



HCL to acquire DWS, expanding geographies

HCL Tech announced that it is going to acquire DWS group headquartered in Australia for AU\$ 158.2. The deal will likely close till December 2020. HCL Tech has strong a foothold in geographies like North America and Europe, but with the acquisition of DWS HCL tech will be able to expand its footprints in Australia and New Zealand. DWS is an Australian company providing range of IT services including Digital transformation, Application development & support, Program & Project Management and Consulting. DWS has more than 700 employees and range of blue chip corporate clients and federal, state and local government agencies. HCL Tech has approximately 1,600 employees in major Australian cities including Canberra, Sydney, Melbourne, Brisbane, and Perth. The acquisition is expected to enhance HCL tech client portfolio across key industries in Australia.

We believe HCL Tech has a better services mix and multiple long term contracts spread across verticals. With depreciation in INR, lower travel cost and strong execution EBITDA margins likely to expand in near term. **We recommend BUY and assign 16x P/E multiple to its FY23E earnings of Rs. 56.7 per share which gives a TP of Rs. 900 per share, an upside of 12%.**

Revision of guidance, Expecting strong recovery

HCL Tech management has come up with mid quarter guidance as it expects strong client side demand recovery across verticals like Healthcare, Financial Services, Telecom & Media. Deal pipeline also remained strong across services and geographies. Management now expects **revenue growth to exceed 3.5% QoQ** in CC terms compared to earlier expectation of 1.5-2.5% CQGR over Q2-Q4FY21 and **margin of 20.5-21%** (guidance of 19.5-20.5% for FY21) for Q2FY21.

Valuation and Outlook

Resilient business structure, better services mix will help HCL Tech to attain long term sustainable growth with a CAGR of 9% over FY21E to FY23E. We are expecting HCL Tech will also to deliver strong margin performance (24% FY22E, 25% FY23E) and healthy return ratios (19% FY22E and 23% FY23E). **We recommend BUY and assign 16x P/E multiple to its FY23E earnings of Rs. 56.7 per share which gives a TP of Rs. 900 per share, an upside of 12%.** (Please refer P/E band charts below).

Key Financials (Consolidated)

(Rs. Cr)	FY20	FY21E	FY22E	FY23E
Net Sales	70,678	77,790	84,992	92,763
EBIDTA	16,694	16,631	17,815	19,991
Net Profit	11,062	11,122	12,118	13,587
EPS (Rs)	40.8	44.9	50.6	56.6
PER (x)	17.9	16.4	14.0	13.1
EV/EBIDTA (x)	7.7	9.5	8.1	7.0
P/BV (x)	3.1	2.3	2.7	2.3
ROE (%)	24%	17%	19%	21%

Source: Company, Axis Research

(CMP as of Sept 21, 2020)

CMP (Rs)	802
Upside /(Downside (%))	12%
High/Low (Rs)	850/375
Market cap (Cr)	Rs 2,16,550
Avg. daily vol. (6m) Shrs.	18,39,129
No. of shares (Cr)	271.36

Shareholding (%)

	Dec -20	Mar -19	Jun-19
Promoter	60.3	60.3	60.0
FIs	26.4	26.4	27.7
MFs / UTI	5.5	5.5	5.6
Banks / FIs	2.0	2.0	0.9
Others	6.2	6.2	5.9

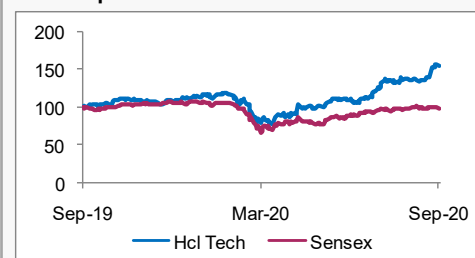
Financial & Valuations

Y/E Mar (Rs. Cr)	2021E	2022E	2023E
Net Sales	77,790	84,992	92,763
EBITDA	16,631	17,815	19,991
Net Profit	11,122	12,118	13,587
EPS (Rs)	44.9	50.6	56.7
PER (x)	16.4	14.0	13.1
EV/EBITDA (x)	9.5	8.1	7.0
P/BV (x)	2.3	2.7	2.3
RoE (%)	17%	19%	21%

Change in Estimates (%)

