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Infosys and HCL Tech: Analyst meet takeaways

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At analyst meetings hosted separately by INFO and HCLT, we noted evolving digital capabilities and growing digital contract sizes at both players. Talent reskilling, a partner ecosystem of mature and niche tech players, and a consultative approach to solutions appears to have become the accepted playbook for the digital business. HCLT emphasised its strategic focus on the products & platforms business, while corporate governance took prominence at INFO. We prefer HCLT (BUY) and TCS (ADD) among large-caps.

Similar playbook for digital business: The digital playbooks of both Infosys (INFO) and HCL Tech (HCLT) focus on (1) talent reskilling, (2) building an ecosystem of technology partners – both mature and niche (150+ at HCLT), and (3) adopting a consultative approach to offer innovative solutions. IT vendors are investing on dedicated innovation labs for collaborative client engagement and fostering new digital capabilities.

INFO – reiterates commitment to corporate governance: Board chairman Nandan Nilekani assured investors of transparent corporate governance and announced that a summary of the investigation into recent whistleblower complaints against INFO would be shared once it reached a conclusion.

Large deals and digital services to catalyse growth: INFO's management is targeting a combination of digital services and large deals to serve as building blocks for topline growth, while value and cost optimisation initiatives will serve to improve margins. A centralised team to spearhead big-ticket contract wins and proactive participation of senior leaders has led to healthy deal traction (+77% YoY in H1FY20).

HCLT – comprehensive strategy in products & platforms business: In contrast to most enterprise software product companies, HCLT aims to emphasise 'customer delight' as a key principle driving the product roadmap. A strong foundation (large product slate, 400+ sales team, 1,750 R&D team, 600+ customer support team) and a ~90% annuity revenue mix safeguard the downside, while successful execution holds the key to potential upsides.

Prefer HCLT, TCS among large-caps: We expect revenue growth to moderate for Indian IT services players in H2FY20 and hence stay selective. HCLT (rated BUY) and TCS (rated ADD) are our preferred stocks among large-caps.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
INFO IN	720	860	ADD
HCLT IN	1,148	1,260	BUY

Price & Target in Rupees

Infosys analyst meet: Key takeaways

- **Corporate governance to the fore:** Board chairman Nandan Nilekani assured investors of the highest standards of corporate governance and of responsible handling of the anonymous whistleblower complaint against the company. While emphasising that premature disclosure of such complaints without establishing their validity was a hinderance to the normal conduct of business, he stated that a summary of the investigation would be shared once it was concluded.

  Management refrained from committing to any deadline for the investigation, considering the involvement of 3-4 audit firms, including Shardul Amarchand Mangaldas & Co.

- **Sales transformation drive underway:** As part of its sales transformation initiative, INFO is focusing on large deals, account mining and targeted new logo additions. The transformation programme includes changes in compensation structure, recruitment of new talent and an ambitious agenda beyond large deals.

- **Large-deal engine:** INFO's strategy for bagging large deals has a twin focus of improving win rates and enlarging the deal pipeline. The company has created a group of directors to shape up a centralised team charged with big-ticket wins and ensuring higher engagement with influencers and deal advisors. It is also creating a proactive deal pipeline through domain-focused investments.

  Besides competitive commercials, creative and innovative solutions now constitute a critical feature of every large deal proposal. The active participation of senior leaders from deal inception has further supported win rates – in H1FY20, contract signings grew 77% YoY and carried a diverse profile.

- **Scalable digital offerings:** Management highlighted that its scale offerings marketed as 'Experience, Insights and Cloud' underpin digital business momentum for the company. In contrast to industry expectations of a reduction in revenues for system integrators (SI) on cloud ERP programs, management believes that the combination of several ancillary services triples the opportunity size for SIs.

  Integrated bundled offerings (cloud + SAAS ERP + Infosys services) are building traction for INFO as clients look at innovative contract structuring to finance their transformation initiatives.

- **Operational efficiency to augment margins:** INFO highlighted the stability of key operational parameters, namely attrition, utilisation, headcount, and onsite/offshore effort mix. The company is well on track to achieve

US$ 100mn-150mn of cost savings in FY20, with ~50% already achieved in H1FY20. Focused efforts are underway to drive further operational excellence, as outlined below. [restructured this section]

- **Fresher hiring** is aimed at correcting both the onsite pyramid structure and attrition.
- The company is taking a renewed approach to **control subcontracting expenses** by converting subcontractors to fulltime employees or judiciously managing contract cycles – this should help minimise any adverse revenue ramifications.
- Recent measures have been launched to improve **digital project pricing** by leveraging the value proposition to clients.
- INFO's internal transformation initiatives aim to achieve agility and efficiency through **intense automation and artificial intelligence (AI)** adoption. Currently, these are adding to the company's competitive advantage in relatively commoditised offerings. Management highlighted that INFO accrued 22% efficiency gains and 17% FTE (full time employee) savings over the last 12 months on the back of these measures.
- INFO has brought together 80 internal applications under four mobile apps to improve **employee efficiency and productivity**. In recent months, 45% of the company's internal ticketing transactions were executed using these apps.

HCL Tech analyst meet: Key takeaways

- **Roadmap for growth:** HCLT's strategic framework includes (1) growth acceleration backed by organic and inorganic initiatives, (2) building an enhanced services and product portfolio to increase share in client spend, (3) pursuing the mode 1-2-3 strategy to sustain growth in core business, (4) creating a diverse ecosystem of partners (+150 at present), and (5) focusing on cost management.
- **Growing large deal momentum:** Management highlighted that its efforts to structure integrated deals by offering a combination of scalable digital and outcome-based engagements is driving momentum for large deals. HCLT successfully renewed 22 large application services contracts and added 45+ new clients with large transformational deals over the last three years (loss of only one client in large contract renewal). Management believes that its scale advantage helps the company win digital contracts.

- **Reshaping engineering services:** Management aims to transform the engineering services business from a mere service-linked, linear-revenue portfolio to a more product-linked portfolio.
- **Scaling up acquired IPs:** HCLT will focus on scaling up acquired IPs before any further inorganic IP portfolio expansion. However, it will continue to evaluate opportunities to strengthen digital services offerings and the engineering services portfolio.
- **Solid foundation for products & platforms business:** A 400+ sales team, 1,750+ R&D team, and 600+ customer support team sets a strong foundation for the software business. Management believes that as the proportion of products & platforms business increases, company-level operating margins will improve over the medium-to-long term. At present, however, HCLT is focused on investments to scale the mode-2 business.

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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)

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