

RESEARCH REPORT ON HCL Technologies

31st March 2022

STATUS: BUY

PEE AAR SECURITIES LTD.

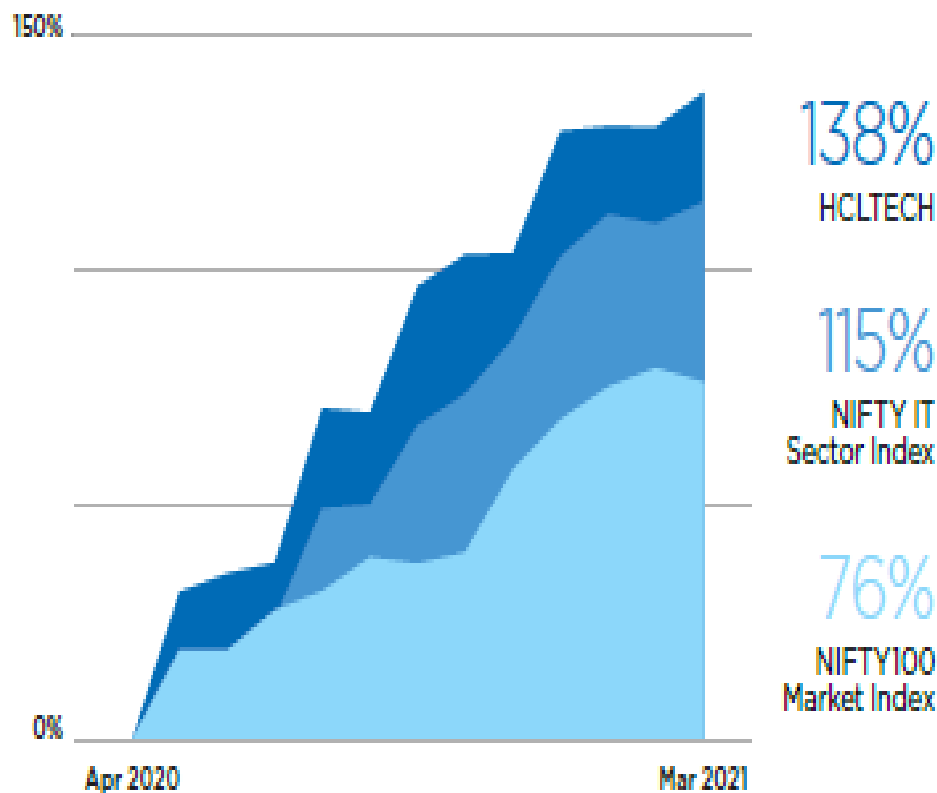
BY: HIMANSHI KHOSLA
(Junior Research Analyst)

Highest shareholder return

delivered in FY21
among Large Cap
Technology Companies

*Basis Indexed share price increase

Shareholder return* FY21 (April 2020 - March 2021)



HCL Technologies, a leading global technology company with **market capitalisation of ₹316196 Cr.** , is **5th strongest Global IT Services brand** ranked in **Brand Finance Global 500 2021**, Up 72 spots to rank 353.

Since its inception into the global landscape after its IPO in 1999, HCL Tech has focused on transformational outsourcing, and offers an integrated portfolio of Products and services including AI (artificial intelligence) engineering, software platform engineering, consumer software, enterprise software, software cyber security, SDN-NFV (software-defined networking-network functions virtualization), aerospace, automotive, industrial, medical devices, semiconductor, telecommunication, ADAS (advanced driver assistance systems), telematics, digital thread, telehealth, OTT (over the top) and contactless retail.

HCL's in a great position of being both a large systems integrator and an independent software vendor, which brings value to its customers by transforming business processes with AWS services, coupled with HCL's product innovations and engineering strength.

MANAGEMENT



Shiv Nadar
Founder and
Chief Strategy Officer

Shiv Nadar

Founder and Chief Strategy Officer, HCL Technologies, was honored by CNBC TV18 with the "Lifetime Achievement Award" at India Business Leader Awards 2021



C Vijayakumar

President and CEO, HCL Technologies, featured in Business Today's Best CEOs of India 2020, recognized as CEO of the Year in the IT/ITES industry



Roshni Nadar Malhotra
Chairperson

Roshni Nadar Malhotra

Chairperson, HCL Technologies, featured in: Forbes Asia's Power Businesswomen 2020; Fortune's 50 Most Powerful Women at #10

Board of Directors

Independent Non-Executive Directors



Robyn Ann Abrams
Director



R Srinivasan
Director



Dr. Sosale Shankara Sastry
Director



S Madhavan
Director



Thomas Sieber
Director



Nishi Vasudeva
Director



Deepak Kapoor
Director



Dr. Mohan Chellappa
Director



Simon John England
Director



Key to Board Committee membership:

- Audit
- Corporate Social Responsibility
- Nomination and Remuneration
- Finance
- Stakeholders' Relationship
- Risk Management
- ESG & Diversity
- Respective Chair of each Committee

Business Segments

A differentiated and integrated portfolio

Enabling outcomes for clients across major industries

Revenue mix

IT and Business Services (ITBS)	For the resilient digital enterprise	70.8%
Engineering and R&D Services (ERS)	To engineer "The Next"	15.6%
Products and Platforms (P&P)	Focused on innovation and client value	13.6%

