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Technology

Q4FY23 result review and earnings revision

Target price: Rs1,065

Earnings revision

(%)	FY24E	FY25E	FY26E
Sales (US\$)	↑ 1.5	↑ 1.9	↑ 1.8
EBIT	↑ 2.6	↓ 1.2	↓ 1.4
EPS	↓ 1.6	↓ 4.7	↓ 5.0

Target price revision

Rs1,065 from Rs1,122

Shareholding pattern

	Jun '22	Sep '22	Dec '22
Promoters	60.7	60.7	60.7
Institutional investors	33.5	33.6	34.2
MFs and others	10.2	10.0	9.0
FIs/Bank	0.1	0.7	0.7
Insurance Cos.	5.1	5.6	6.1
FII	18.1	17.3	18.4
Others	5.8	5.7	5.1

Source: www.nseindia.com

ESG disclosure score

Year	2021	2022	Chg
ESG score	56.2	58.4	2.2
Environment	44.3	46.7	2.4
Social	34.2	38.5	4.3
Governance	89.9	89.9	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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INDIA

ICICI Securities

HCL Technologies

HOLD

Maintain

Inline results and guidance: Low exposure to troubled BFSI clients leads to better outcome

Rs1,038

HCL Tech (HCLT) reported its Q4FY23 revenues at US\$3,235mn, down 0.3% QoQ in USD and down 1.2% QoQ in CC terms (better than our estimate of -1.9% and consensus at -1.5%). Revenues in CC terms were up 10.5% YoY in Q4FY23. IT and business services (74% of revenues) grew 1.6% QoQ CC, ER&D (16% of revenues) declined 3.8% QoQ CC, due to delay in decision-making in discretionary spending. HCLT's software business (~10% of revenues) fell 14.6% QoQ CC due to seasonality. For full year FY23, the company's services segment grew 15.8% CC, slightly lower than the annual guidance of 16-16.5%. Q4FY23 EBIT margin came in at 18.2%, lower than our estimate of 18.9% and consensus at 18.4%, due to which EBIT of Rs48bn was 4% below our estimate and 2% below Bloomberg consensus. PAT at Rs40bn was 2% below I-Sec estimates and 3% above Bloomberg consensus.

New deal wins' TCV was soft at US\$2,074mn, down 8% YoY. Company won 13 large deals in Q4FY23 vs 17 in Q3FY23 and 10 in Q4FY22. Headcount at 226K was up 1.7% QoQ and 8.2% YoY.

Guidance: HCLT has guided for 6-8% CC growth for FY24 and 6.5-8.5% for the services business. This is in line with I-Sec and consensus expectations and compares to the 13.7% CC growth in FY23. On EBIT margin, HCLT has guided for 18-19% for FY24 vs 18.2% in FY23.

What to do with the stock:

HCLT's limited exposure to troubled BFSI clients and recent large deal ramp-ups in the BFSI vertical led to strong segmental growth of 6.9% QoQ CC, contrary to weak growth at both TCS and Infosys lately. Also, HCLT's lower exposure to discretionary projects over Infosys and higher towards run side of the business, led to hardly any major project ramp-downs or cancellations. As a result of these two factors, we expect HCLT to grow faster than both Infosys and TCS in FY24. We estimate HCLT growth at 7.9% YoY in CC terms for FY24E, close to the top end of the guidance of 6-8%. As a result, we increase our revenue forecasts over FY24E-FY26E by up to 2% each year. On EBIT margin, we have lowered our outer year assumptions due to the company's higher focus on cost take-out deals in which margins are lower. Due to our higher tax rate assumption, we lower our FY24E-FY26E EPS forecasts by 2-5%. We maintain our **HOLD** rating on HCLT with a revised 12-month target price of Rs1,065. This implies 3% potential upside wherein the stock may react positively to HCLT's results given the management's better growth guidance than Infosys and no mention of project cancellations / ramp-downs.

