

**BUY**

TP: Rs 920 | ▲ 15%

**HCL TECHNOLOGIES**

| IT Services

| 21 September 2020

## Acquisition spree on; DWS to expand footprint in Australia

**HCL Technologies (HCLT) acquired Australian IT firm DWS for US\$115.8mn. This acquisition serves the purpose of expanding HCLT's reach in Australia and New Zealand (ANZ) and brings in marquee ANZ clientele. DWS has domain expertise in BFSI and Govt. and defence verticals, together forming 72% of its revenues. These verticals are a safe bet during the ongoing pandemic. For the long term, this acquisition looks EPS accretive, though the gains will be negligible. Retain BUY.**

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**A tuck-in acquisition:** DWS has extensive capabilities in the BFSI and Govt./Federal verticals which form ~72% of its total revenues. These verticals have been more resilient vs. the rest during the pandemic. Its management expects the good growth to continue driven by assured federal projects and state govt. work. DWS' FY20 annual revenue stood at AU\$167.9mn, which is roughly 1%+ of HCLT's FY20 revenue. EBITDA margin excluding one off acquisition costs stands at 15-17%. Despite the pandemic, its revenue grew by 2.7% and underlying EBITDA margin by 80bps, YoY. Though its revenue growth has fluctuated over the years, its 5-year CAGR stood strong at 12% over FY15-20.

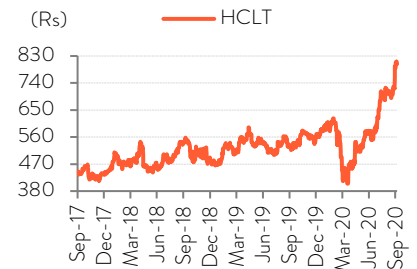
**Geographical diversification:** DWS' strong presence in Australia across Melbourne, Sydney, Canberra, Brisbane and Adelaide will help HCLT in geographic diversification. Out of its 150k employees, HCLT has only 1600 employees working in Australia. DWS will add its 700 employees to HCLT.

**EPS accretive:** Through small scale, this acquisition will be EPS accretive in our view. This acquisition will enhance HCLT's presence in Australia and New Zealand region especially in BFSI and Govt./defence segment creating potential for cross selling led synergies. Also, HCLT's robust track record with acquisitions is a plus.

Ticker/Price	HCLT IN/Rs 803
Market cap	US\$ 29.6bn
Shares o/s	2,713mn
3M ADV	US\$ 69.7mn
52wk high/low	Rs 850/Rs 375
Promoter/FPI/DII	60%/27%/13%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	6,04,280	7,06,780	7,52,867	8,42,502	9,21,977
EBITDA (Rs mn)	1,40,020	1,66,930	1,96,347	2,17,607	2,41,057
Adj. net profit (Rs mn)	99,757	1,10,940	1,24,938	1,35,450	1,53,388
Adj. EPS (Rs)	36.7	40.9	46.0	49.9	56.5
Adj. EPS growth (%)	16.3	11.5	12.6	8.4	13.2
Adj. ROAE (%)	25.2	23.5	22.5	21.8	22.0
Adj. P/E (x)	21.9	19.6	17.4	16.1	14.2
EV/EBITDA (x)	15.5	13.0	11.0	9.8	8.5

Source: Company, BOBCAPS Research

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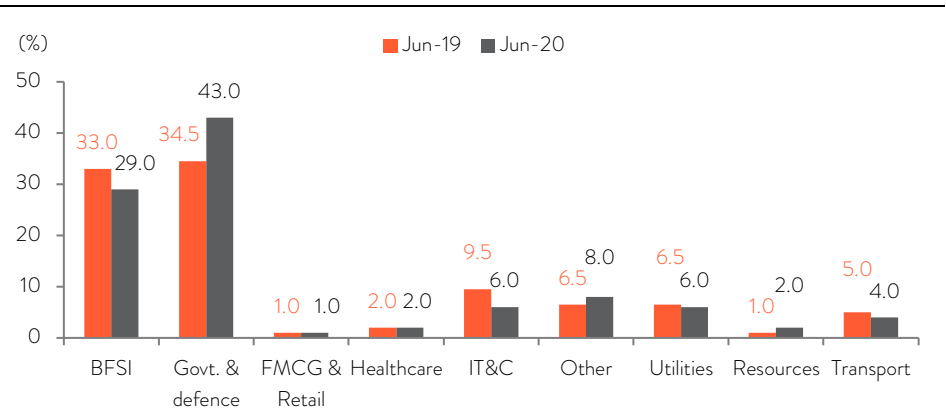
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### Other key highlights