Revenue mix by industry

21.9%
Financial Services

17.9%
Manufacturing

17.4%
Technology and Services

13.9%
Lifesciences and Healthcare

10.8%
Public Services

10.2%
Retail and CPG

7.9%
Telecom, Media, Publishing and Entertainment

IT and Business Services

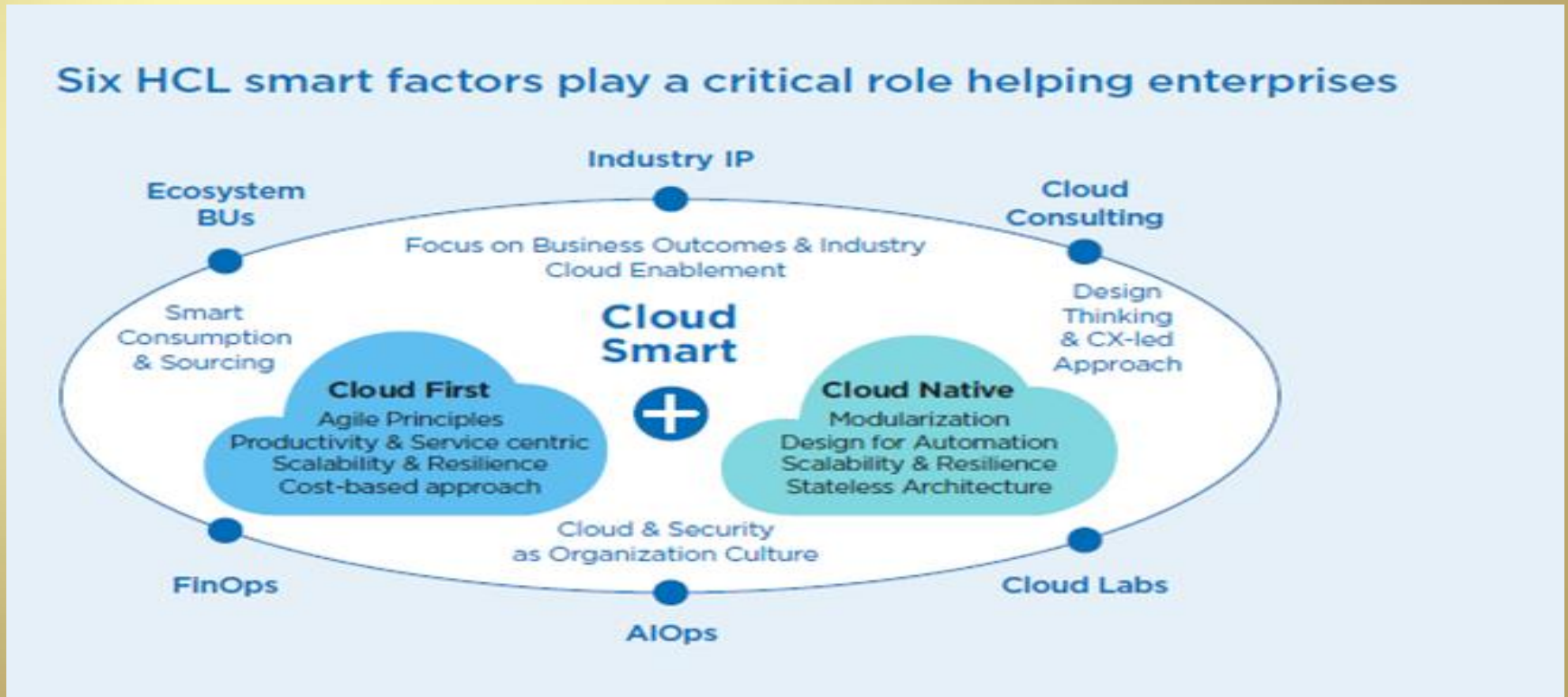
IT and Business Services (ITBS): A comprehensive suite of end-to-end digital offerings to address the traditional and transformational needs of large enterprises. This segment has seen 18.8% YoY revenue growth.

The ITBS segment comprises three sets of services that reflect crucial building blocks of every enterprise adopting next-generation technologies:

- Digital foundation: hybrid cloud, digital workplace, next-generation network, and cybersecurity/ governance, risk and compliance (GRC) services
- Digital business: consulting, applications and platforms, insights (data and analytics), and IoT services
- Digital operations: Integrated IT operations, security operations, and process operations

Cloud Smart

HCL Cloud Smart is a suite of industry-aligned offerings, capabilities, products and platforms to help enterprises build smart and agile businesses. The approach is driven by innovative cloud services, intelligent automation, industry aligned solutions, and a powerful global partner ecosystem.



FENIX 2.0

As client demand moves from seeking a partner for operating model transformation to a partner for end-to-end digital transformation journeys, the Digital Business team worked closely with various business units within HCL to evolve the FENIX 2.0 digital execution framework. This framework allows to execute scaled digital transformation programs and is the de-facto framework driving digital enablement for a large number of clients. FENIX 2.0 adoption amongst clients has increased by 30 percent in FY21.

With the trend of large-scale digital transformation, HCL sees a growing demand for engineering services outsourcing as organizations look for strategic partnerships with ESPs to provide critical solutions and services such as:

- In-depth domain-centric product engineering solutions
- Robust engineering talent and collaboration with start-up and global capability centres (GCC) ecosystem

World class partnerships

Hyperscalers



Tech OEMs



Products and Platforms

HCL P&P provides modernized software products and IP-led offerings for enterprise innovation across a broad range. This segment has seen 20.5% YoY revenue growth.