Market Cap	Rs2815bn/US\$34.3bn
Reuters/Bloomberg	HCLT.BO/HCLT IN
Shares Outstanding (mn)	2,713.7
52-week Range (Rs)	1150/883
Free Float (%)	39.3
FII (%)	18.4
Daily Volume (US\$'000)	40,670
Absolute Return 3m (%)	(6.3)
Absolute Return 12m (%)	(0.2)
Sensex Return 3m (%)	(1.5)
Sensex Return 12m (%)	5.9

Year to March	FY23	FY24E	FY25E	FY26E
Revenue (Rs mn)	10,14,560	11,26,852	12,68,022	14,27,392
Net Income (Rs mn)	1,48,480	1,64,455	1,90,693	2,02,083
EPS (Rs)	54.8	60.7	70.4	74.6
% Chg YoY	10.1	10.7	16.0	6.0
P/E (x)	18.9	17.1	14.7	13.9
CEPS (Rs)	70.2	77.9	89.8	96.4
EV/E (x)	11.6	10.2	8.7	8.0
Dividend Yield (%)	4.6	4.2	4.8	5.6
RoCE (%)	17.5	21.4	24.4	25.1
RoE (%)	23.3	24.7	27.6	28.4

Please refer to important disclosures at the end of this report

Key takeaways from earnings call

- Deal pipeline remains near all-time highs with spread across geographies, verticals and service lines. Large cost take-out deals are in the pipeline, more around the run side of the business.
- HCLT is not seeing any stress in the run side of the business, but sees delay in decision-making in discretionary spending.
- Company saw strong growth in the BFSI segment during Q4FY23 with increase of 6.9% QoQ CC (contrary to weakness seen in the case of both TCS and INFY) on the back of ramp-up of large deals. HCLT has less than 1% revenue exposure to the overall BFSI vertical (toward smaller regional banks in US), which is the reason the company is less impacted by the recent crises. It sees good growth outlook for the BFSI vertical with recent deal wins across geographies including the US, EU and Latin America.
- ER&D saw weak growth during the quarter due to cuts in discretionary spending, largely in the hi-tech and telecom verticals.
- HCLT expects attrition to further drop from current level of 19.5% given easing of demand- and supply-side pressures.
- On pricing, HCLT expects it to remain stable in the current environment with certain pressures in cost take-out deals. This is one of the reasons for the muted EBIT margin guidance.
- Company expects tech spend intensity to remain higher than pre-pandemic levels given the core modernisation initiatives; it also expects the time to recovery in demand to be short.

Note: Target price methodology – Our 12-month target price of Rs1,065 is based on 16x FY26E EPS of Rs 75, discounted back by WACC of 12%.

Downside risks: 1) Longer than expected current global macro downcycle extending beyond CY23E, 2) weakness in the BFSI vertical due to tepid credit demand and weakness in the retail / manufacturing verticals attributable to persistently high inflation, 3) pricing pressure in large deals (particularly around cost optimisation), 4) INR appreciation against the USD.

Upside risks: 1) INR depreciation against the USD, 2) P&P business showing stability and strong growth after a hiatus (which we don't expect at this stage), 3) global macro concerns around high interest rates and inflation subsiding sooner than expected, 4) ER&D business witnessing higher than expected growth owing to increased level of outsourcing globally in the digital engineering field.

Table 1: Q4FY23 actuals vs estimates

(Rs bn)	Q4FY23	Q3FY23	QoQ	Q4FY22	YoY	Q4FY23E-ISEC	vs our estimates	Cons	vs Cons
CC growth	-1.2%	5.0%		1.1%					
Sales (\$ m)	3,235	3,244	-0.3%	2,993	8.1%	3,224	0.3%	3,229	0%
USD/INR	82.2	82.3	-0.1%	75.5	8.9%	82.7		82.7	
Sales (Rs bn)	266	267	-0.4%	226	17.7%	267	-0.2%	267	0%
EBIT	48	52	-7.5%	41	18.8%	50	-3.8%	49.2	-2%
EBIT Margin	18.2%	19.6%	-141 bps	18.0%	17 bps	18.9%	-68 bps	18.4%	-24 bps
Reported PAT	40	41	-2.8%	36	10.8%	41	-1.7%	38.7	3%
EPS	14.7	15.1	-2.8%	13.3	10.7%	14.9	-1.7%	14.3	3%