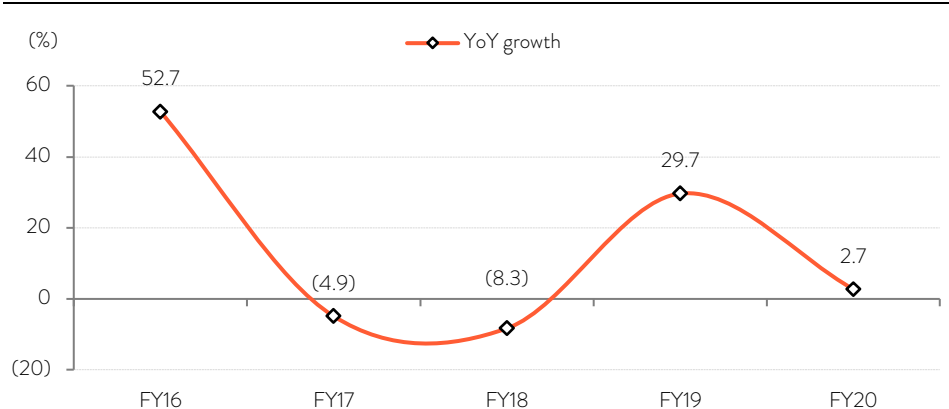
- DWS provides a wide range of IT services including digital transformation, application development & support, program & project management and consulting.
- HCLT will be spending US\$115.8mn in this acquisition, expected to be closed in Dec'20. DWS has a debt of AU\$39mn and a decent cash balance of AU\$14million as of June'20 (net debt at AU\$25mn). DWS' FY20 EPS of 5.7 cents (declined 27% YoY) is roughly 10% of HCLT's.
- DWS' immediate focus is ramping up its core business and growing its acquired businesses to pay down debt.
- DWS groups other holdings include Symplicit, Phoenix and Project Assured.
- Project Assured continues to perform strongly and is forecast to continue its growth in FY21.
- The acquisition is expected to close in Dec-20.

**FIG 1 – BFSI AND GOVT & DEFENCE SEGMENT CONTRIBUTED 72% OF REVENUE IN FY20**



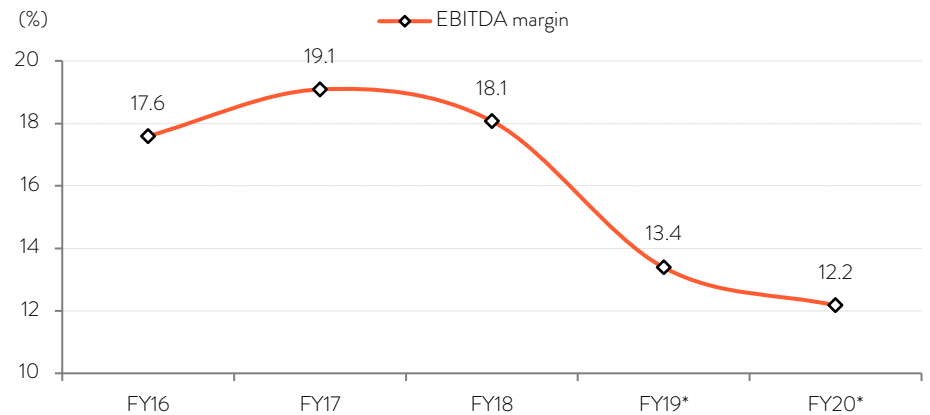
Source: BOBCAPS Research, Company

**FIG 2 – DWS' YOY REVENUE GROWTH**



Source: BOBCAPS Research, Company

**FIG 3 – REPORTED EBITDA MARGIN**



Source: BOBCAPS Research, Company. | \*Note: Excluding acquisition costs and one off expenses, adjusted EBITDA margin was 17% and 16.2% for FY20 and FY19 respectively.

**FIG 4 – NOTABLE CLIENTELE OF DWS**



Source: Company, BOBCAPS Research

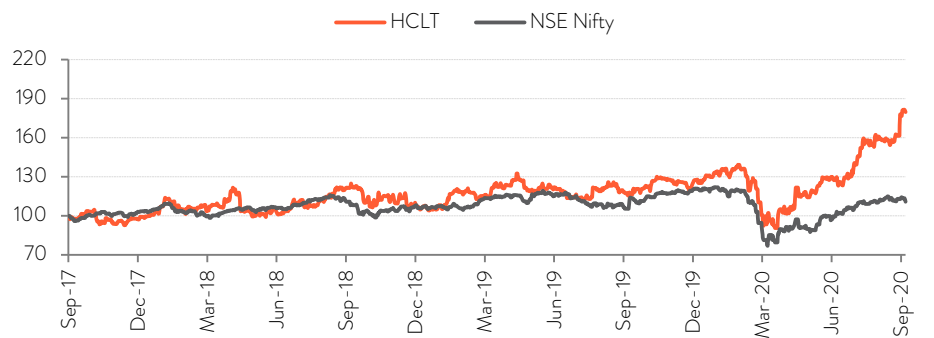
## Valuation methodology

We keep our FY21/FY22/FY23 EPS and Sep'21 target price at Rs 920, set at a target P/E multiple of 17x which is at 20% discount to target multiple for Infosys and 1.2SD above the last five-year average P/E.

