

HCL Technologies

HOLD

Client specific challenges to impact near term growth

Summary

HCL Technologies (HCLT) reported weak results (revenue down 1.3% QoQ) mainly due to weakness in Tech & Telecom vertical. As highlighted in our IT thematic we were seeing weakness in HCL Tech clients. We continue to believe that macro challenges will impact company's near term revenue growth. Hence, we maintain our stance of company's revenue to be at the lower end of the guidance mainly led by lower ACV (down 21% YoY), client specific challenges and slowdown in discretionary spends. 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 2% for FY25E. Hence, we maintain our HOLD rating on the stock with a revised target price of Rs 1100 (18x PE on FY25E EPS).

Key Highlights and Investment Rationale

- Conversion of deal pipeline challenging:** HCL Technologies has reported weak ER&D revenues led by challenges in Tech & Telecom vertical. The company's deal wins has also decelerated from ~US\$2 bn to US\$1.6 bn and ACV down 21% YoY. The company is seeing acceleration in deal pipeline led by large deals across US & Europe, however, conversion of the same & ramp down in other projects remains key overhang in driving revenues. Even at a lower end of the guidance (CQGR of 2.5%) seems a tall task. Hence, we expect US\$ revenue CAGR of 7.5% 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 at 18.0% in FY24E & FY25E, respectively.

TP	Rs 1,100
CMP	Rs 1,110
Potential upside/downside	-1%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	(2.6)	1.4	19.6
Rel to Sensex	(6.8)	(6.9)	(1.7)

V/s Consensus

EPS (Rs)	FY24E	FY25E
IDBI Capital	56.6	61.1
Consensus	59.4	66.2
% difference	(4.8)	(7.7)

Key Stock Data

Bloomberg/Reuters	HCLT IN/ HCLT.BO
Sector	IT Services
Shares o/s (mn)	2,714
Market cap. (Rs mn)	3,012,304
3-m daily avg Trd value (Rs mn)	86.8
52-week high / low	Rs1,203 / 876
Sensex / Nifty	65,394 / 19,384

Shareholding Pattern (%)

Promoters	60.8
FII	18.9
DII	14.5
Public	5.8

Financial snapshot

	(Rs mn)				
Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	7,53,790	8,56,510	10,14,560	10,96,005	11,96,232
Change (yoy, %)	7	14	18	8	9
EBITDA	2,07,750	2,05,300	2,26,280	2,40,699	2,66,037
Change (yoy, %)	24	(1)	10	6	11
EBITDA Margin (%)	27.6	24.0	22.3	22.0	22.2
Adj. PAT	1,29,410	1,34,990	1,46,870	1,53,759	1,65,867
EPS (Rs)	47.7	49.7	54.1	56.6	61.1
Change (yoy, %)	18	4	9	5	8
PE(x)	23	22	21	20	18
Dividend Yield (%)	2	4	4	4	5
EV/EBITDA (x)	14	14	13	12	10
RoE (%)	23.3	22.2	23.1	23.0	23.7
RoCE (%)	26	24	26	27	28

Source: IDBI Capital Research;

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Other Key Highlights

- Revenue in CC terms was down 1.3% QoQ & up by 6.3% YoY. Services revenue was down 1% QoQ due to demand softness in large verticals, project ramp downs & reduced discretionary spends.
- EBIT margin declined on QoQ basis by 110 bps from 18.1% to 17%. Software segment margin growth was flat QoQ as the negative impact of revenue decline was offset by onetime benefit from amortization reversal of intangible assets. Services margin dropped by 120 bps on the back of 10bps impact due to forex, 36 bps impact due to reduced utilisation, 33 bps impact due to travel and other costs and 42 bps impact due to the presence of one-time benefit in previous quarter numbers which was absent during Q1FY24.
- In terms of Segmental performance , IT and Business services had good momentum on new deals signed but most were offsets with reduction in discretionary spend leading to flat QoQ revenues in CC. ER&D services saw QoQ contraction by 5.2% due to deal ramp downs. Management informed that this segment has now stabilized. Software revenue was stable YoY in CC terms.
- In terms of Industry verticals, Financial services grew 5.1% sequentially & 14.4% YoY in CC, Manufacturing grew 3.6% sequentially & 16.5% YoY, life sciences grew 13.4% YoY this has been due to great execution of large deals which translated into revenue which has helped in offset of discretionary spend reduction in these vertical. Tech and Telecom vertical saw significant decline primary driven by cuts in discretionary spend and associated ramp downs.
- In terms of geography, US reported flat growth; Europe & ROW reported negative growth on a constant currency basis sequentially. TCV of new deal wins at \$1.6bn was soft on a QoQ basis. Management expects some spike in coming quarters. Pipeline remain strong (+17.7% QoQ and +26.2% YoY).
- Company won 18 large deals (11 in software & 7 large deals in services). Company guided that despite the demand environment being challenging, it is confident of achieving its FY24 revenue growth guidance of 6%-8% YoY in CC terms (services revenue growth expects to be 6.6%-8.5% YoY in CC terms) as it expects growth to pick up in the coming quarters given the strong pipeline. EBIT margin is expected to be between 18%-19% . We believe inorganic growth could also drive revenues.
- The company has made an acquisition of ASAP group (an Auto ER&D company) for Euro 251 mn and revenue of Euro 154 mn. Acquisition is expected to be completed by September 2023.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q1FY24	Q4FY23	QoQ (%)	Q1FY23	YoY (%)
Revenues (US\$ mn)	3,200	3,235	(1.1)	3,025	5.8
Revenues	2,62,960	2,66,060	(1.2)	2,34,640	12.1
COGS	1,73,300	1,73,270	0.0	1,54,570	12.1
Gross profit	89,660	92,790	(3.4)	80,070	12.0
SG&A	35,790	34,160	4.8	30,320	18.0
EBITDA	53,870	58,630	(8.1)	49,750	8.3
Depreciation & amortization	9,270	10,270	(9.7)	9,830	(5.7)
EBIT	44,600	48,360	(7.8)	39,920	11.7
Other income	2,360	3,590	(34.3)	3,450	(31.6)
PBT	46,960	51,950	(9.6)	43,370	8.3
Tax	11,650	12,140	(4.0)	10,560	10.3
Minority interest	-30	-20	n.m.	-20	n.m.
Reported net profit	35,340	39,830	(11.3)	32,830	7.6
Diluted EPS (Rs)	13.1	14.7	(11.3)	12.1	7.6
As % of net revenue					
Gross profit	34.1	34.9		34.1	34.1
SG&A	13.6	12.8		12.9	13.6
EBITDA	20.5	22.0		21.2	20.5
EBIT	17.0	18.2		17.0	17.0
Reported net profit	13.4	15.0		14.0	13.4
Tax rate	24.8	23.4		24.3	24.8