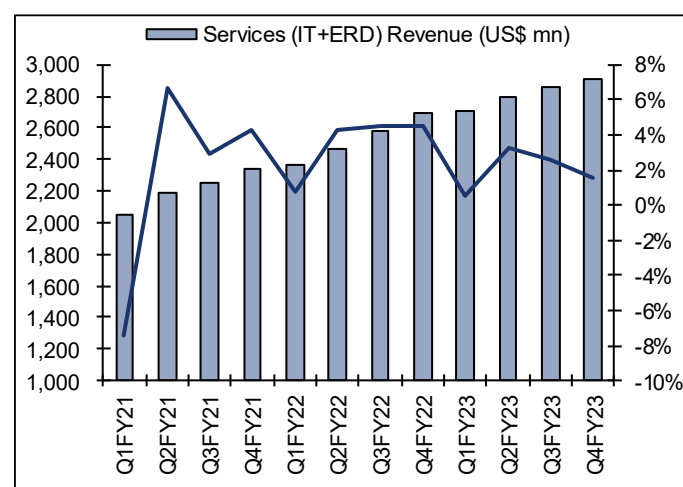
Source: Company data, I-Sec research, Consensus estimates from Bloomberg

Table 2: HCLT – change in estimates

	Revised			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenues (US\$ mn)	13,632	15,340	17,268	13,426	15,058	16,959	1.5	1.9	1.8
Revenue growth YoY CC	7.9%	12.5%	12.6%	6.1%	12.2%	12.6%	180bps	40bps	-10bps
Revenue growth YoY US\$	8.3%	12.5%	12.6%	6.8%	12.2%	12.6%	150bps	40bps	-10bps
Rs bn									
Revenues	1,127	1,268	1,427	1,110	1,245	1,402	1.5	1.9	1.8
EBIT	208	242	257	203	245	261	2.6	(1.2)	(1.4)
EBIT margin	18.5%	19.1%	18.0%	18.3%	19.7%	18.6%	20bps	-60bps	-60bps
EPS (Rs/share)	60.7	70.4	74.6	61.7	73.9	78.5	(1.6)	(4.7)	(5.0)

