	3.2	2.0
Europe	-0.1	-8.5	2.2	6.3	0.7
RoW	0.9	-5.1	9.0	-4.5	13.3

Source: Company, ICICI Direct Research

Revenue growth was across geographies

Exhibit 4: Industry wise break-up

	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
Revenue by verticals (%)					
Financial Services	21.1	22.4	22.1	21.4	21.6
Manufacturing	20.7	18.1	17.7	18.1	17.7
Lifesciences & Healthcare	12.5	13.7	14.1	13.6	14.1
Public Services	11.1	11.0	10.7	10.4	11.2
Retail & CPG	10.2	10.0	10.4	10.5	10.1
Telecommunications, Media, Publishing & Entertainment	8.3	7.6	7.7	8.3	8.1
Technology & Services	16.2	17.2	17.3	17.8	17.2
Growth QoQ (%) - Constant currency					
Financial Services	-1.1	-1.7	2.6	-0.4	3.3
Manufacturing	-0.2	-18.8	1.5	5.6	0.3
Lifesciences & Healthcare	2.3	1.9	8.6	0.0	6.6
Public Services	2.9	-7.1	0.2	0.5	9.9
Retail & CPG	0.3	-9.0	8.4	3.7	-0.9
Telecommunications, Media, Publishing & Entertainment	-6.6	-15.5	6.1	12.1	-0.1
Technology & Services	7.2	-1.2	6.3	6.8	-0.6

Source: Company, ICICI Direct Research

Financial services, lifescience & healthcare & public services led growth in quarter

Exhibit 5: Segment offering wise break-up

	% contribution to revenues Q4FY21	% contribution to revenues Q3FY21	CC Growth QoQ (%)	CC Growth YoY (%)
Revenue by verticals (%)				
IT and Business Services	71.9	70.4	4.4	3.7
Engineering and R&D Services	15.1	15.5	0.7	-2.7
Products & Platforms	13.0	14.1	-4.9	3.3

Source: Company, ICICI Direct Research

On QoQ basis, revenue growth was driven by IT Services

Exhibit 6: Client & human resource matrix

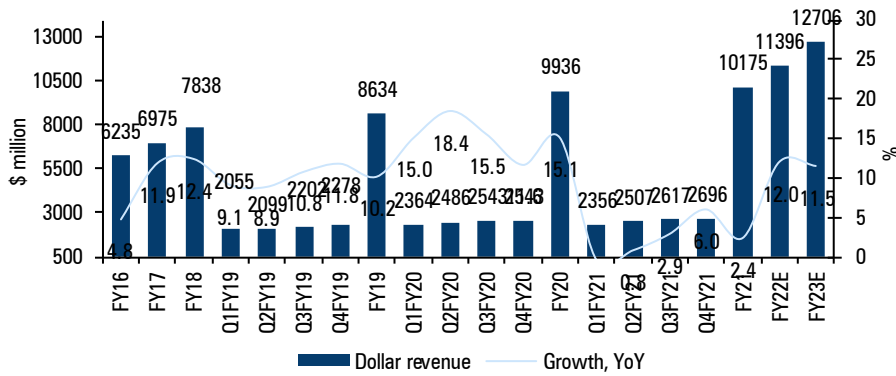
	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
<u>Client metrics</u>					
US\$1-5 million	483	528	548	502	491
US\$10-20 million	75	80	81	76	82
US\$50-100 million	15	14	15	16	20
US\$100 million+	15	15	14	15	15
<u>Headcount, Utilization & Attrition</u>					
Total Employees	1,50,423	1,50,287	1,53,085	1,59,682	1,68,977
Attrition - IT Services (LTM)	16.3	14.6	12.2	10.2	9.9

