Sector	IT
Recommendation	BUY
Upside	16%

HCL Tech | CMP: ₹1300-1330 | Target: ₹1525

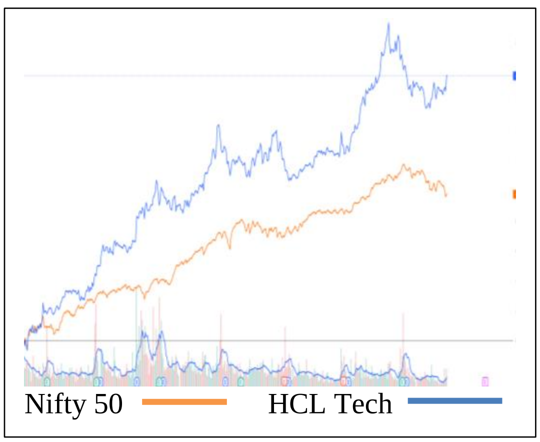
Stock Data	
Sensex	56319
52 Week h/l (₹)	1378/850
Market cap (`Cr)	327,011
BSE code	532281
NSE code	HCLTECH
FV (₹)	2.0
Div. yield (%)	0.83%

Shareholding Pattern

	Mar-21	Jun-21	Sep-21
FII+DII	35.17	34.56	34.77
Promoter	60.33	60.33	60.33
Public	4.97	5.09	4.88
Others	0.02	0.02	0.02

Source: www.bseindia.com

Share Price Data



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21st December, 2021

Profile

HCL Tech's focus on hardware and system integration business during late 1990s and early 2000s turned out to be a poor choice. However, since then, it has been the most proactive to experiment with pricing strategies, having entered into revenue-sharing agreements with clients. Further, it developed expertise in infrastructure services. Its ERP offerings and consulting abilities improved after the acquisition of Axon. This enhances HCL Tech's full services ability and its standing in winning large total-outsourcing deals. Its BPO business also diversified into offering platform-based BPO solutions for the insurance domain by acquiring Liberata Financial Services. Unlike most other vendors, services to manufacturing industry clients contribute the most to its revenue.

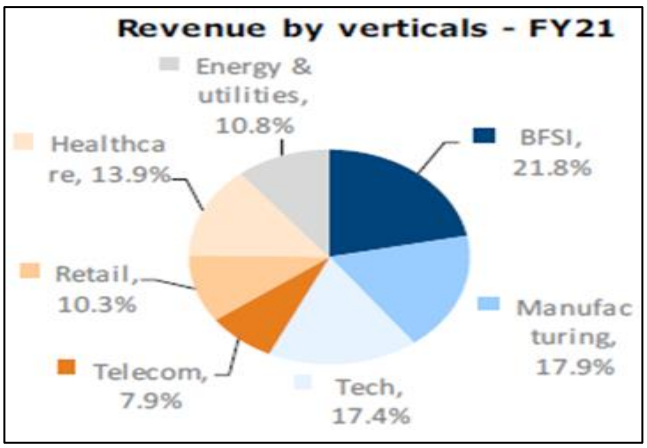
Investment Rationale

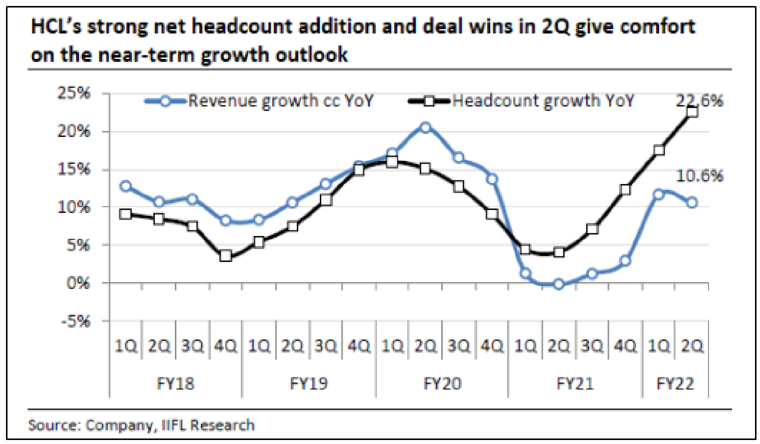
Manufacturing and Lifesciences led the growth: Growth of 3.5% cc QoQ was led by Manufacturing (+8.1%) and Life Sciences (+7%), while BFSI (+0.4%) and Retail (+0.9%) were weak. HCL sees strong demand outlook for digital engineering, application modernisation and cloud transformation. Products & Platforms is expected to grow at 0-1% (from a mid-single digit) in FY22. HCL expects momentum in the services business to continue and P&P to bounce back due to seasonality and return of deferred revenues in 3Q.