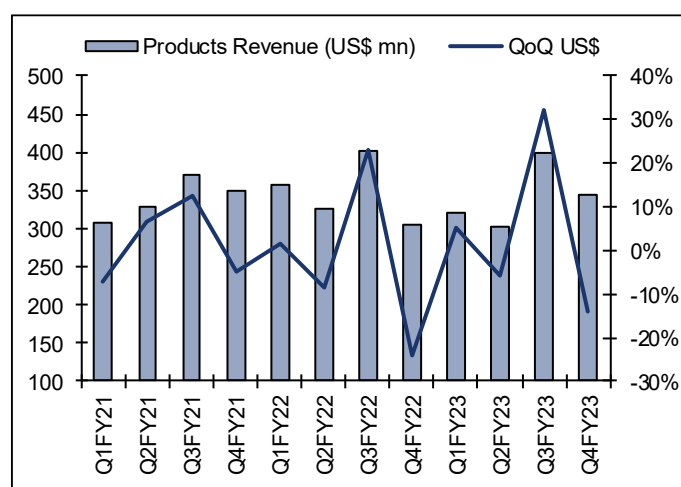
Source: Company, I-Sec research

Chart 1: Healthy growth in services despite weak macro



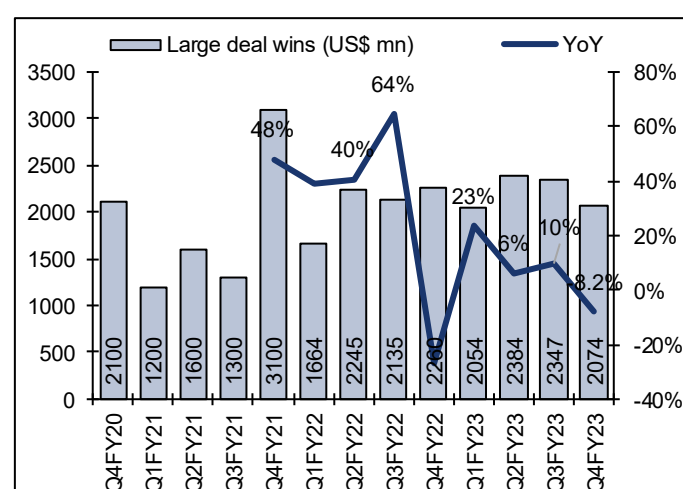
Source: Company, I-Sec research

Chart 2: Products business declined due to seasonal weakness



