

### IT & ER&D services perform, Ghost of P&P still haunts.

**HCL Tech's Q2FY22 performance was below our expectations on revenue and profitability front. However, performance was marred by Products & Platforms business, excluding P&P growth was in-line with estimates**

- Dollar revenue came in at \$2,791 Mn,  $+2.6$  qoq /  $+11.3\%$  yoy and  $1.9\%$  below our est. of \$2,844 Mn
- INR revenue came in at INR 206,550 Mn,  $+2.9\%$  qoq /  $+11.1\%$  yoy and  $-2.0\%$  vs our estimate
- EBIT stood at INR 39,160 Mn,  $-0.4\%$  qoq /  $-2.5\%$  yoy and  $-7.2\%$  versus our estimate
- EBIT margins came in at  $19\%$ ,  $-62$  bps qoq /  $-264$  bps yoy and  $107$  bps below our expectations
- PAT stood at INR 32,650 Mn,  $+1.6\%$  qoq /  $+3.9\%$  yoy and  $-6.4\%$  vs our estimate
- EPS came in at INR 12.01 vs INR 11.8 / 11.6 in Q1FY22 / Q2FY21 respectively and below our estimate of INR 12.9
- New deal wins were encouraging with TCV wins of \$2.245 Bn in Q2FY22 vs \$1.664 Bn in Q1FY22

### Segmental Trends

Growth was led by:

- IT and Business Services (72.6% of Revenue)** grew by  $5.2\%$  QoQ /  $13\%$  YoY
- ER&D Services (15.7% of Revenue)** grew at  $5.4\%$  QoQ /  $10.7\%$  YoY
- Products & Platforms (11.7% of Revenue)** declined by  $-8\%$  QoQ /  $-5.5\%$  YoY

### Segmental Analysis

- Growth was led by **Lifesciences & Healthcare** ( $15.3\%$  of revenue) growing at  $7\%$  QoQ /  $20.1\%$  YoY and **Manufacturing** ( $17.9\%$  of revenue) growing at  $8.1\%$  QoQ /  $11.9\%$  YoY. **Telecom, Media & Entertainment** ( $7.9\%$  of revenue) followed with  $3\%$  QoQ /  $13.4\%$  YoY and **Technology & Services** ( $17.2\%$  of revenue) grew at  $2.6\%$  QoQ /  $10.8\%$  YoY
- Mode II services (25.8% of revenue)** outperformed with  $12.5\%$  QoQ /  $36.3\%$  YoY cc growth. **Mode I Services (60.9% of revenue)** had a moderate growth at  $2.8\%$  QoQ /  $6.1\%$  YoY.

### Financial Summary

Y/E Mar (Rs mn)	FY 19	FY 20	FY 21E	FY 22E	FY 23E
Net sales	604,280	706,780	753,790	846,925	943,623
EBIT	118,210	137,377	160,730	163,330	184,451
Adjusted net profit	101,530	110,107	131,240	136,589	146,266
Free cash flow	70,191	52,019	79,365	109,605	155,873
EPS (Rs)	36.4	40.6	48.4	50.4	53.9
growth (%)	16	11	19	4	7
P/E (x)	17.2	30.8	25.8	24.8	23.2
P/B (x)	4.2	6.6	5.7	5.1	4.6
EV/EBITDA (x)	12.2	20.3	16.7	16.1	14.0
D/E	0.1	0.1	0.1	0.1	0.1
ROCE (%)	25.3	22.6	23.5	21.5	22.0
RoE (%)	26.1	23.8	23.6	21.6	20.8
Dividend yield (%)	0.6	0.6	1.0	2.0	2.2

Source: Company

Rating	TP (Rs)	Up/Dn (%)
<b>SELL</b>	<b>1,078</b>	<b>(13.8)</b>

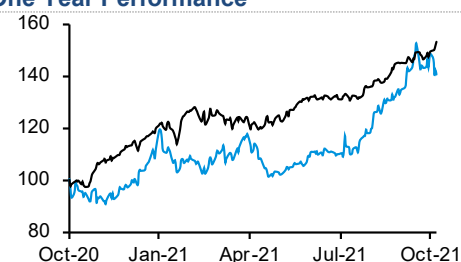
### Market data

<b>Current price</b>	Rs	1,251
Market Cap (Rs.Bn)	(Rs Bn)	3,395
Market Cap (US\$ Mn)	(US\$ Mn)	45,269
Face Value	Rs	2
52 Weeks High/Low	Rs	1,378 / 792
Average Daily Volume	('000)	5,855
BSE Code		535755