Over the years, HCL has created thousands of solutions for clients, resulting in valuable intellectual property (IP), and products and platforms that provide quantifiable client value spanning traditional, emerging, and future technology needs. P&P, comprising businesses including HCL Software, DRYiCE Software, Actian, and Industry Software Division of HCL Technologies, boasts more than 500 product releases and targets Mode 3 revenue. The P&P business unit represents a fundamental differentiator for HCL.

HCL leverages its **DRYiCE** Autonomics and Orchestration platform to deliver IA-enabled integration, development, and managed services, as well as products such as the DRYiCE Lucy cognitive virtual assistant, the DRYiCE iAutomate (intelligent runbook automation tool), and the DRYiCE OptiBot (end-user experience and service desk automation suite).

Engineering and R&D Services

HCL's ERS practice is amongst the most valued global engineering service providers (ESPs). With more than four decades of experience in operating under complex multi-vendor environments and client value chains, it possesses the capacity and know-how to seamlessly integrate with, and complement, the product engineering and research and development (ER&D) efforts of clients. ERS leverages more than 50 solution accelerators and next-generation technologies such as IoT, AI, augmented reality and virtual reality (AR/VR), and autonomous vehicles.

HCL clients include leaders across several asset-heavy engineering industries, such as Aerospace and Defense, Automotive, Industrial Manufacturing, Medical Devices and Office Automation, and asset-light industries, such as Telecommunications, Consumer HighTech, Semiconductor, and Software & Internet.

Latest Quarter's Growth in different segments

Strong revenue growth at 7.6% QoQ in **Constant Currency**, highest in the last 12 years.

Services business has grown at 5.3% QoQ cc this quarter on back of robust 5.2% QoQ cc in Q2.

1. **Engineering and R&D Services** grew at robust 8.3% QoQ cc (19.7% YoY cc) driven by traction in digital engineering and IoT Works.
2. **IT and Business Services** grew at healthy 4.7% QoQ cc (15.3% YoY cc), driven by acceleration in cloud transformation and application modernization deals.

Products and Platforms revenue grew at 24.5% QoQ cc (8.2% YoY cc) driven by significant traction in HCL DX and HCL Commerce products.