Y/E Mar	FY21E	FY22E	FY23E
Sales	1%	2%	3%
EBITDA	2%	2%	3%
PAT	1%	3%	3%

Relative performance



Source: Capitaline, Axis Securities

Omkar Tanksale

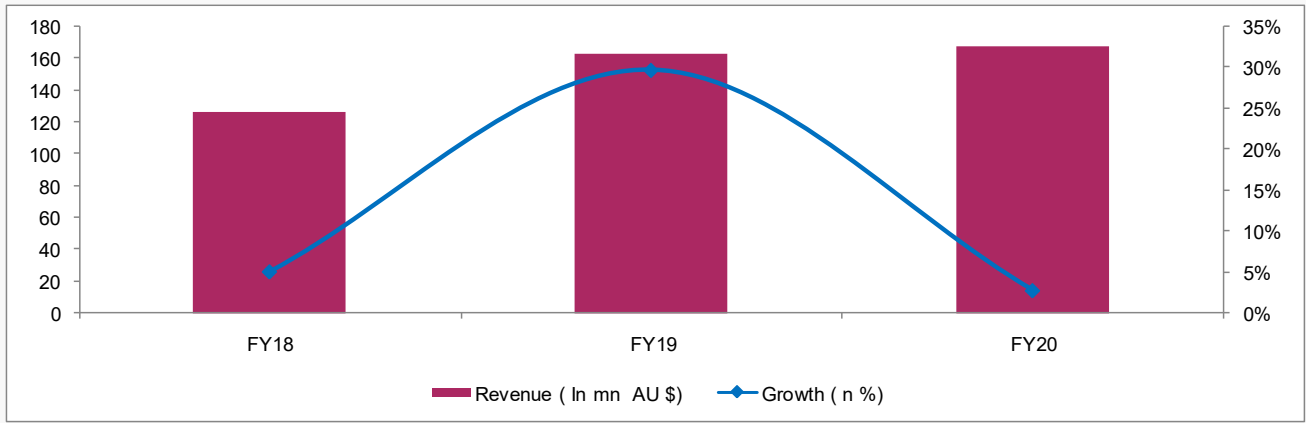
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Strategic capability based acquisition

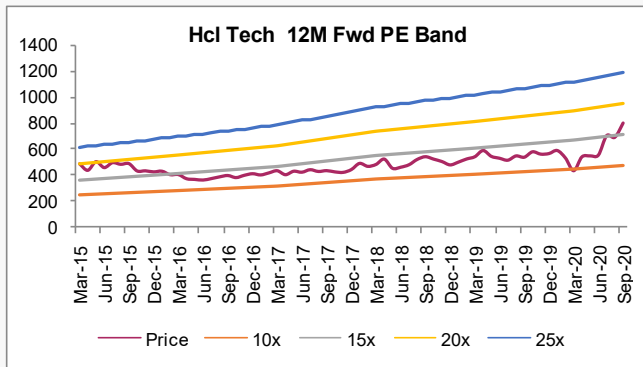
DWS is an Australian Software services company. HCL Tech will pay AU\$ 158.2 mn as an equity value. Purchase consideration implies ~0.94x FY20 revenue and ~21x FY20 PAT. DWS has been active in acquiring companies and has made three acquisitions in past 5 years and 11 acquisitions in past 15 years. Despite inorganic push, company has grown at ~6% CAGR over FY13-20. Given the onsite delivery presence, margin of DWS is decent with 11.7% EBITDA margin. This acquisitions will help HCL Tech to expand its footprints in new geographies like Australia & Newzealand.

Revenue performance of DWS AU \$



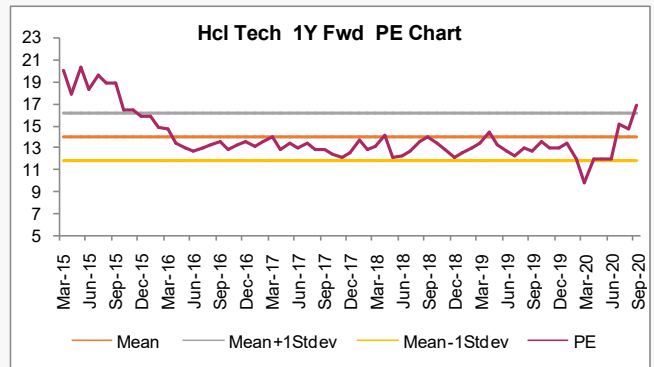
Source: Company, Axis Securities

HCL Tech 12M Fwd PE Band



Source: Company, Axis Securities

HCL Tech 1Y Fwd PE Chart



Financials (Consolidated)

Profit & Loss

(Rs Cr)