Bloomberg HCLT.IN

Source: Bloomberg

### One Year Performance



— HCL Technologies Ltd — Nifty Index

Source: Bloomberg

% Shareholding	Jun-22	Mar-22
Promoters	60.33	60.33
Public	36.97	36.97
Others	0.50	0.48
<b>Total</b>	<b>100</b>	<b>100</b>

Source: BSE

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## Conference Call Key Highlights

- ER&D services: Segment crossed the pre-pandemic revenue levels during the quarter. Digital engineering services drove performance. Strong recovery in asset heavy industries. Hitech and telecom performance stood out.
- P&P: Q2 is the weakest quarter for new deals and renewals. Few deals slipped to next quarter. Q3 is seasonally strong for P&P and expect a good bounce-back. Expect most of it to be recovered in the next quarter and hence one can expect P&P to grow at 0-1% for FY22e (vs. lower single digits growth guided earlier). Additionally, if there is any slip up in P&P business, management is confident of compensating it with Services
- ITBS driven by digital business in App offerings of Mode II services. Performance was driven by Customer experience, analytics, Cloud, etc. Large deal was absent in Financial Services but momentum remains strong
- Increased payout policy to 75% of net income which will happen over a period of 5 years
- Lower margins in Q2 due to P&P revenue impact. Services margins were largely flat qoq.
- Increments were rolled out during the quarter. Apart from that, other headwinds were hiring, retention, special allowances, training costs etc.
- ETR expected at 22-23% for the rest of the year
- Hired 5,500 freshers during the quarter which will take 1 more quarter before becoming productive
- Execution of deals signed will happen with a 1 quarter delay and one can expect same trajectory to continue
- GTM strategy working well in Sri Lanka, Costa Rica and Romania and management seeing good traction in these geographies

**FY22e guidance:**  
- Revenue guidance retained at double digits  
  
- EBIT margin guidance retained at 19-21%

## Quarterly Performance Analysis

### Exhibit 1

YE March (Rs mn)	Q2 FY22	Q1 FY22	Q-o-Q change %	Q2 FY21	Y-o-Y change %	Q2 FY22 Estimates	Deviation %
Revenues (\$)	2,791	2,720	2.6	2,507	11.3	2,844	-1.9
Revenues (INR)	2,06,550	2,00,680	2.9	1,85,940	11.1	2,10,685	-2.0
Direct Cost	1,27,580	1,21,970	4.6	1,09,290	16.7	1,29,220	-1.3
Gross Profit	78,970	78,710	0.3	76,650	3.0	81,465	-3.1
SG&A	30,590	29,630	3.2	27,140	12.7	29,496	3.7
EBITDA	48,380	49,080	-1.4	49,510	-2.3	51,969	-6.9
Depreciation & Amortisation	9,220	9,770	-5.6	9,350	-1.4	9,770	-5.6
EBIT	39,160	39,310	-0.4	40,160	-2.5	42,199	-7.2
PreTax Income	41,230	41,250	0.0	41,520	-0.7	44,306	-6.9
Adjusted Pretax Income	41,230	41,250	0.0	41,520	-0.7	44,306	0.0
Tax	8,460	8,940	-5.4	9,990	-15.3	9,602	0.0
Share of Minority Interest	130	160	0.0	110	0.0	168	0.0
Net Profit	32,900	32,150	2.3	31,420	4.7	34,871	-5.7
Adjusted Net Profit	32,900	32,150	2.3	31,420	4.7	34,871	-5.7
Diluted EPS (Rs)	12.1	11.8	2.4	11.6	4.7	12.9	0.0
Adjusted Diluted EPS	12.1	11.8	2.4	11.6	4.7	12.9	-5.7
No. of Shares (mn) - Diluted	2,713	2,714		2,714	0.0	2,713	0.0
<b>Margin Analysis (%)</b>			<b>Change in bps</b>		<b>Change in bps</b>		
EBIT Margin (%)	19.0%	19.6%	(63)	21.6%	(264)	20.0%	(107)
EBITDA Margin (%)	23.4%	24.5%	(103)	26.6%	(320)	24.7%	(124)
Net Profit Margin (%)	15.9%	16.0%	(9)	16.9%	(97)	16.6%	(62)
Adjusted NPM (%)	15.9%	16.0%	(9)	16.9%	(97)	16.6%	(62)
Effective Tax rate (%)	20.5%	21.7%	(115)	24.1%	(354)	21.7%	(115)
<b>Cost Analysis (%)</b>			<b>Change in bps</b>		<b>Change in bps</b>		
Direct cost as % of Sales	61.8%	60.8%	99	58.8%	299	61.3%	43
SG&A as % of Sales	14.8%	14.8%	5	14.6%	21	14.0%	81

Revenue growth in ITBS and ER&D services was in-line with our expectations. However, overall revenue was marred by dismal performance of Products & Platforms segment due to a seasonally weak quarter coupled with new deals and renewals slipping into Q3.

