

HCL Technologies

HOLD

Cautious on ramp downs and discretionary spends

Summary

HCL Technologies (HCLT) reported 15.8% cc organic growth in FY23E led by market share gains. The company's Q4 IT services revenues was also healthy up 0.6% QoQ led by ramp of mega deals won. Going forward the company has guided FY24E revenue growth of 6-8% YoY and EBIT margins of 18-19% for FY24E. We expect the company to be at the lower end of the guidance mainly led by lower ACV growth (up 4.3% YoY vs 21% YoY in FY22). Further, we expect ramp downs in projects, delay in renewals and lower discretionary spend to further impact revenue growth. In addition, due to headwinds like wage hikes and lower ability to manage cost in uncertainty we have assumed margins at the lower end of guidance (18%). Consequently we have lowered our EPS estimates by 1.7% & 1.6% for FY23E & FY24E. Hence, we maintain our HOLD rating on the stock with a revised target price of Rs 1010 (16x PE on FY25E EPS).

Key Highlights and Investment Rationale

- **Vendor consolidation & cost efficiency to drive growth:** HCL Technologies is in a sweet spot to gain market share as cost efficiency deals are forte of the company. Further, winning of multiple mega deals, ramp up in large deals, lower impact of banking crisis (very miniscule) and vendor consolidation will drive revenue growth. However, poor outlook of tech sector, delay in decision making, lower discretionary spend in ER&D and weak product growth could act as a headwind to company's growth trajectory. Hence, we expect US\$ revenue CAGR of 7.6% over FY23-25E.
- **Operating margins to remain range bound:** The company has multiple levers like higher utilisation, pyramid utilisation and offshoring to drive margins. However, wage hike and lower revenues growth prompt us to keep margins in a narrow range of 18.1% and 18.3% in FY24E & FY25E, respectively.

TP	Rs 1,010
CMP	Rs 1,038
Potential upside/downside	-3%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	(4.9)	(6.3)	(4.8)
Rel to Sensex	(8.4)	(4.7)	(9.3)

V/s Consensus

EPS (Rs)	FY24E	FY25E
IDBI Capital	56.4	62.3
Consensus	61.0	68.3
% difference	(7.6)	(8.8)

Key Stock Data

Bloomberg/Reuters	HCLT IN/ HCLT.BO
Sector	IT Services
Shares o/s (mn)	2,714
Market cap. (Rs mn)	2,815,563
3-m daily avg Trd value (Rs mn)	95.9
52-week high / low	Rs1,157 / 876
Sensex / Nifty	59,632 / 17,624

Shareholding Pattern (%)

Promoters	60.7
FII	18.3
DII	15.1
Public	5.9

Financial snapshot

(Rs mn)

Year	FY21	FY22	FY23E	FY24E	FY25E
Revenue	753,790	856,510	1,014,560	1,096,587	1,198,167
Change (yoy, %)	7	14	18	8	9
EBITDA	207,750	205,300	226,280	245,328	269,805
Change (yoy, %)	24	-1	10	8	10
EBITDA Margin (%)	27.6	24.0	22.3	22.4	22.5
Adj. PAT	129,410	134,990	148,510	153,131	169,070
EPS (Rs)	47.7	49.7	54.7	56.4	62.3
Change (yoy, %)	18	4	10	3	10
PE(x)	22	21	19	18	17
Dividend Yield (%)	3	4	5	4	5
EV/EBITDA (x)	13	13	12	11	10
RoE (%)	23.3	22.2	23.3	22.9	24.1
RoCE (%)	26	24	26	27	28

Source: IDBI Capital Research;