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

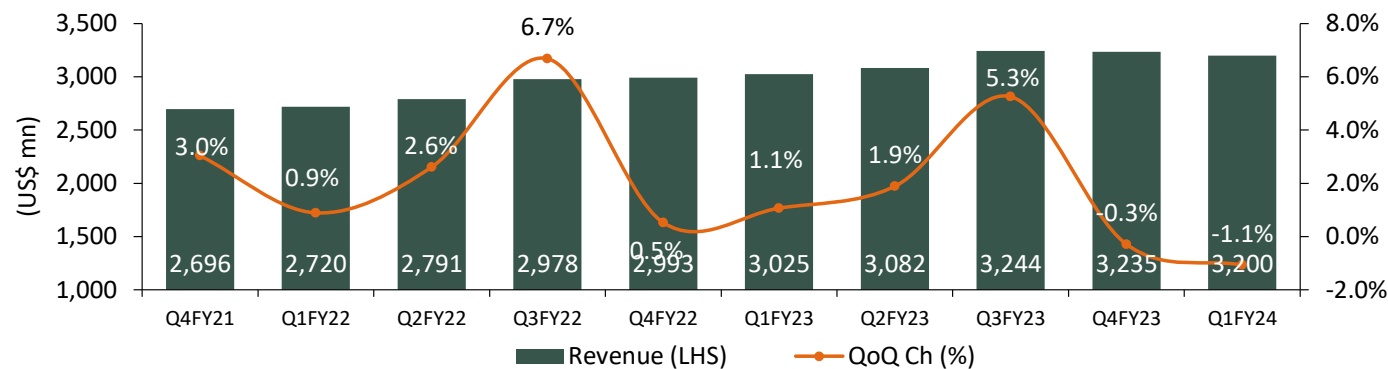
Year-end: March	FY24F			FY25E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	13,334.4	13,340.5	(0.0)	14,552.7	14576.2	(0.2)
Revenue (Rs bn)	1,096.0	1,096.6	(0.1)	1,196.2	1198.2	(0.2)
EBIT (Rs bn)	197.3	198.7	(0.7)	215.8	219.6	(1.7)
EBIT margin (%)	18.00	18.12	(12) bps	18.04	18.32	(28)bps
EPS (Rs)	56.6	56.4	0.4	61.1	62.3	(1.9)

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

Year to March	Q1FY24	Q1FY24E	Variance (%)
Revenue (US\$ mn)	3,200	3,243	(1.3)
Revenue (Rs mn)	2,62,960	2,66,574	(1.4)
EBIT (Rs mn)	44,600	47,200	(5.5)
EBIT margin (%)	17.0%	17.7%	(75)bps
PAT (Rs mn)	35,340	36,827	(4.0)
PAT margin (%)	13.4%	13.8%	38bps
EPS (Rs)	13.1	13.6	-4.0

Source: Company; IDBI Capital Research

Exhibit 4: Q1FY24 revenue growth was impacted by demand softness

Source: Company; IDBI Capital Research

Exhibit 5: Growth in large clients

Year-end: March	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
US\$100m +	15	15	16	17	17	17	19	20
US\$50m +	41	42	43	42	42	45	46	48
US\$20m +	109	110	118	127	128	130	131	127
US\$10m +	190	198	208	218	220	221	229	237
US\$5m +	329	346	349	353	356	365	375	390
US\$1m +	836	864	882	880	890	937	939	947