We reiterate BUY as we see relatively higher near-to-mid-term growth visibility for the company vis-à-vis peers on the back of:

- its growing software (Mode-3) business which forms 16.2% of revenue and is relatively immune to Covid-led volatility (this also brings in structural potential for margin improvement),
- healthy large deal wins (11 contracts won in Q1FY21), and
- its IMS heritage which offers unique positioning to leverage the cloud
- migration opportunity accelerated by the pandemic.

**FIG 5 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- Slowdown in deal momentum
- Less market share gain going forward due to high competition
- Cloud spending contraction

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>6,04,280</b>	<b>7,06,780</b>	<b>7,52,867</b>	<b>8,42,502</b>	<b>9,21,977</b>
EBITDA	1,40,020	1,66,930	1,96,347	2,17,607	2,41,057
Depreciation	21,480	28,400	41,518	45,014	47,808
EBIT	1,18,540	1,38,530	1,54,829	1,72,593	1,93,249
Net interest income/(expenses)	(1,693)	0	0	0	0
Other income/(expenses)	7,720	1,790	3,444	3,316	5,956
Exceptional items	0	0	0	0	0
EBT	1,24,567	1,40,320	1,58,273	1,75,909	1,99,206
Income taxes	24,810	29,380	33,334	40,459	45,817
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>99,757</b>	<b>1,10,940</b>	<b>1,24,938</b>	<b>1,35,450</b>	<b>1,53,388</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>99,757</b>	<b>1,10,940</b>	<b>1,24,938</b>	<b>1,35,450</b>	<b>1,53,388</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	1,26,860	2,59,090	2,63,503	2,94,876	3,22,692
Provisions	0	0	15,057	16,850	18,440
Debt funds	39,860	50,930	50,930	50,930	50,930
Other liabilities	4,540	5,280	5,280	5,280	5,280
Equity capital	2,812	2,812	2,812	2,812	2,812
Reserves & surplus	4,14,888	5,14,048	5,78,866	6,49,137	7,28,715
Shareholders' fund	4,22,240	5,22,140	5,86,958	6,57,229	7,36,807
<b>Total liabilities and equities</b>	<b>5,88,960</b>	<b>8,32,160</b>	<b>9,16,449</b>	<b>10,19,885</b>	<b>11,28,869</b>
Cash and cash eq.	59,290	48,430	1,22,505	2,54,544	3,58,728
Accounts receivables	1,46,100	1,77,720	1,95,952	2,07,740	2,27,337
Inventories	0	0	0	0	0
Other current assets	37,160	79,030	90,344	84,250	92,198
Investments	58,520	1,05,680	1,05,680	1,05,680	1,05,680
Net fixed assets	1,32,396	62,440	40,000	14,486	(13,822)
CWIP	0	0	0	0	0
Intangible assets	1,02,564	2,94,210	2,94,210	2,94,210	2,94,210
Deferred tax assets, net	0	0	0	0	0
Other assets	52,930	64,650	67,758	58,975	64,538
<b>Total assets</b>	<b>5,88,960</b>	<b>8,32,160</b>	<b>9,16,449</b>	<b>10,19,885</b>	<b>11,28,869</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	1,20,740	1,39,340	1,66,457	1,80,464	2,01,196
Interest expenses	(4,480)	(1,790)	(3,444)	(3,316)	(5,956)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(24,660)	47,020	(13,183)	36,253	(3,702)
Other operating cash flows	(1,936)	(40,905)	0	0	0
<b>Cash flow from operations</b>	<b>89,664</b>	<b>1,43,665</b>	<b>1,49,830</b>	<b>2,13,401</b>	<b>1,91,538</b>
Capital expenditures	(34,340)	(1,50,090)	(19,079)	(19,500)	(19,500)
Change in investments	5,200	47,160	0	0	0
Other investing cash flows	(3,604)	1,790	3,444	3,316	5,956
<b>Cash flow from investing</b>	<b>(32,744)</b>	<b>(1,01,140)</b>	<b>(15,635)</b>	<b>(16,184)</b>	<b>(13,544)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	36,230	0	0	0	0
Interest expenses	(39,860)	0	0	0	0
Dividends paid	(10,990)	(53,384)	(60,120)	(65,178)	(73,810)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(14,620)</b>	<b>(53,384)</b>	<b>(60,120)</b>	<b>(65,178)</b>	<b>(73,810)</b>
<b>Changes in cash and cash eq.</b>	<b>42,300</b>	<b>(10,859)</b>	<b>74,075</b>	<b>1,32,038</b>	<b>1,04,184</b>
<b>Closing cash and cash eq.</b>	<b>59,290</b>	<b>48,430</b>	<b>1,22,505</b>	<b>2,54,544</b>	<b>3,58,728</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	36.7	40.9	46.0	49.9	56.5
Adjusted EPS	36.7	40.9	46.0	49.9	56.5
Dividend per share	14.7	16.4	18.4	20.0	22.6
Book value per share	155.2	192.4	216.3	242.2	271.5