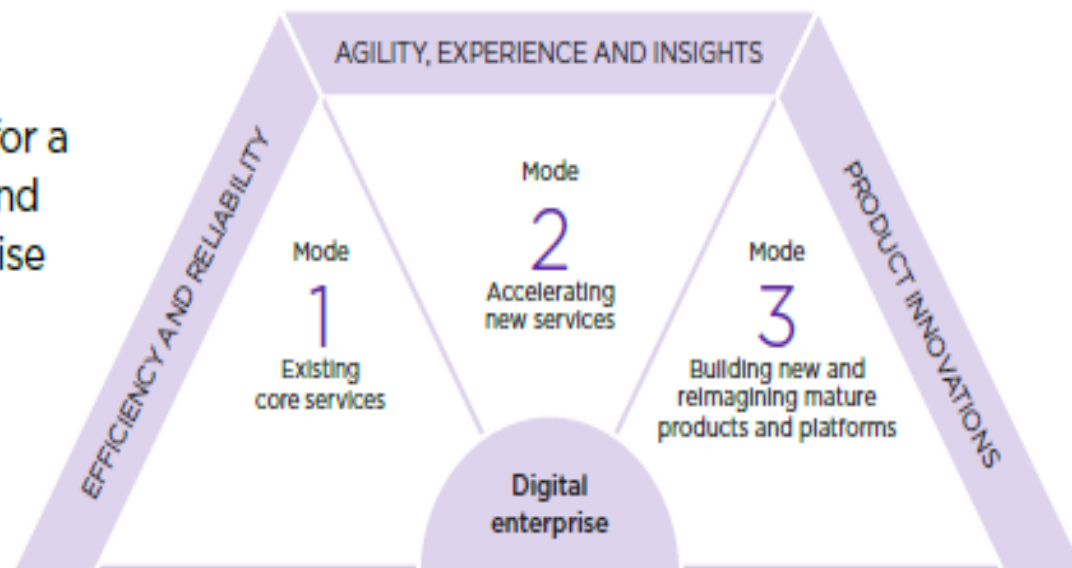
Business Strategy

Mode 1-2-3 strategy

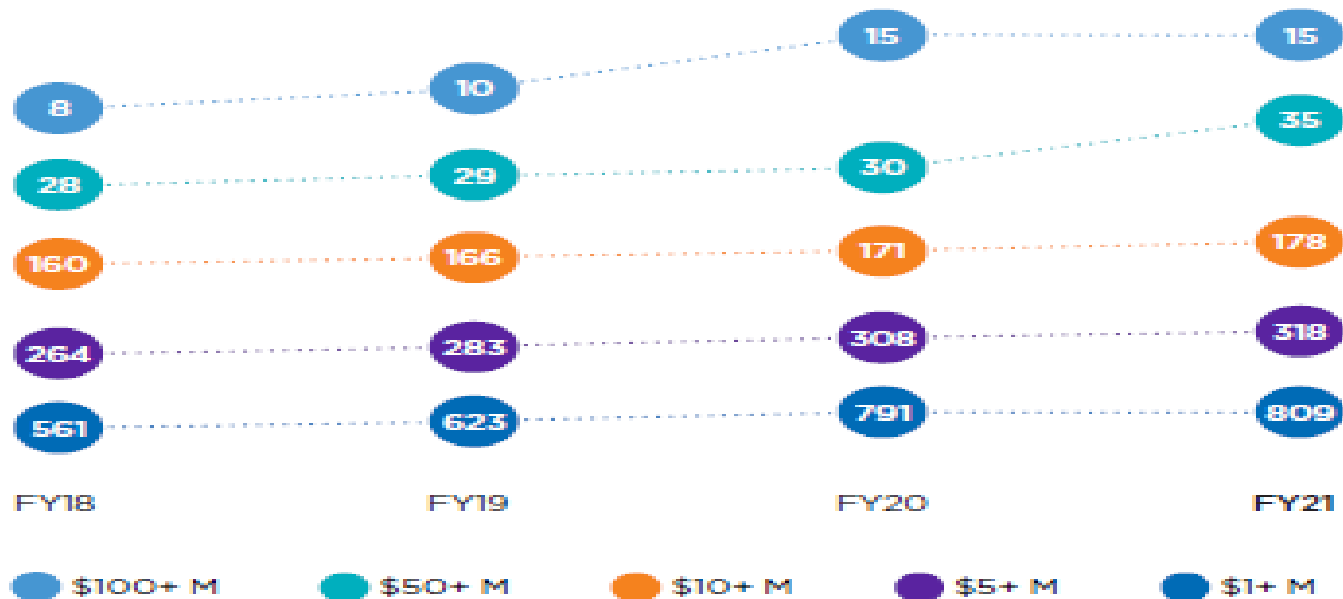
The growth blueprint for a sustainable, scalable and resilient digital enterprise

25.6% CAGR
for Mode 2 over four years

Sustaining our industry-leading momentum



Client category
(Number of clients)



- They don't have very large deals but small deals are increasing.

Future Contracts of HCL

HCL had an all-time high of large deals TCV (Total Contract Value). In Q3, FY'22, HCL Technologies won eight large services deals and eight significant product deals. It has been selected to provide global service desk and on-site support to global healthcare **company Novo Nordisk**. Through the partnership, HCL will help Novo Nordisk transform its IT operations and create world-class end-user experiences and drive efficiency across its workforce.

Strong Booking performance: TCV (Total Contract Value) of New Deal wins at US\$ 2,135 mn registering 64% YoY growth.

Services TCV at US\$ 1,968 mn (63% YoY) enabled by 8 net new large Services deal wins

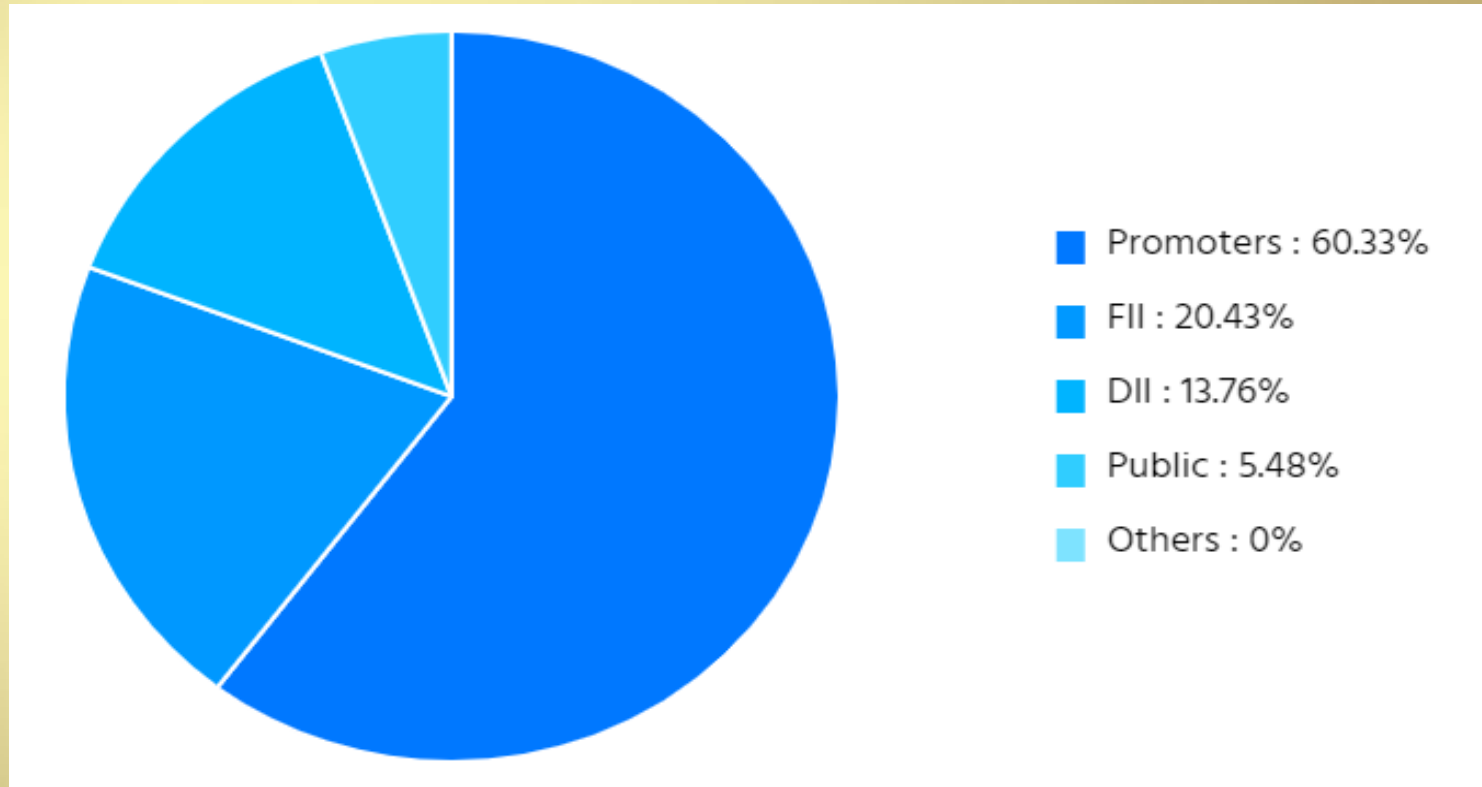
Products TCV at US\$ 167 mn (70% YoY) enabled by 8 net new large Product deal wins