Source: Company, ICICI Direct Research

Attrition declined in quarter. The number of employees increased by 9,295

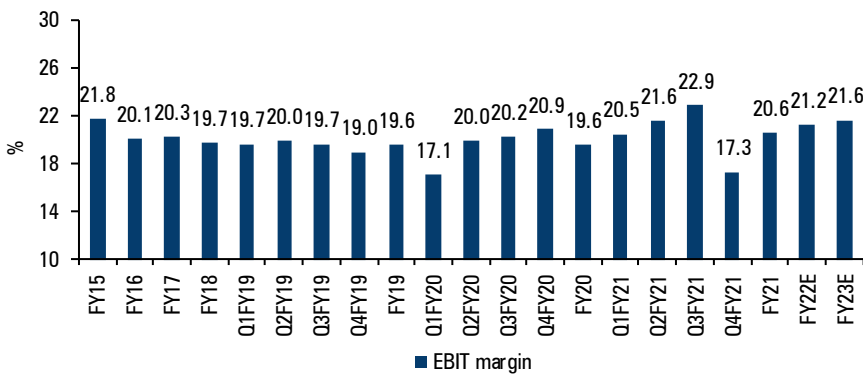
Financial story in charts

Exhibit 7: Dollar revenues to increase at CAGR of 11.7% over FY21-23E



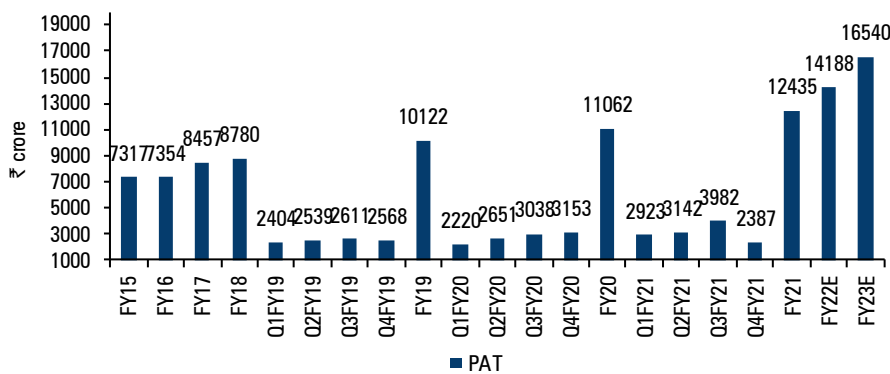
Source: Company, ICICI Direct Research

Exhibit 8: Revise our margin estimates for FY22E & FY23E



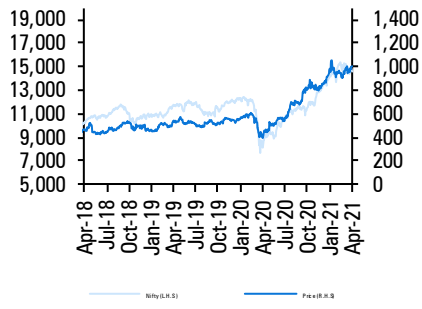
Source: Company, ICICI Direct Research

Exhibit 9: PAT trend



Source: Company, ICICI Direct Research

Exhibit 10: Price Performance



Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: 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	52,392	59,099	
S,G&A expenses	8,690	9,348	11,111	12,554	
Total Operating Expenditure	53,985	55,898	63,502	71,653	
EBITDA	16,694	19,482	21,965	24,914	
Growth (%)	19.5	16.7	12.7	13.4	
Depreciation	2,841	3,985	3,804	4,009	
Amortisation	-	-	-	-	
Net Other Income	178	657	705	1,076	
PBT	14,031	16,154	18,866	21,981	
Forex adjustments	-	-	-	-	
Total Tax	2,938	3,663	4,622	5,385	
PAT	11,062	12,435	14,188	16,540	
Growth (%)	9.3	12.4	14.1	16.6	
EPS (₹)	40.8	45.8	52.3	60.9	
Growth (%)	9.2	12.4	14.1	16.6	

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement		₹ crore			
	FY20	FY21	FY22E	FY23E	
PBT	14,031	16,154	18,866	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)	(4,622)	(5,385)	
CF from operating activities	13,359	19,618	16,126	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)	(6,384)	(6,384)	
Inc/(dec) in debentures	-	-	-	-	
Others	(1,297)	(1,155)	-	-	
CF from financing activities	(3,168)	(11,180)	(6,884)	(6,884)	
Net Cash flow	(2,183)	2,696	8,237	10,678	
Exchange difference	42	65	-	-	
Opening Cash	7,117	4,976	8,888	17,125	
Bank bal + unclaimed dvd.	-	-	-	-	
Cash & bank c/f to balance sh	4,976	8,888	17,125	27,803	