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Other Key Highlights

- Overall revenue in CC terms grew by 1.2%/10.5% QoQ/YoY. Growth was impacted by seasonal softness in the products business (-14.6% QoQ in CC) and ramp down of discretionary spend in Telecom and Tech verticals of ER&D business which declined by 3.8% QoQ. IT business services grew by 0.6% QoQ.
- EBIT margin declined by 140 bps QoQ to 18.2%. 125 bps impact was due to the seasonality in products business; 50 bps impact was due to the ramp down in ER&D business which was negated to the extent of 20 bps by growth in IT services margin.
- TCV of new deal wins was down 8% YoY to \$2,074 mn during the quarter. For FY23, the ACV of order book grew by 4.2%. Total booking for FY23 grew by 19% in FY23.
- Company guided revenue growth for FY24E to be in the range of 6%-8% in CC terms and EBIT margin between 18%-19%. Growth is expected to be driven by volume addition as HCL believes the demand environment is not suitable for price hikes. Tax rate for FY24E is expected to be in the range of 25.5%-26.5% as against 23.8% in FY23. Rise in tax rate is on account of changes in UK tax laws and few units coming out of the SEZ benefit in India. HCL aspires to achieve EBIT margin of 19%-20% in medium term.
- Outlook – Discretionary spends are seeing project ramp downs and delayed decision making. Due to the challenging macro conditions, cost take out deals are seeing uptick in demand. In terms of verticals, financial services will remain robust, tech and telecom which are currently observing slowdown are expected to grow on the back of increased cost take out opportunities. In terms of geo, North America remains robust, Europe is seeing healthy pipeline and should be on growth trajectory by Q2FY24E. Moreover, HCL expects the overall recovery to be quicker as its pipeline has reached record high and opportunities in the form of vendor consolidation provide growth opportunities.
- In terms of verticals, manufacturing and technology declined sequentially. Financial services and lifescience recorded growth. HCL alluded that it has gained market share in financial services, retail & CPG, technology and telecommunication. In terms of geo, Americas grew 1.8% in CC while Europe declined by 1.4% in CC.
- Company added 3,674 employees during the quarter; fresher addition stood at 4,480 (i.e. lateral exit of 806). LTM attrition came down to 19.5% v/s 21.7% in previous quarter.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q4FY23	Q3FY23	QoQ (%)	Q4FY22	YoY (%)
Revenues (US\$ mn)	3,235	3,244	(0.3)	2,993	8.1
Revenues	266,060	267,000	(0.4)	225,970	17.7
COGS	173,270	171,350	1.1	146,720	18.1
Gross profit	92,790	95,650	(3.0)	79,250	17.1
SG&A	34,160	32,000	6.7	28,720	18.9
EBITDA	58,630	63,650	(7.9)	50,530	16.0
Depreciation & amortization	10,270	11,370	(9.7)	9,840	4.4
EBIT	48,360	52,280	(7.5)	40,690	18.8
Other income	3,590	1,440	149.3	2,510	43.0
PBT	51,950	53,720	(3.3)	43,200	20.3
Tax	12,140	12,760	(4.9)	7,210	68.4
Minority interest	(20)	0	n.m.	60	n.m.
Reported net profit	39,830	40,960	(2.8)	35,930	10.9
Diluted EPS (Rs)	14.7	15.1	(2.8)	13.3	10.9
As % of net revenue					
Gross profit	34.9	35.8		35.1	
SG&A	12.8	12.0		12.7	
EBITDA	22.0	23.8		22.4	
EBIT	18.2	19.6		18.0	
Reported net profit	15.0	15.3		15.9	
Tax rate	23.4	23.8		16.7	