- HCL Technologies has **launched two new 5G applications** to help mobile network operators optimize customer experience and reduce energy consumption across their 4G and 5G infrastructure. To improve network performance in places with high traffic congestion, such as city centers and large sporting events, HCL's QoE application allows mobile network operators to provide seamless, fast and reliable 5G services, by using artificial intelligence (AI). HCL's Energy Savings application reduces the operating costs of delivering 5G, using AI-based network automation capabilities.
- A U.S.-based Fortune 500 global life sciences company has selected HCL for supporting and transforming the hybrid cloud environment. HCL's SmartOps solution will help clients' IT meet their rapidly growing business needs. The solution will increase infrastructure availability while eliminating technical debt and enhancing end-user experience.

RISKS

1. US Demand softening for the whole IT sector : If tech blow-up, inflation rise and demand softening continue in US then the deal will totally dry up for Indian IT companies. The current boom will slow down.
2. Acquisitions : HCL has been an acquisition driven business. There have been several acquisitions in the products and platform business over time. The problem with products is that they could become obsolete. In 2017-18, HCL Tech signed a deal with IBM where products like IBM Lotus were transferred to HCL. These were late stage products but the strategy of HCL was that these products will do well in future once they are modernized, which could not happen. This 1.8bn dollar deal with IBM was not good for the company.
3. High attrition rates : High attrition rates impact an IT company profit margin as it is a long process to find a new engineer, train and replace them.

Share Holding Pattern



FINANCIALS

Balance Sheet

Consolidated Balance Sheet as at 31 March 2021

(All amounts in crores of ₹, except share data and as stated otherwise)

		As at	As at
		31 March 2021	31 March 2020
I	ASSETS		
	(1) Non-current assets		
	(a) Property, plant and equipment	5,642	5,494
	(b) Capital work in progress	312	400
	(c) Right-of-use assets	2,410	2,648
	(d) Goodwill	17,192	16,154
	(e) Other intangible assets	11,901	13,194
	(f) Financial assets		
	(i) Investments	89	77
	(ii) Others	2,569	2,373
	(g) Deferred tax assets (net)	1,181	2,317
	(h) Other non-current assets	1,847	1,829
	(2) Current assets		
	(a) Inventories	94	91
	(b) Financial assets		
	(i) Investments	6,773	6,989
	(ii) Trade receivables	13,663	14,131
	(iii) Cash and cash equivalents	6,521	4,848
	(iv) Other bank balances	2,367	128
	(v) Loans	4,841	3,422
	(vi) Others	5,889	5,937
	(c) Current tax assets (net)	131	157
	(d) Other current assets	2,772	2,717
	TOTAL ASSETS	86,194	82,906

II	EQUITY		
	(a) Equity share capital	543	543
	(b) Other equity	59,370	50,724
	Equity attributable to shareholders of the Company	59,913	51,267
	Non-controlling interest	169	154
	TOTAL EQUITY	60,082	51,421
III	LIABILITIES		
	(1) Non-current liabilities		
	(a) Financial liabilities		
	(i) Borrowings	3,828	2,848
	(ii) Lease liabilities	1,903	2,179
	(iii) Others	973	1,194
	(b) Provisions	1,333	1,048
	(c) Deferred tax liabilities (net)	147	87
	(d) Other non-current liabilities	545	399
	(2) Current liabilities		
	(a) Financial liabilities		
	(i) Borrowings	-	1,845
	(ii) Trade payables	1,726	1,166
	(iii) Lease liabilities	691	715
	(iv) Others	8,421	14,340
	(b) Other current liabilities	4,299	3,889
	(c) Provisions	963	706
	(d) Current tax liabilities (net)	1,283	1,069
	TOTAL EQUITY AND LIABILITIES	86,194	82,906

Profit and Loss for the year ended 31 March 2021

Consolidated Statement of Profit and Loss for the year ended 31 March 2021

(All amounts in crores of ₹, except share data and as stated otherwise)