Management expects de-growth in P&P segment to retrace in Q3.

Source: Dalal & Broacha Research, Company

## Valuation & Outlook

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**HCL Tech is currently trading at 24.8x / 23.2x FY22e / FY23e.**

HCL Tech's overall Q1FY22 performance was dismal and subdued vs our estimates as Products & Platforms segment dragged the overall growth. We believe that company is having a hard time turning around the performance of the P&P division - which was one of the major concerns when the company acquired end-of-life-cycle products from IBM. However, ITBS and ER&D services performance was in-line with our estimates.

Having said that, management is confident that performance in P&P will bounce-back in Q3FY22. Although performance of ITBS and ER&D showed a good spurt in Q2FY22, Q3FY22 will again be marred by furloughs and order book of Q1FY22 and Q2FY22 has been relatively weaker than Q4FY21 - which is expected to materialize in H2FY22. Margins will also be range bound and witness pressure on the back of supply crunch and return of travel and facility costs.

Therefore, there are several moving parts and uncertainties in the company which has peers with better visibility, orderbook and outlook.

**We reduce our EPS estimates due to margin headwinds from INR 52.2 / 55.9 to INR 50.4 / 53.9. We maintain our multiple at 20x FY22e EPS and downgrade our rating from BUY to SELL - with a reduced target price of INR 1,078 (INR 1,117 earlier).**