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

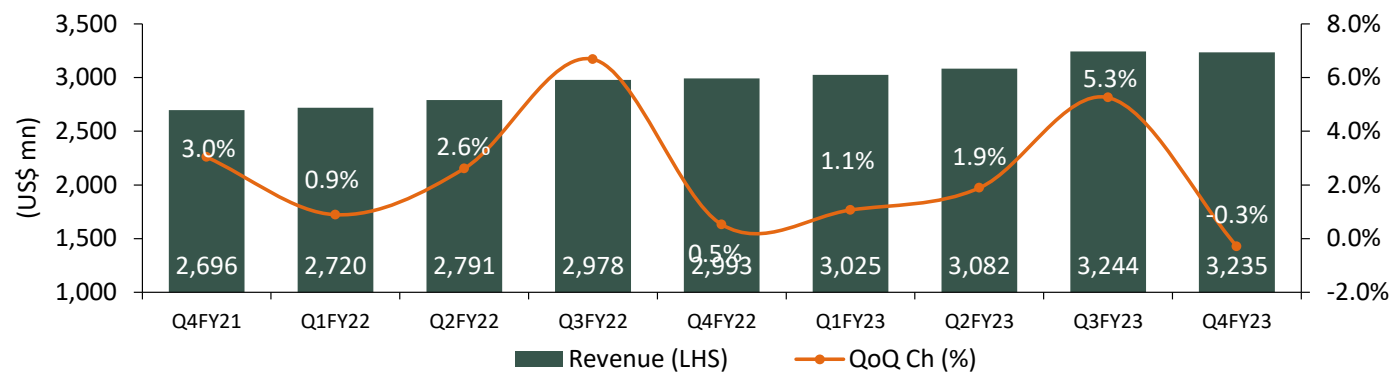
Year-end: March	FY24F			FY25E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	13,340.5	13,456.7	(0.9)	14,576.2	14868.9	(2.0)
Revenue (Rs bn)	1,096.6	1,077.9	1.7	1,198.2	1191.0	0.6
EBIT (Rs bn)	198.7	199.7	(0.5)	219.6	221.4	(0.8)
EBIT margin (%)	18.12	18.53	(41) bps	18.32	18.59	(26) bps
EPS (Rs)	56.4	57.4	(1.7)	62.3	63.3	(1.6)

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

Year to March	Q4FY22	Q4FY22E	Variance (%)
Revenue (US\$ mn)	3,235	3,217	0.6
Revenue (Rs mn)	266,060	264,561	0.6
EBIT (Rs mn)	48,360	49,177	(1.7)
EBIT margin (%)	18.2%	18.6%	(41)bps
PAT (Rs mn)	39,830	38,269	4.1
PAT margin (%)	15.0%	14.5%	51bps
EPS (Rs)	14.7	14.1	4.1

Source: Company; IDBI Capital Research

Exhibit 4: Q4FY23 revenue growth was impacted by ER&D and products business

Source: Company; IDBI Capital Research

Exhibit 5: Growth in large clients

Year-end: March	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
US\$100m +	14	15	15	16	17	17	17	19
US\$50m +	37	41	42	43	42	42	45	46
US\$20m +	104	109	110	118	127	128	130	131
US\$10m +	178	190	198	208	218	220	221	229
US\$5m +	326	329	346	349	353	356	365	375
US\$1m +	817	836	864	882	880	890	937	939