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet		₹ crore			
	FY20	FY21	FY22E	FY23E	
Liabilities					
Equity Capital	543	543	543	543	
Reserve and Surplus	50,724	59,370	67,173	77,328	
Total Shareholders funds	51,267	59,913	67,716	77,871	
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	76,293	86,144	
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	17,125	27,803	
Total Current Assets	38,420	43,051	54,954	69,665	
Total Current Liabilities	21,885	17,383	19,709	22,269	
Net Current Assets	16,535	25,668	35,245	47,396	
Other non current assets	6,519	5,597	5,597	5,597	
Application of Funds	61,021	68,811	76,293	86,144	

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios		₹ crore			
	FY20	FY21	FY22E	FY23E	
Per share data (₹)					
EPS	40.8	45.8	52.3	60.9	
Cash EPS	51.2	60.5	66.3	75.7	
BV	189.0	220.8	249.5	287.0	
DPS	9.5	24.3	23.5	24.4	
Cash Per Share	18.3	32.8	63.1	102.5	
Operating Ratios (%)					
EBIT Margin	19.6	20.6	21.2	21.6	
PBT Margin	19.9	21.4	22.1	22.8	
PAT Margin	15.7	16.5	16.6	17.1	
Debtor days	73	66	66	66	
Return Ratios (%)					
RoE	21.6	20.8	21.0	21.2	
RoCE	23.0	23.5	24.7	25.5	
RoIC	28.2	29.2	34.7	40.5	
Valuation Ratios (x)					
P/E	23.4	20.9	18.3	15.7	
EV / EBITDA	15.1	12.7	10.9	9.1	
EV / Net Sales	3.6	3.3	2.8	2.4	
Market Cap / Sales	3.7	3.4	3.0	2.7	
Price to Book Value	5.1	4.3	3.8	3.3	
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 15: ICICI Direct coverage universe (IT)

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	EPS (₹)				P/E (x)				RoCE (%)				RoE (%)			
					FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
HCL Tech (HCLTEC)	956	1,110	Buy	2,59,371	40.8	45.8	52.3	60.9	23	21	18	16	23.0	23.5	24.7	25.5	21.6	20.8	21.0	21.2
Infosys (INFTEC)	1,334	1,650	Buy	5,68,229	38.9	45.5	55.0	64.1	34	29	24	21	30.8	31.7	34.1	36.9	25.2	25.2	27.9	30.2
TCS (TCS)	3,110	3,800	Buy	11,50,700	86.2	86.7	109.3	128.7	36	36	28	24	44.4	45.9	51.2	54.4	38.4	37.5	43.3	45.7
Tech M (TECMAH)	950	1,120	Buy	91,909	45.9	53.4	58.9	69.2	21	18	16	14	19.1	20.5	20.4	21.5	18.5	19.4	18.8	19.3
Wipro (WIPRO)	476	530	Hold	2,60,945	16.6	19.1	20.5	24.8	29	25	23	19	19.3	21.3	21.6	25.7	17.4	19.5	21.0	25.4
Mindtree (MINCON)	2,024	2,390	Buy	33,359	38.3	67.4	79.8	94.0	53	30	25	22	23.0	32.5	32.6	32.6	20.0	25.7	25.5	25.3
LTI (LTINFC)	3,903	4,580	Hold	68,194	86.6	107.7	125.5	149.1	45	36	31	26	30.7	32.4	31.7	31.6	28.1	28.7	28.0	27.9
Coforge (NIITEC)	2,850	3,300	Hold	17,272	71.4	72.3	102.9	121.2	40	39	28	24	23.0	23.5	26.4	27.1	18.5	19.4	23.9	24.4
Infoedge (INFEDG)	4,882	5,725	Hold	62,775	26.8	21.8	38.9	49.0	182	224	125	100	18.0	8.3	14.0	16.3	13.5	6.3	10.5	12.3
Teamlease (TEASER)	3,091	3,290	Buy	5,285	20.5	53.1	68.8	85.6	151	58	45	36	15.0	13.5	15.7	16.5	6.5	14.4	15.5	16.3

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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