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.6	3.1	2.9	2.5	2.2
EV/EBITDA	15.5	13.0	11.0	9.8	8.5
Adjusted P/E	21.9	19.6	17.4	16.1	14.2
P/BV	5.2	4.2	3.7	3.3	3.0

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	80.1	79.1	78.9	77.0	77.0
Interest burden (PBT/EBIT)	105.1	101.3	102.2	101.9	103.1
EBIT margin (EBIT/Revenue)	19.6	19.6	20.6	20.5	21.0
Asset turnover (Revenue/Avg TA)	112.6	99.5	86.1	87.0	85.8
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.6	1.6	1.5
Adjusted ROAE	25.2	23.5	22.5	21.8	22.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	19.5	17.0	6.5	11.9	9.4
EBITDA	22.4	19.2	17.6	10.8	10.8
Adjusted EPS	16.3	11.5	12.6	8.4	13.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	23.2	23.6	26.1	25.8	26.1
EBIT margin	19.6	19.6	20.6	20.5	21.0
Adjusted profit margin	16.5	15.7	16.6	16.1	16.6
Adjusted ROAE	25.2	23.5	22.5	21.8	22.0
ROCE	24.9	23.4	23.3	27.1	33.3
<b>Working capital days (days)</b>					
Receivables	81	84	91	87	86
Inventory	0	0	0	0	0
Payables	92	130	171	163	166
<b>Ratios (x)</b>					
Gross asset turnover	4.8	7.3	14.7	30.9	2,774.1
Current ratio	2.3	1.4	1.7	1.9	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.1)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

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### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

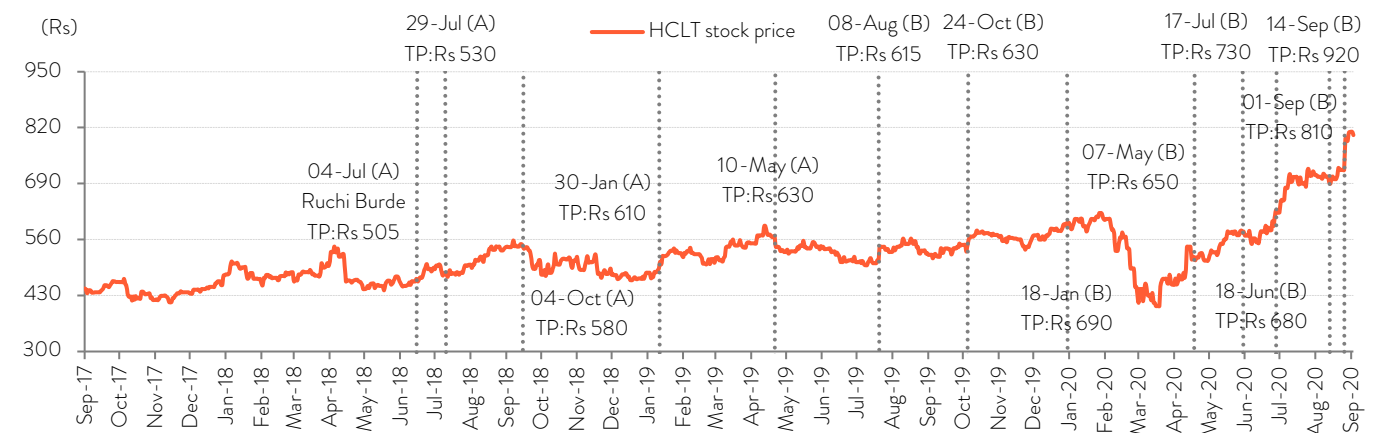
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): HCL TECHNOLOGIES (HCLT IN)



B – Buy, A – Add, R – Reduce, S – Sell

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