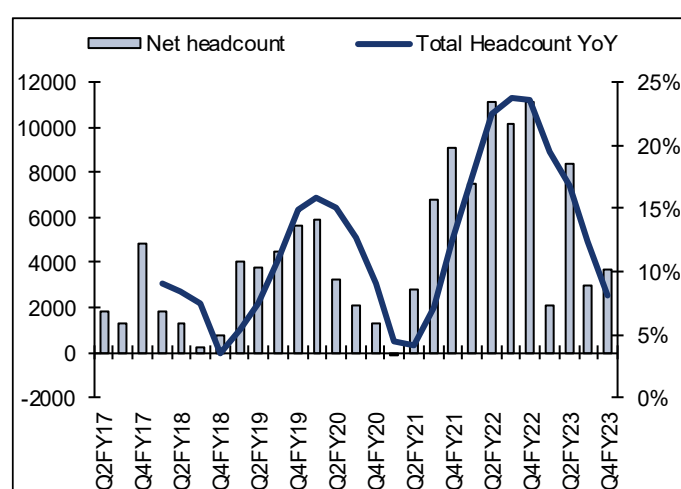
Source: Company, I-Sec research

Chart 3: Muted large deal wins

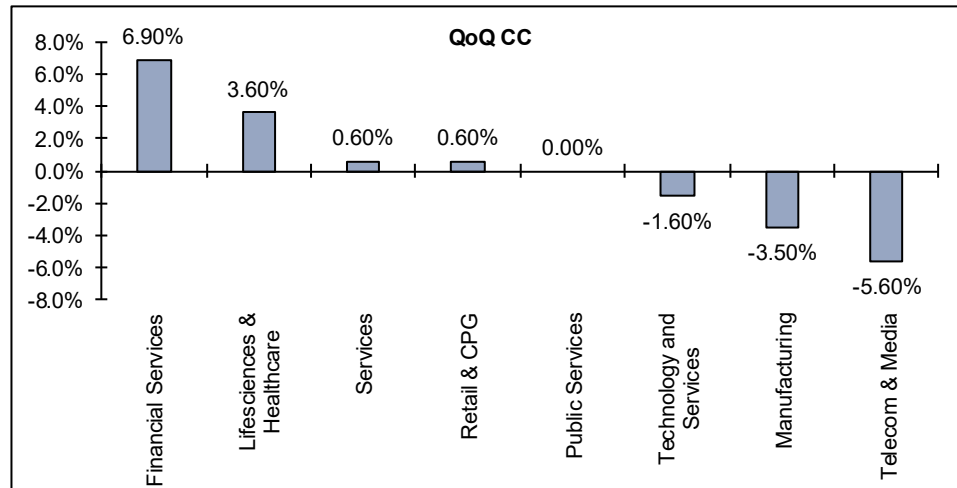


Source: Company, I-Sec research

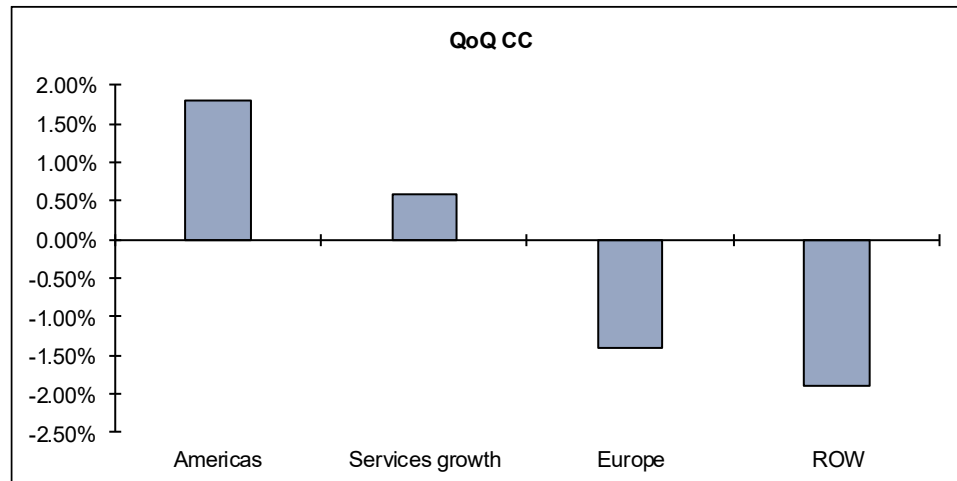
Chart 4: Headcount growth slowing but healthy compared to peers