	FY20	FY21E	FY22E	FY23E
Net sales	70,678	77,790	84,992	92,763
Growth, %	17%	10%	9%	9%
Other income	193	814	1,133	1,204
Total income	7,087	7,860	8,613	9,397
Employee expenses	44,018	51,046	56,978	61,640
Other Operating expenses	9,966	10,113	10,199	11,132
EBITDA	16,694	16,631	17,815	19,991
Growth, %	20%	0%	7%	12%
Margin, %	24%	21%	21%	22%
Depreciation	2,841	2,413	2,602	2,904
EBIT	1,385	1,503	1,635	1,829
Growth, %	17%	9%	9%	12%
Margin, %	2%	2%	2%	2%
Interest paid	-15	262	148	134
Pre-tax profit	14,061	14,772	16,198	18,157
Tax provided	2,938	3,619	4,050	4,539
Profit after tax	11,123	11,153	12,149	13,618
Net Profit	11,062	11,122	12,118	13,587
Growth, %	9%	1%	9%	12%
Net Profit (adjusted)	11,062	11,122	12,118	13,587

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY20	FY21E	FY22E	FY23E
Cash & bank	8,385	10,499	11,194	16,605
Debtors	14,134	15,941	17,881	19,516
Other current assets	5,188	5,188	5,188	5,188
Total current assets	38,333	43,292	47,057	54,633
Goodwill and Intangible Assets	0	0	0	0
Net fixed assets	5,713	1,961	1,484	899
CWIP	531	531	531	531
Other Non-current assets	0	0	0	0
Total Non Current Assets	2,946	2,998	3,080	3,080
	0	0	0	0
Total assets	83,216	92,562	110,420	110,420
	0	0	0	0
Creditors	1,917	2,005	2,019	2,187
Provisions	8,000	7,500	7,500	7,500
Total current liabilities	20,889	19,184	19,109	19,931
Other liabilities	2,548	2,548	2,548	2,548
Paid-up capital	543	543	543	543
Reserves & surplus	51,143	59,725	69,303	80,350
Total equity & liabilities	83,216	92,562	110,420	110,420

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E March	FY20	FY21E	FY22E	FY23E
Pre-tax profit	14,062	14,773	16,200	18,159
Depreciation	2,841	2,413	2,602	2,904
Chg in working capital	338	-4,550	-3,144	-1,343
Total tax paid	294	362	405	454
Cash flow from operating activities	14,345	13,413	16,435	20,497
Capital expenditure	0	1,945	2,125	2,319
Cash flow from investing activities	-11,374	-7,632	-7,812	-8,007
Free cash flow	297	384	650	1,017
Dividend (incl. tax)	2,540	2,540	2,540	2,540
Cash flow from financing activities	5,551	-1,339	-1,339	0
Net chg in cash	3,045	1,578	695	5,411

Source: Company, Axis Securities

Ratio Analysis

(%)

Y/E March	FY20	FY21E	FY22E	FY23E
Per Share data				
EPS (INR)	40.76	44.90	50.60	56.67
Growth, %	10%	10%	13%	12%
Book NAV/share (INR)	375.7	438.0	507.7	587.9
FDEPS (INR)	39	42	46	46
CEPS (INR)	100.5	97.8	106.4	119.3
CFPS (INR)	36.5	43.8	42.8	47.936
DPS (INR)	23	25	27	30.24
Return ratios				
Return on assets (%)	24%	20%	19%	18%
Return on equity (%)	24%	17%	19%	21%
Return on capital employed (%)	14%	13%	13%	13%
Turnover ratios				
Asset turnover (x)	0.9	0.9	0.9	0.9
Sales/Total assets (x)	1.2	1.2	1.3	1.456
Receivables Days	70.4	70.4	70.4	70.4
Cash conversion cycle	36	35	35	39.2
Liquidity ratios				
Current ratio (x)	2.4	2.6	2.8	3.136
Interest cover (x)	0	112	132	147.84
Valuation				
PER (x)	17.9	16.4	14.0	13.1
Price/Book (x)	3.1	2.3	2.7	2.3
EV/Net sales (x)	2.6	2.4	2.1	1.8
EV/EBITDA (x)	7.7	9.5	8.1	7.0
Dividend Yield	1.0	1.2	1.7	2.2

Source: Company, Axis Securities

About the analyst**Analyst:** Omkar Tanksale**Contact Details:** omkar.tanksale@axissecurities.in**Sector:** IT Services**Analyst Bio:** Omkar Tanksale is BE (Computer) and MBA (Finance) with over 8 years of research experience in the IT sector**Disclosures:**

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