		Year ended	Year ended
		31 March 2021	31 March 2020
I	Revenue		
	Revenue from operations	75,379	70,676
	Other income	927	589
	Total income	76,306	71,265
II	Expenses		
	Purchase of stock-in-trade	1,698	1,536
	Changes in inventories of stock-in-trade	(3)	-
	Employee benefits expense	38,853	34,928
	Finance costs	511	505
	Depreciation, amortization and impairment expense	4,611	3,420
	Outsourcing costs	10,158	10,700
	Other expenses	4,625	6,196
	Total expenses	60,453	57,285
III	Profit before tax	15,853	13,980
IV	Tax expense		
	Current tax	3,719	2,821
	Deferred tax charge	965	102
	Total tax expense	4,684	2,923
V	Profit for the year	11,169	11,057

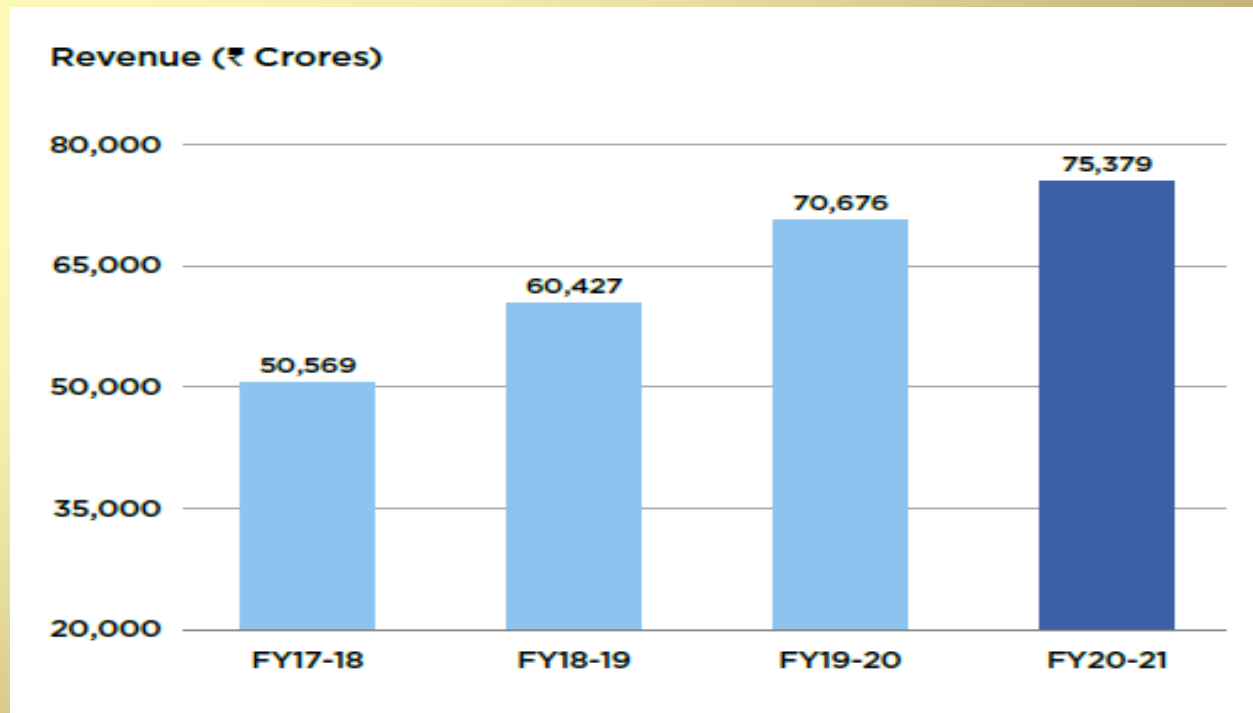
VI	Other comprehensive income		
(A)	(i) Items that will not be reclassified to statement of profit and loss	33	(85)
	(ii) Income tax on items that will not be reclassified to statement of profit and loss	(10)	18
(B)	(i) Items that will be reclassified subsequently to statement of profit and loss	913	441
	(ii) Income tax on items that will be reclassified subsequently to statement of profit and loss	(178)	105
VII	Total other comprehensive income	758	479
VIII	Total comprehensive income for the year	11,927	11,536
	Profit for the year attributable to		
	Shareholders of the Company	11,145	11,057
	Non-controlling interest	24	-
		11,169	11,057
	Total comprehensive income for the year attributable to		
	Shareholders of the Company	11,908	11,525
	Non-controlling interest	19	11
		11,927	11,536
	Earnings per equity share of ₹ 2 each		
	Basic (in ₹)	41.07	40.75
	Diluted (in ₹)	41.07	40.75

Cash Flow Statement

	Mar 2017	Mar 2018	Mar 2019	Mar 2020	Mar 2021
Cash from Operating Activity +	8,995	8,328	8,971	13,359	19,618
Cash from Investing Activity +	-3,890	-2,236	-3,256	-12,332	-5,677
Cash from Financing Activity +	-4,517	-5,714	-1,471	-3,168	-11,180
Net Cash Flow	588	378	4,244	-2,141	2,761