Margins in line with expectation: EBIT margins at 19.0% (-60bps QoQ) were broadly in line with expectations primarily driven by lower P&P revenues. HCLT reiterated its guidance for margins to be in the 19-21% range in FY22, while quarterly margins could go below the guidance range due to the tight supply-side conditions in the near term.

Strong ER&D and IT: HCL Tech's 2QFY22 revenue of USD2.79bn grew 3.5% cc QoQ, below IIFL/consensus expectations of 5.4%/5.0% cc QoQ. Among the different segments, ER&D (+5.4% cc QoQ) and IT & Business Services (+5.2% cc QoQ) were the key growth drivers, buoyed by the Manufacturing and Lifesciences verticals. HCLT is seeing strong demand, particularly in digital engineering, application modernisation and cloud transformation; it expects the momentum to continue over the near term. HCLT is seeing opportunities in integration Application and Infrastructure deals. The Management expects Products & Platforms segment revenues to bounce back in 3Q.

Manufacturing and Lifesciences drove the growth: Among verticals, Manufacturing bounced back to +8.1% cc QoQ after declining in 1Q. Lifesciences saw the third straight quarter of mid-single digit sequential growth, of +7% cc QoQ. Telecom grew at +3% cc QoQ, Technology grew at 2.6% cc QoQ and Energy grew at 1.9% cc QoQ. Growth in Financial Services at 0.4% cc QoQ and in Retail at 0.9% cc QoQ was lacklustre. Client mining during the quarter led to addition of clients across all buckets.





Strong deal wins and pipeline to drive growth over the near term: HCLT reiterated its double-digit revenue growth (in constant currency) guidance for FY22 which implies an ask rate of 2.2% CQGR over the next 2 quarters. HCL signed 14 large deal wins in the quarter, with a total TCV of USD2.2bn (+38% YoY), and also mentioned that its deal pipeline continues to be strong. HCLT added 11.1k+ net employees during the quarter which is its highest historically, on the back of the strong demand it is seeing.

Risks

Lower growth of some segments: Headwinds to margins included lower revenue growth from the Products & Platforms business and wage hikes during the quarter, partly offset by lack of one-off costs from the last quarter. Services margins were broadly flat.

Outlook & Valuation:

Management is confident about P&P bouncing back in 3Q, as the 2Q decline was due to delay in renewals. Growth in Services was broad based across geographies, while Manufacturing and Lifesciences led the growth among verticals. EBIT margins at 19% (-60bps QoQ) were also primarily impacted by lower P&P revenues; Services margins were flat despite wage hikes. For FY22, HCLT has reiterated its guidance of double-digit cc revenue growth and EBIT margins to range at 19-21%. Deal wins of USD2.2bn in 2Q (38% YoY) were strong for a 3rd straight quarter. Net employee addition at 11.1k was the highest ever for HCL and 23% YoY growth in headcount should give comfort on the growth outlook. At 22x FY23ii P/E, the stock trades at 30% discount to peers, though it could rerate if deals and hiring translate into revenues. Thus, we recommend a BUY with a long-term target of ₹1525.

Financial Summary

Consolidated (INR in bn)	FY20	FY21	FY22ii	FY23ii	FY24ii
Total Income	706,748	753,712	845,089	946,842	1,038,273
YoY growth (%)	17.0	6.6	12.1	12.0	9.7
EBITDA margin (%)	23.6	26.6	23.7	23.4	23.8
PAT	110,596	125,321	136,104	156,724	177,673
ROE (%)	23.6	22.8	21.2	23.1	24.6
P/B (x)	6.5	5.5	5.1	4.9	4.6
EV/EBITDA (x)	19.8	16.1	15.8	14.2	12.5
Net Debt/Equity (x)	(0.2)	(0.3)	(0.4)	(0.4)	(0.4)

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