# Financial

P&L Statement						Balance Sheet					
YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E	YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E
<b>Total Revenues</b>	<b>6,04,280</b>	<b>7,06,780</b>	<b>7,53,790</b>	<b>8,46,925</b>	<b>9,43,623</b>	Equity Capital	2,710	5,430	5,430	5,430	5,430
<i>Revenue Growth (Y-o-Y)</i>	<i>19.5%</i>	<i>17.0%</i>	<i>6.7%</i>	<i>12.4%</i>	<i>11.4%</i>	Reserves & Surplus	4,10,950	5,07,240	5,93,700	6,61,995	7,35,128
<b>Less:</b>						<b>Equity</b>	<b>4,13,660</b>	<b>5,12,670</b>	<b>5,99,130</b>	<b>6,67,425</b>	<b>7,40,558</b>
Employees Cost	3,92,680	4,43,080	4,45,920	5,11,949	5,68,565	<b>Net Worth</b>	<b>4,13,660</b>	<b>5,12,670</b>	<b>5,99,130</b>	<b>6,67,425</b>	<b>7,40,558</b>
SG&A	71,910	96,770	1,07,290	1,25,765	1,36,825	<b>Capital Employed</b>	<b>4,66,868</b>	<b>6,07,862</b>	<b>6,85,061</b>	<b>7,59,848</b>	<b>8,39,080</b>
<b>Total Op. Expenditure</b>	<b>4,64,590</b>	<b>5,39,850</b>	<b>5,53,210</b>	<b>6,37,714</b>	<b>7,05,390</b>	<b>Assets</b>					
<b>EBIDTA</b>	<b>1,39,690</b>	<b>1,66,930</b>	<b>2,00,580</b>	<b>2,09,211</b>	<b>2,38,233</b>	Gross Block	1,03,260	1,12,350	1,53,840	1,63,840	1,73,840
<i>EBIDTA Growth (Y-o-Y)</i>	<i>22.1%</i>	<i>19.5%</i>	<i>20.2%</i>	<i>4.3%</i>	<i>13.9%</i>	Less: Depreciation	50,330	57,410	97,260	1,07,030	1,16,250
Less: Depreciation	21,480	29,553	39,850	45,881	53,782	<b>Net Block</b>	<b>52,930</b>	<b>54,940</b>	<b>56,580</b>	<b>56,810</b>	<b>57,590</b>
<b>Operating Profit</b>	<b>1,18,210</b>	<b>1,37,377</b>	<b>1,60,730</b>	<b>1,63,330</b>	<b>1,84,451</b>	<b>Investments</b>	<b>16,410</b>	<b>24,500</b>	<b>26,580</b>	<b>30,701</b>	<b>34,979</b>
<i>Growth (Y-o-Y)</i>	<i>18.4%</i>	<i>16.2%</i>	<i>17.0%</i>	<i>1.6%</i>	<i>12.9%</i>	Intangible Assets	1,75,950	2,93,480	2,90,930	3,20,930	3,40,930
Non-operating Income	8,050	1,790	6,570	8,407	8,493	Other Non-current Assets	38,540	1,14,660	1,10,300	1,23,928	1,38,078
<b>Profit Before tax</b>	<b>1,26,260</b>	<b>1,39,167</b>	<b>1,67,300</b>	<b>1,71,737</b>	<b>1,92,943</b>	<b>Current Assets</b>					
Tax	24,810	29,380	36,630	35,715	47,271	Sundry Debtors	1,17,060	1,41,310	1,36,630	1,62,424	1,80,969
<b>Net Profit</b>	<b>1,01,530</b>	<b>1,10,107</b>	<b>1,31,240</b>	<b>1,36,589</b>	<b>1,46,266</b>	Cash and Bank Balance	75,588	47,412	85,671	64,711	82,887
Adjusted Net Profit	1,01,530	1,10,107	1,31,240	1,36,589	1,46,266	Other Current Assets	65,210	88,110	87,920	1,01,631	1,13,235
<b>Diluted EPS (Rs.)</b>	<b>36.4</b>	<b>40.6</b>	<b>48.4</b>	<b>50.4</b>	<b>53.9</b>	<b>Total Current Assets</b>	<b>2,71,888</b>	<b>3,11,962</b>	<b>3,59,571</b>	<b>3,84,686</b>	<b>4,44,111</b>
<i>Growth (Y-o-Y) %</i>	<i>15.6%</i>	<i>11.4%</i>	<i>19.2%</i>	<i>4.1%</i>	<i>7.1%</i>	<b>Less: Current Liabilities</b>					
<b>Adjusted Diluted EPS</b>	<b>36.4</b>	<b>40.6</b>	<b>48.4</b>	<b>50.4</b>	<b>53.9</b>	Sundry Creditors	13,050	11,660	17,260	14,026	15,577
<i>Growth (Y-o-Y) %</i>	<i>15.6%</i>	<i>11.4%</i>	<i>19.2%</i>	<i>4.1%</i>	<i>7.1%</i>	<b>Total Current Liabilities</b>	<b>1,15,750</b>	<b>2,18,850</b>	<b>1,73,830</b>	<b>1,86,472</b>	<b>2,09,455</b>
						<b>Capital Applied</b>	<b>4,66,868</b>	<b>6,07,862</b>	<b>6,85,061</b>	<b>7,59,848</b>	<b>8,39,080</b>
Key Ratios						Free Cash Flow Analysis					
YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E	YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E
<b>EBITDA Margin %</b>	<b>23.1%</b>	<b>23.6%</b>	<b>26.6%</b>	<b>24.7%</b>	<b>25.2%</b>	EBITDA	1,39,690	1,66,930	2,00,580	2,09,211	2,38,233