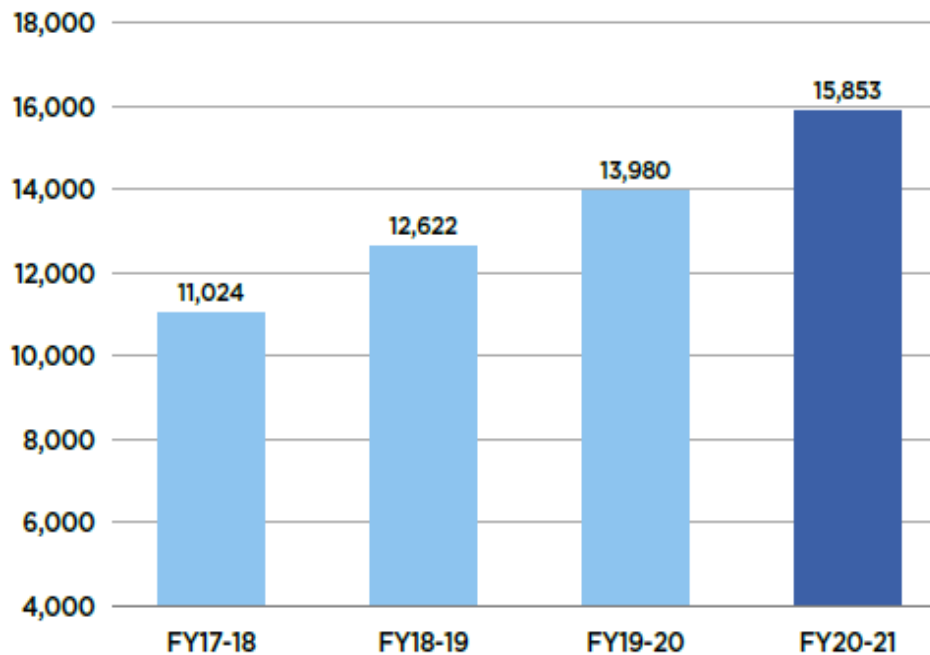
Profit and Loss account Analysis

Revenue has increased from ₹ 50,569 Crores in FY18 to ₹75,379 Crores in FY21, with a compounded annual growth rate (CAGR) of 14.2 percent over the last three years. Revenue increased by 6.7% YoY which shows poor sales growth over the past year.



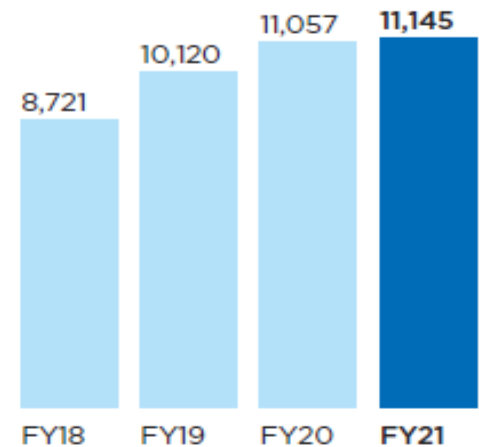
Profit before tax has increased from ₹ 11,024 Crores in FY18 to ₹ 15,853 Crores in FY21, with a compounded annual growth rate (CAGR) of 12.9 percent over the last three years. Profit after tax shows poor growth over the last three years

Profit Before Tax (₹ Crores)