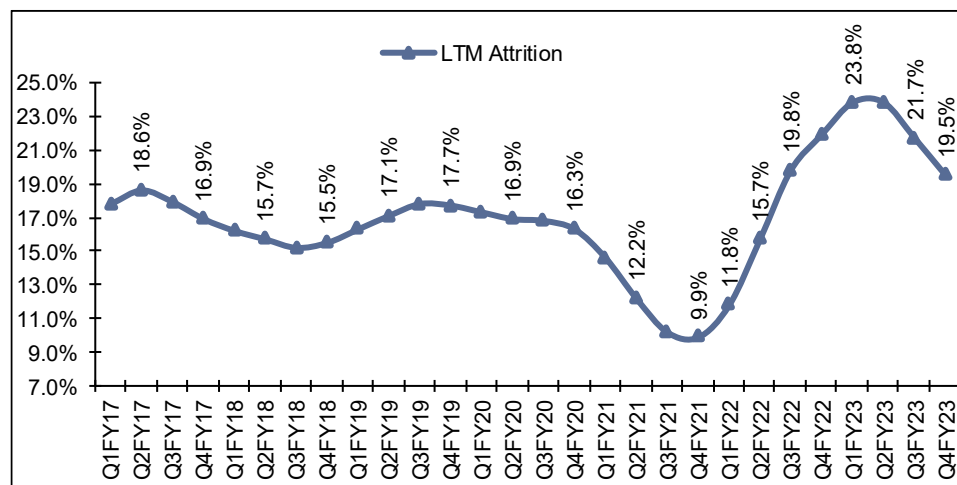
Source: Company, I-Sec research

Chart 5: Growth led by BFSI; weakness in telecom and technology services

Source: Company, I-Sec research

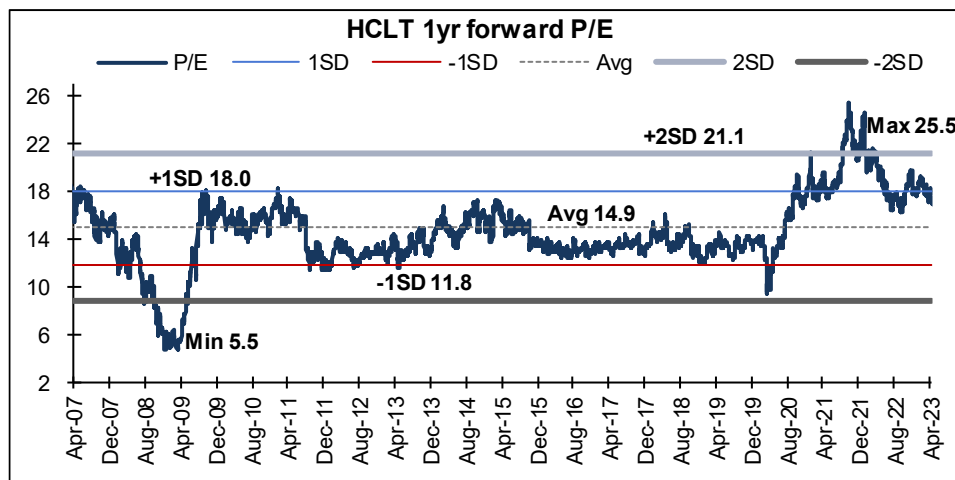
Chart 6: Growth led by Americas

Source: Company, I-Sec research

Chart 7: LTM attrition has come down sharply

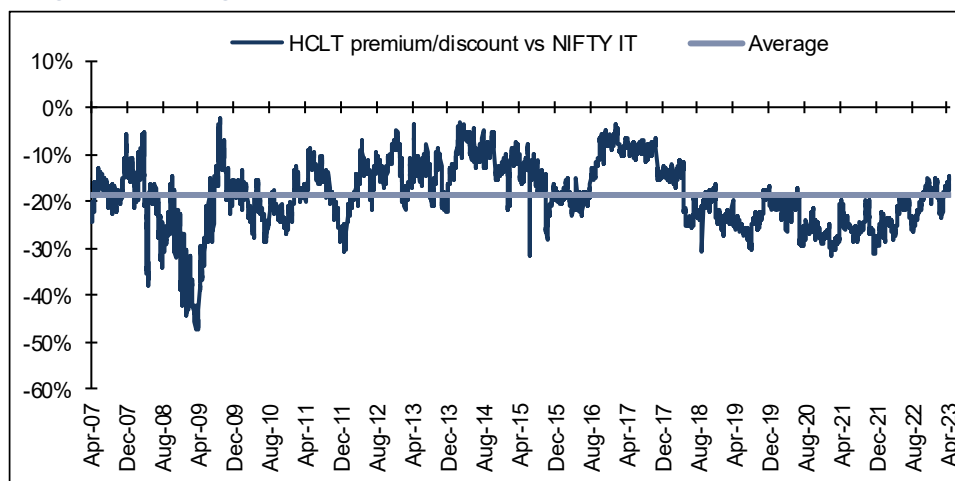
Source: Company, I-Sec research

Chart 8: HCLT is currently trading at ~17x (1-year forward P/E) vs its historical long term avg multiple of 15x



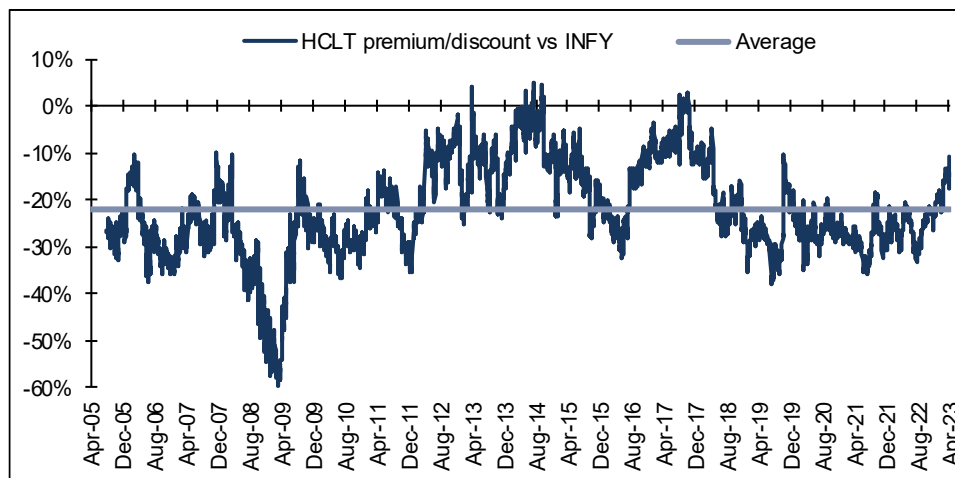
Source: Bloomberg, I-Sec research.