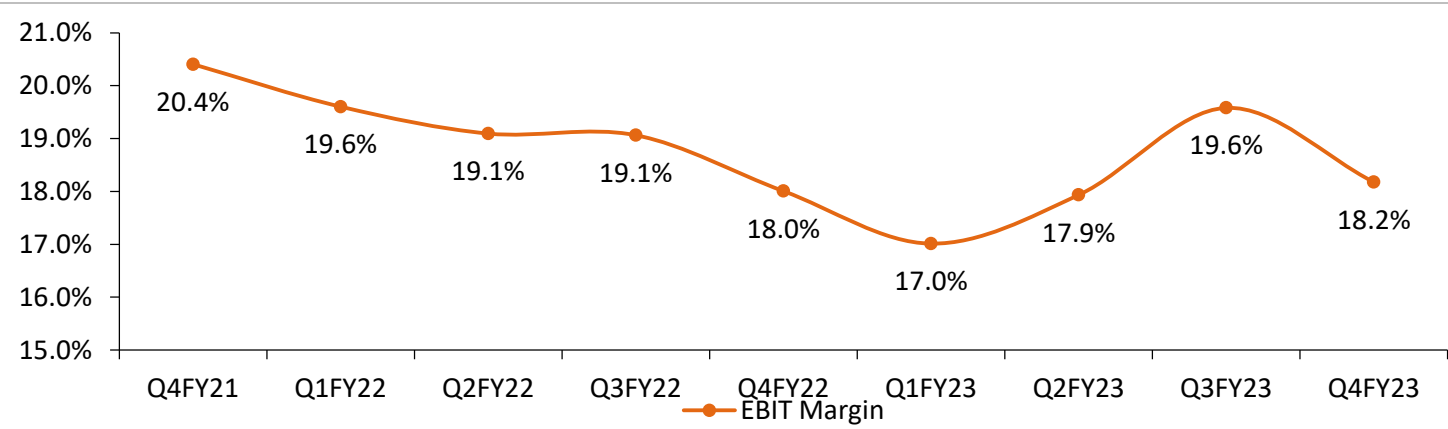
Source: Company; IDBI Capital Research

Exhibit 6: Revenue growth across various segments (%)

Parameters	% of revenue	QoQ CC growth	YoY CC growth
Overall revenue growth		1.2	10.5
Geography			
US	63.8	1.8	10.0
Europe	28.9	(1.4)	14.6
ROW	7.3	(1.9)	1.4
Service-lines			
IT and Business services	73.8	1.6	11.4
Engineering and R&D Services	16.1	(3.8)	7.3
Products and Platforms	10.1	(14.6)	8.2
Verticals			
Financial Services	21.2	6.9	9.6
Manufacturing	19.0	(3.5)	11.8
Technology & Services	14.4	(1.6)	11.8
Telecom &Media Publishing	8.8	(5.6)	7.6
Retail & CPG	9.0	0.6	1.6
Life science & Healthcare	17.5	3.6	17.9
Public Services	10.2	-	8.9