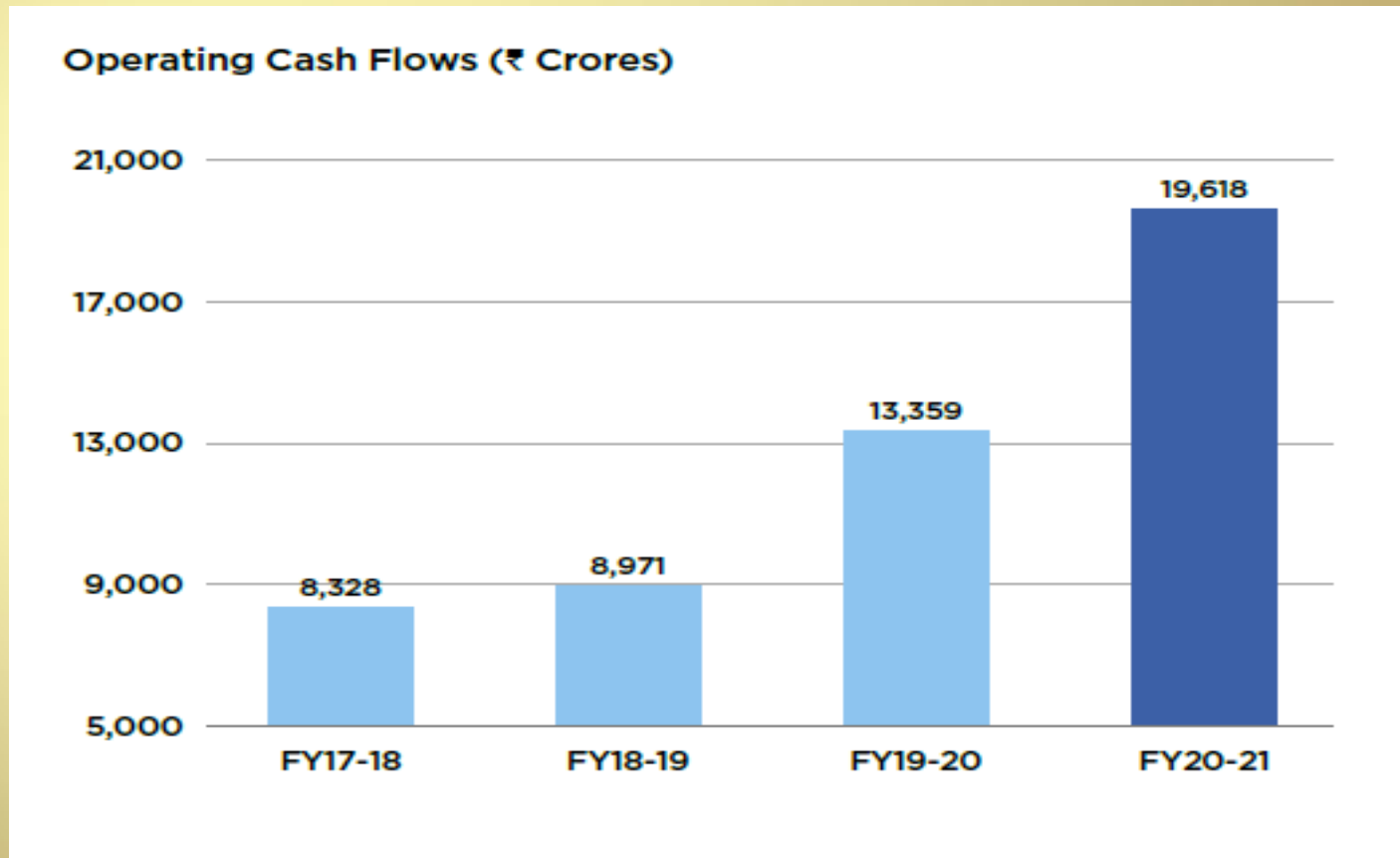


Profit after Tax
(₹ Cr)

8.5% CAGR*



Operating cash flows of the Company has increased from ₹ 8,328 Crores in FY18 to ₹ 19,618 Crores in FY21, with a compounded annual growth rate (CAGR) of 33.1 percent over the last three years.

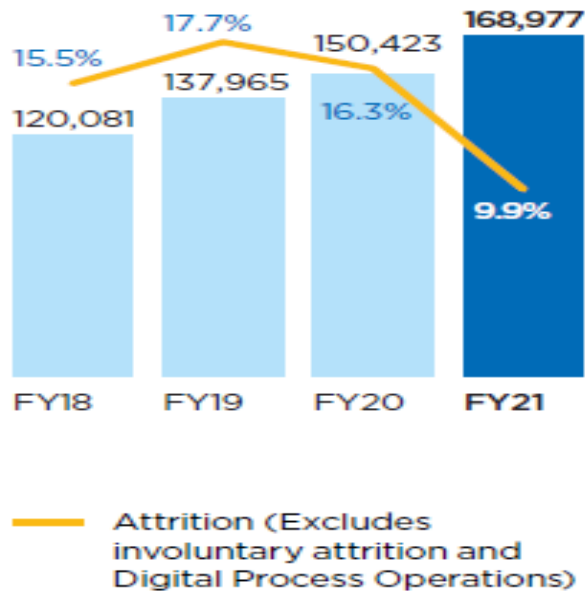


Key Ratio Analysis

PE ratio: - Price to Earnings' ratio, which indicates for every rupee of earnings how much an investor is willing to pay for a share. A general rule of thumb is that shares trading at a low P/E are undervalued (it depends on other factors too). HCL Tech. has a PE ratio of 28.72 which is lowest as compared to its peers so it is **undervalued** at this point of time.

Dividend Yield: - It tells us how much dividend we will receive in relation to the price of the stock. The current year dividend for HCL Tech. is **₹ 10 per share per quarter** and the yield is 2.75 %. **HCL distributes 75% of its net income as dividend** under its dividend distribution policy. It also paid one time bonus of ₹ 700 Cr in quarter 4 of FY20.

Employee Metrics (Headcount)



Training is an important aspect of IT and ER&D businesses. This in turn means employee retention is also important.

The engineers' bench size remains slightly large. For this reason, there's high degree of Operating Leverage when large no. of contracts come. A small change in operating margins as happened during the COVID times, would cause a huge change in profit margins.

Although attrition impacts the IT Service businesses but ER&D businesses are significantly impacted. As it is a long process to find a new engineer, train and replace them.

Return on Equity	
10 Years:	25%
5 Years:	24%
3 Years:	23%
Last Year:	20%

Return on Equity (ROE): ROE measures the ability of a firm to generate profits from its shareholders investments in the company. In other words, the return on equity ratio shows how much profit each rupee of common stockholders' equity generates. HCL has a healthy ROE track record of 20 % for the latest year.

Return on Capital Employed (ROCE): The Company has been maintaining a healthy Return on Capital Employed at 20% for last 3 years. The ROCE for the latest year is 25.7% which is good but less than its competitors.

CONCLUSION

HCL Technologies has been named as the **No. 1 player** in the United States in Engineering R&D Services in the **annual Zinnov Zones for ER&D 2021 ratings**. This recognition validates HCL Technologies' expertise in end-to-end engineering, R&D and Mode 2-led digital engineering services across multiple verticals.

India's ER&D services' is expected to grow at 15-16% CAGR for 3-4 years and the IT services' is expected to grow at 9-10% CAGR for 3-4 years.

Once a product becomes an intrinsic part of an enterprises' processes, it is difficult to displace it. This is the stickiness that HCL is bringing into its strong network of global partnerships by focusing on robust product and platform offerings, highly skilled talent, and engineering legacy that make it a preferred engineering partner for clients across aerospace, enterprise and consumer software, industrial and telecommunications verticals

Buy HCL Tech share and hold it for long term