Chart 9: HCLT is currently trading at 15% discount to NIFTY IT, vs its historical long term average discount of 19%



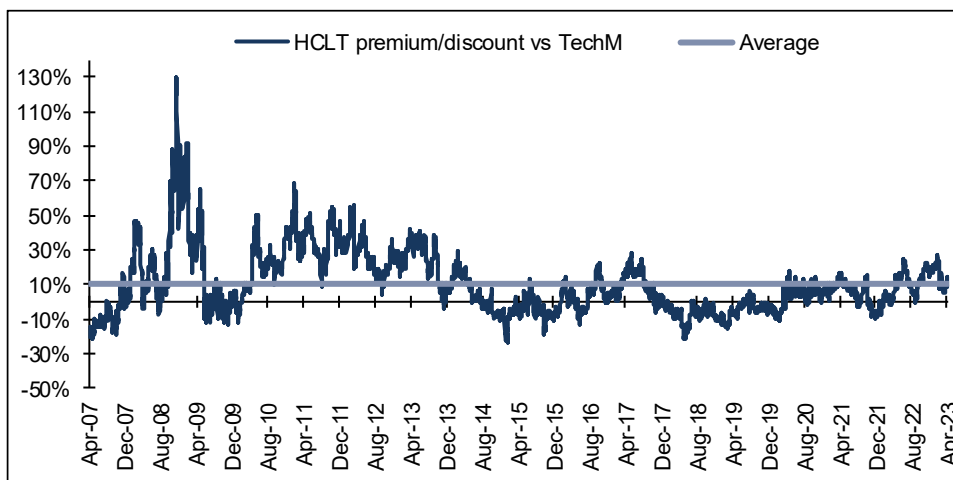
Source: Bloomberg, I-Sec research

Chart 10: HCLT is currently trading at 11% discount to INFY, vs its historical long term average discount of 22%



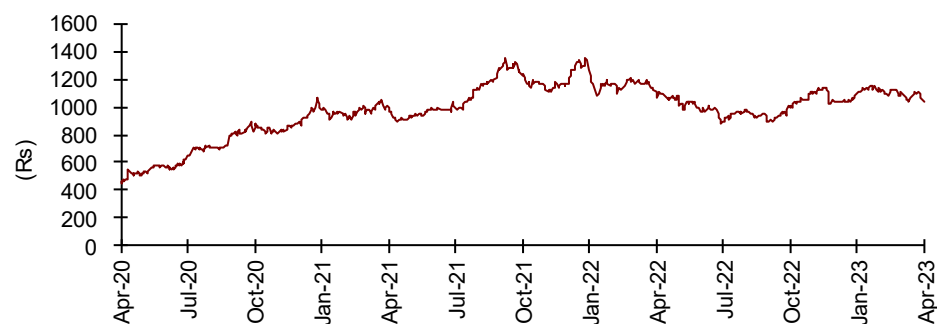
Source: Bloomberg, I-Sec research.

Chart 11: HCLT is currently trading at 12% premium to TechM, vs its historical long term average premium of 10%



Source: Bloomberg, I-Sec research.

Price chart



Source: Bloomberg

Financial summary

Table 3: Profit and loss statement
(Rs mn, year ending March 31)

	FY23	FY24E	FY25E	FY26E
Revenues (US\$mn)	12,586	13,632	15,340	17,268
Operating Revenues (Sales)	10,14,560	11,26,852	12,68,022	14,27,392
Operating Expenses	7,88,270	8,71,863	9,73,479	11,11,308
EBITDA	2,26,290	2,54,989	2,94,543	3,16,084
% margins	22.3	22.6	23.2	22.1
Depreciation/Amortisation	41,440	46,490	52,312	58,887
EBIT	1,84,850	2,08,499	2,42,231	2,57,197
% margins	18.2	18.5	19.1	18.0
Other Income	10,030	13,629	15,355	15,781
Recurring PBT	1,94,880	2,22,129	2,57,585	2,72,977
Less: Taxes	46,420	57,753	66,972	70,974
Less: Minority Interest	(20)	(80)	(80)	(80)
Less: Extraordinary items	-	-	-	-
Net Income (Reported)	1,48,480	1,64,455	1,90,693	2,02,083

Source: Company data, I-Sec research

Table 4: Balance sheet
(Rs mn, year ending March 31)