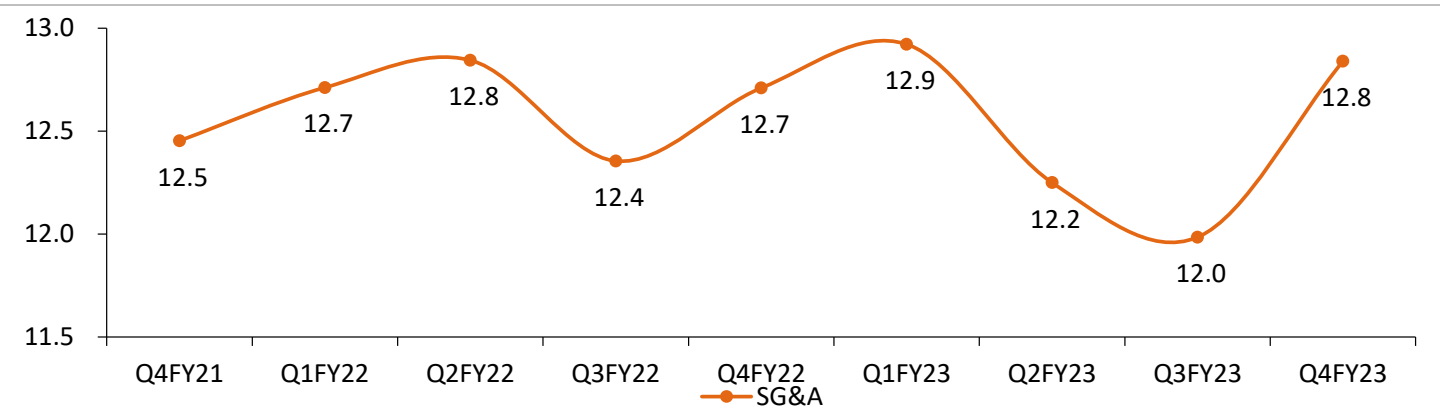
Source: Company; IDBI Capital Research

Exhibit 7: Q4FY23 EBIT margin declined by 140 bps QoQ



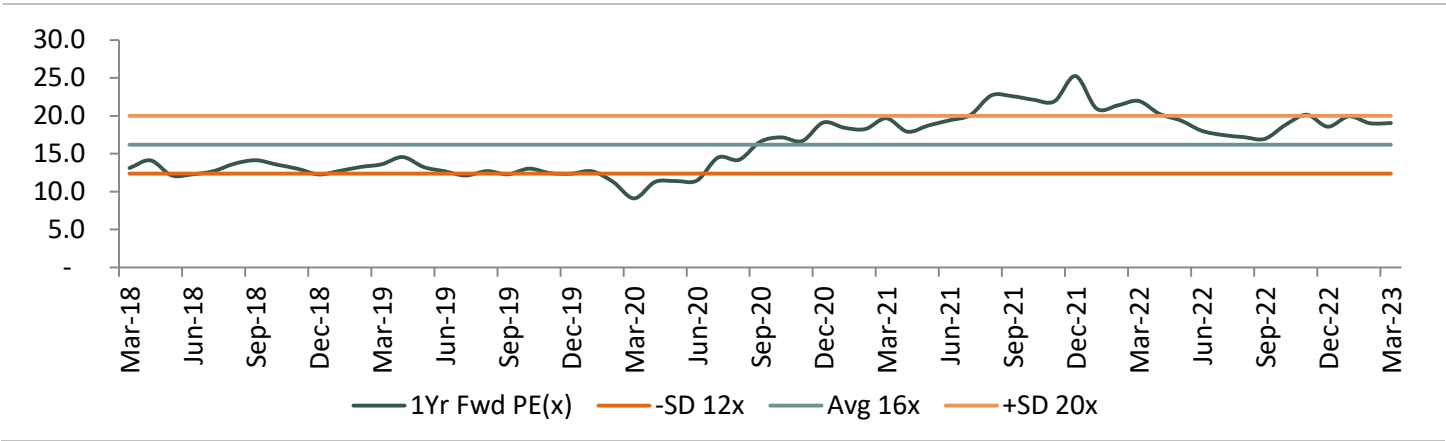
Source: Company; IDBI Capital Research

Exhibit 8: SG&A saw a QoQ rise



Source: Company; IDBI Capital Research

Exhibit 9: One-year forward PER trend



Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Net sales	706,780	753,790	856,510	1,014,560	1,096,587	1,198,167
<i>Change (yoy, %)</i>	17	7	14	18	8	9
Operating expenses	(539,850)	(546,040)	(651,210)	(788,280)	(851,259)	(928,361)
EBITDA	166,930	207,750	205,300	226,280	245,328	269,805
<i>Change (yoy, %)</i>	20	24	-1	10	8	10
<i>Margin (%)</i>	23.6	27.6	24.0	22.3	22.4	22.5
Depreciation	(28,400)	(46,110)	(43,260)	(41,450)	(46,651)	(50,251)
EBIT	138,530	161,640	162,040	184,830	198,677	219,555
Interest paid	-	-	-	-	-	-
Other income	1,790	4,160	7,470	10,050	9,510	10,000
Pre-tax profit	140,320	165,800	169,510	194,880	208,187	229,555
Tax	(30,748)	(36,150)	(34,280)	(46,420)	(54,256)	(59,684)
<i>Effective tax rate (%)</i>	21.9	21.8	20.2	23.8	26.1	26.0
Minority Interest	(320.0)	(240.0)	(240.0)	50.0	(800.0)	(800.0)
Net profit	109,252	129,410	134,990	148,510	153,131	169,070
Exceptional items	-	-	-	-	-	-
Adjusted net profit	109,252	129,410	134,990	148,510	153,131	169,070
<i>Change (yoy, %)</i>	8	18	4	10	3	10
EPS	40.3	47.7	49.7	54.7	56.4	62.3
Dividend per sh	6	26	44	48	45	50
<i>Dividend Payout %</i>	18	55	88	88	80	80