EBIT Margins %	19.6%	19.4%	21.3%	19.3%	19.5%	Add: Depreciation Tax Shie	4,221	6,239	8,725	9,541	13,177
<b>NPM (%)</b>	<b>16.8%</b>	<b>15.6%</b>	<b>17.4%</b>	<b>16.1%</b>	<b>15.5%</b>	Less: Inc in FC Investment	-49,540	-1,26,620	-38,940	-40,000	-30,000
RoE (%)	26.1%	23.8%	23.6%	21.6%	20.8%	Taxes Paid	24,810	29,380	36,630	35,715	47,271
<b>RoCE (%)</b>	<b>25.3%</b>	<b>22.6%</b>	<b>23.5%</b>	<b>21.5%</b>	<b>22.0%</b>	<b>Total Free Cash Flows</b>	<b>70,191</b>	<b>52,019</b>	<b>79,365</b>	<b>1,09,605</b>	<b>1,55,873</b>
BV/Per Share Rs.	297	189	221	246	273						
Valuation Ratios						Cash Flow Statement					
YE March (Rs. mn)	FY19E	FY20	FY21	FY22E	FY23E	YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E
P/E (x)	17.2x	30.8x	25.8x	24.8x	23.2x	PAT	1,01,530	1,10,107	1,31,240	1,36,589	1,46,266
<b>EV/EBITDA</b>	<b>12.2x</b>	<b>20.3x</b>	<b>16.7x</b>	<b>16.1x</b>	<b>14.0x</b>	Less: Non Operating Income	8,050	1,790	6,570	8,407	8,493
P/BV (x)	4.2x	6.6x	5.7x	5.1x	4.6x	Add: Depreciation	21,480	29,553	39,850	45,881	53,782
<b>Market Cap / Sales</b>	<b>2.9x</b>	<b>4.8x</b>	<b>4.5x</b>	<b>4.0x</b>	<b>3.6x</b>	Tax Adjustment	-6,180	1,380	11,360	-13,951	-3,181
						<b>Operating Profit before WC Changes</b>	<b>1,08,780</b>	<b>1,39,250</b>	<b>1,75,880</b>	<b>1,60,113</b>	<b>1,88,375</b>
Key Operating Ratios						(Inc)/Dec in Current Assets	-15,280	-68,250	-9,320	-46,145	-41,152
YE March (Rs. mn)	FY19	FY20	FY21	FY22E	FY23E	Inc/(Dec) in Current Liabilities	15,100	1,03,100	-45,020	12,642	22,983
EBITDA Margin (%)	23.1%	23.6%	26.6%	24.7%	25.2%	<b>Net Cash Generated From Operations</b>	<b>1,09,410</b>	<b>1,74,100</b>	<b>1,21,510</b>	<b>1,26,680</b>	<b>1,70,205</b>
<b>Tax / PBT (%)</b>	<b>19.6%</b>	<b>21.1%</b>	<b>21.9%</b>	<b>20.8%</b>	<b>24.5%</b>	<b>Cash Flow from Investing Activities</b>					
Net Profit Margin (%)	16.8%	15.6%	17.4%	16.1%	15.5%	(Inc)/Dec in Fixed Assets	-28,810	-31,563	-41,490	-46,111	-54,562
<b>RoE (%)</b>	<b>26.1%</b>	<b>23.8%</b>	<b>23.6%</b>	<b>21.6%</b>	<b>20.8%</b>	Add: Non Operating Income	8,050	1,790	6,570	8,407	8,493
RoCE (%)	25.3%	22.6%	23.5%	21.5%	22.0%	<b>Net Cash Flow from/(used in) Invest inc</b>	<b>-59,760</b>	<b>-2,33,163</b>	<b>-29,210</b>	<b>-85,839</b>	<b>-84,898</b>
<b>Current Ratio (x)</b>	<b>2.3x</b>	<b>1.4x</b>	<b>2.1x</b>	<b>2.1x</b>	<b>2.1x</b>	<b>Cash Flow from Financing Activities</b>					
Dividend Payout (%)	11.0%	19.7%	24.8%	50.0%	50.0%	Inc/(Dec) in Total Loans	37,670	42,080	-9,310	6,604	6,099
<b>BV Per Share (Rs.)</b>	<b>296.9</b>	<b>189.0</b>	<b>220.9</b>	<b>246.0</b>	<b>273.0</b>	Dividend Paid	-11,137	-21,702	-32,552	-68,295	-73,133
<b>Growth Indicators %</b>						<b>Net Cash Flow from Financing</b>	<b>-14,060</b>	<b>30,983</b>	<b>-54,090</b>	<b>-61,691</b>	<b>-67,035</b>
Gross Block Growth (%)	17.7%	8.8%	36.9%	6.5%	6.1%	<b>Net Inc/Dec in cash equivalents</b>	<b>34,960</b>	<b>-62,930</b>	<b>92,580</b>	<b>12,583</b>	<b>36,442</b>
Sales Growth (%)	19.5%	17.0%	6.7%	12.4%	11.4%	<b>Opening Balance</b>	<b>1,72,979</b>	<b>2,07,939</b>	<b>1,45,009</b>	<b>2,37,589</b>	<b>2,50,172</b>
EBITDA Growth (%)	22.1%	19.5%	20.2%	4.3%	13.9%	<b>Closing Balance Cash</b>	<b>2,07,939</b>	<b>1,45,009</b>	<b>2,37,589</b>	<b>2,50,172</b>	<b>2,86,614</b>
Net Profit Growth (%)	15.6%	8.4%	19.2%	4.1%	7.1%						
Diluted EPS Growth (%)	15.6%	11.4%	19.2%	4.1%	7.1%						

Source: Dalal &amp; Broacha Research, Company

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