	FY23	FY24E	FY25E	FY26E
Assets				
Total Current Assets	5,35,770	5,91,921	6,45,757	6,88,877
Total Current Liabilities & Provisions	2,14,310	2,35,660	2,65,182	2,98,579
Net Current Assets	3,21,460	3,56,261	3,80,575	3,90,298
Investments	4,880	3,780	3,780	3,780
Net Fixed Assets	3,46,590	3,27,220	3,31,220	3,35,220
Other Assets	46,870	34,350	34,350	34,350
Total Assets	7,19,800	7,21,611	7,49,925	7,63,648
Liabilities				
Borrowings	21,110	21,110	21,110	21,110
Other Liabilities	44,710	24,890	24,890	24,890
Net Worth	6,53,980	6,75,611	7,03,925	7,17,648
Total Liabilities	7,19,800	7,21,611	7,49,925	7,63,648

Source: Company data, I-Sec Research

Table 5: Quarterly trend
(Rs mn, year ending March 31)

	Jun-22	Sep-22	Dec-22	Mar-23
Net sales	2,34,640	2,46,860	2,67,000	2,66,060
% growth (QoQ)	3.8	5.2	8.2	(0.4)
EBIT	39,920	44,280	52,290	48,360
Margin (%)	17.0	17.9	19.6	18.2
Other income	3,450	1,570	1,440	3,570
Reported Net Income	32,830	34,870	40,970	39,810

Source: Company data, I-Sec research

Table 6: Cashflow statement
(Rs mn, year ending March 31)

	FY23	FY24E	FY25E	FY26E
Operating Cash flow before W Cap changes	1,90,310	1,97,315	2,27,651	2,45,190
Working Capital Inflow / (Outflow)	(10,130)	97,172	(9,995)	(11,307)
Operating Cash flow	1,80,180	2,94,487	2,17,656	2,33,882
Capex	(23,670)	(27,120)	(56,312)	(62,887)
Other investing activities	(15,640)	27,249	15,355	15,781
Proceeds from Issue of Share Capital	-	70	-	-
Inc/(Dec) in Borrowings / other L Term Liabs	(28,860)	(19,820)	-	-
Dividend paid	(1,29,950)	(1,42,894)	(1,62,379)	(1,88,360)
Increase/(Decrease) in Cash	(17,940)	1,31,973	14,318	(1,584)

Source: Company data, I-Sec research

Table 7: Key ratios
(Year ending March 31)

	FY23	FY24E	FY25E	FY26E
Per Share Data (in Rs.)				
Diluted Adjusted EPS	54.8	60.7	70.4	74.6
Recurring Cash EPS	70.2	77.9	89.8	96.4
Dividend per share (DPS)	48.0	44.0	50.0	58.0
Book Value per share (BV)	241.6	249.6	260.1	265.2
Growth Ratios (%)				
Operating Income (Sales) - US\$ terms	9.6	8.3	12.5	12.6
Operating Income (Sales)	18.5	11.1	12.5	12.6
EBITDA	10.2	12.7	15.5	7.3
Reported Net Income	10.0	10.8	16.0	6.0
Adjusted EPS	10.1	10.7	16.0	6.0
Recurring Cash EPS	6.7	11.1	15.2	7.4
Valuation Ratios (x)				
P/E	18.9	17.1	14.7	13.9
P/CEPS	14.8	13.3	11.5	10.8
P/BV	4.3	4.2	4.0	3.9
EV / EBITDA	11.6	10.2	8.7	8.0
EV / Sales	2.6	2.3	2.0	1.8
Operating Ratio				
Other Income / PBT (%)	5.1	6.1	6.0	5.8
Effective Tax Rate (%)	23.8	26.0	26.0	26.0
Receivables (days)	70	70	70	70
Return/Profitability Ratio (%)				
Reported Net Income Margins	14.6	14.6	15.0	14.2
RoCE (Based on Avg)	17.5	21.4	24.4	25.1
RoNW (Based on Avg)	23.3	24.7	27.6	28.4
Dividend Yield	4.6	4.2	4.8	5.6
EBITDA Margins	22.3	22.6	23.2	22.1

Source: Company data, I-Sec research

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