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Shareholders' funds	512,670	599,130	619,140	654,050	685,006	718,327
Share capital	5,427	5,427	5,430	5,430	5,430	5,430
Reserves & surplus	507,243	593,703	613,710	648,620	679,576	712,897
Total Debt	46,930	38,280	39,230	21,110	21,110	21,110
Other liabilities	25,900	37,200	31,530	32,190	58,175	64,574
Curr Liab & prov	218,850	173,830	187,750	214,310	228,269	249,099
Current liabilities	201,100	151,370	164,820	181,610	195,626	212,941
Provisions	17,750	22,460	22,930	32,700	32,643	36,159
Total liabilities	291,680	249,310	258,510	267,610	307,554	334,784
Total equity & liabilities	805,890	850,130	878,570	921,590	993,290	1,054,641
Net fixed assets	352,420	350,470	329,010	323,220	306,534	286,284
Investments	770	890	1,030	1,100	1,100	1,100
Other non-curr assets	66,700	68,260	68,120	61,500	99,143	108,327
Current assets	386,000	430,510	480,410	535,770	586,512	658,929
Inventories	910	940	1,610	2,280	1,502	1,641
Sundry Debtors	141,310	136,630	154,760	195,720	211,506	231,098
Cash and Bank	119,650	156,610	188,750	201,090	225,774	264,774
Loans and advances	34,220	48,410	30,080	26,030	28,135	30,741
Total assets	805,890	850,130	878,570	921,590	993,290	1,054,641

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Pre-tax profit	140,320	165,800	169,510	194,880	208,187	229,555
Depreciation	19,000	46,110	43,260	41,450	46,651	50,251
Tax paid	(30,758)	(24,190)	(34,580)	(46,690)	(54,256)	(59,684)
Chg in working capital	57,750	(54,560)	13,450	(11,020)	(3,154)	(1,507)
Other operating activities	(17,980)	27,375	(18,043)	18,830	(20,605)	(13,863)
Cash flow from operations (a)	168,331	160,535	173,597	197,450	182,253	204,751
Capital expenditure	(140,190)	(44,160)	(21,800)	(35,660)	(29,965)	(30,000)
Chg in investments	80	(120)	(140)	(70)	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(140,110)	(44,280)	(21,940)	(35,730)	(29,965)	(30,000)
Equity raised/(repaid)	2	-	3	-	-	-
Debt raised/(repaid)	9,920	(8,650)	950	(18,120)	-	-
Dividend (incl. tax)	(19,604)	(70,555)	(119,460)	(130,320)	(122,175)	(135,750)
Chg in minorities	190	(90)	(1,010)	(940)	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(9,491)	(79,295)	(119,517)	(149,380)	(122,175)	(135,750)
Net chg in cash (a+b+c)	18,730	36,960	32,140	12,340	24,683	39,001

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	189	221	228	241	252	265
Adj EPS (Rs)	40.3	47.7	49.7	54.7	56.4	62.3
Adj EPS growth (%)	8	18	4	10	3	10
EBITDA margin (%)	24	28	24	22	22	23
Pre-tax margin (%)	20	22	20	19	19	19
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	27	26	24	26	27	28
ROE (%)	23.6	23.3	22.2	23.3	22.9	24.1

DuPont Analysis

Asset turnover (x)	1.0	0.9	1.0	1.1	1.1	1.2
Leverage factor (x)	1.5	1.5	1.4	1.4	1.4	1.5
Net margin (%)	15.5	17.2	15.8	14.6	14.0	14.1

Working Capital & Liquidity ratio

Inventory days	0	0	1	1	1	1
Receivable days	73	66	66	70	70	70
Payable days	8	12	13	12	12	12

Valuations

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
PER (x)	25.8	21.8	20.9	19.0	18.4	16.7
Price/Book value (x)	5.5	4.7	4.5	4.3	4.1	3.9
EV/Net sales (x)	3.9	3.6	3.1	2.6	2.4	2.1
EV/EBITDA (x)	16	13	13	12	11	10
Dividend Yield (%)	1	3	4	5	4	5

Source: Company; IDBI Capital Research



Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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