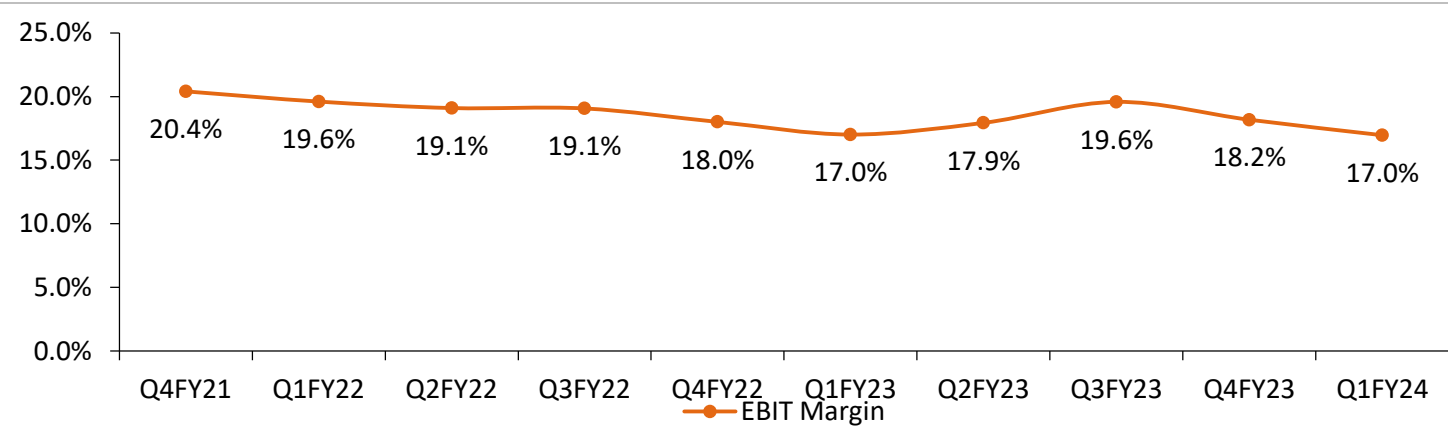
Source: Company; IDBI Capital Research

Exhibit 6: Revenue growth across various segments (%)

Parameters	% of revenue	QoQ CC growth	YoY CC growth
Overall revenue growth		-1.3	6.3
Geography		-1.3	6.3
US	64.5	0.2	7.3
Europe	28.7	(2.4)	10.5
ROW	6.8	(6.2)	(6.0)
Service-lines			
IT and Business services	73.8	(0.1)	9.1
Engineering and R&D Services	16.1	(5.2)	(1.8)
Products and Platforms	10.1	(3.1)	(0.1)
Verticals			
Financial Services	22.6	5.1	14.4
Manufacturing	19.9	3.6	16.5
Technology & Services	13.4	(7.8)	(7.0)
Telecom &Media Publishing	7.6	(14.4)	(11.7)
Retail & CPG	9.1	0.3	3.2
Life science & Healthcare	17.5	(1.3)	13.4
Public Services	10.0	(2.2)	6.8

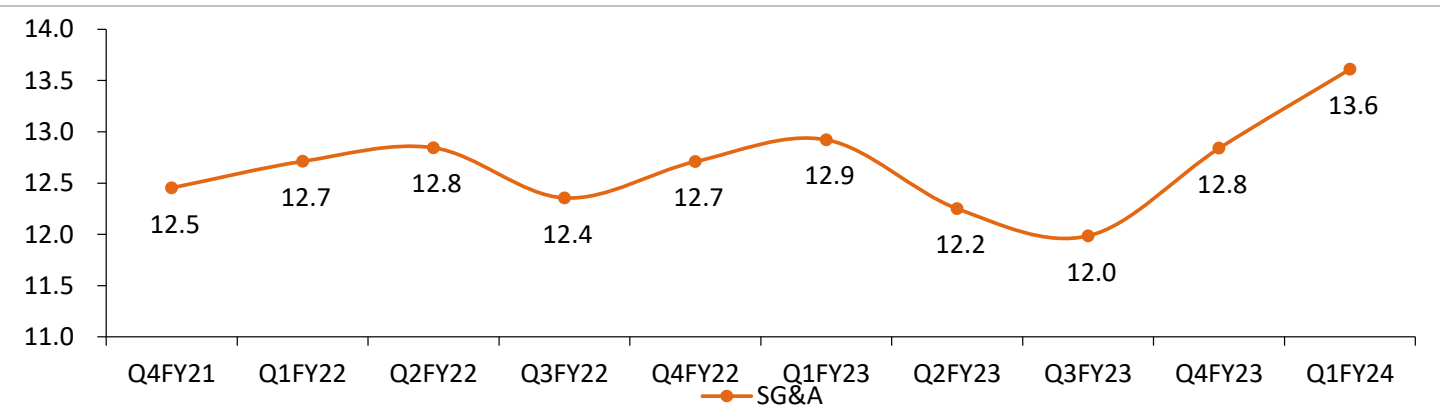
Source: Company; IDBI Capital Research

Exhibit 7: Q1FY24 EBIT margin declined by 120 bps QoQ



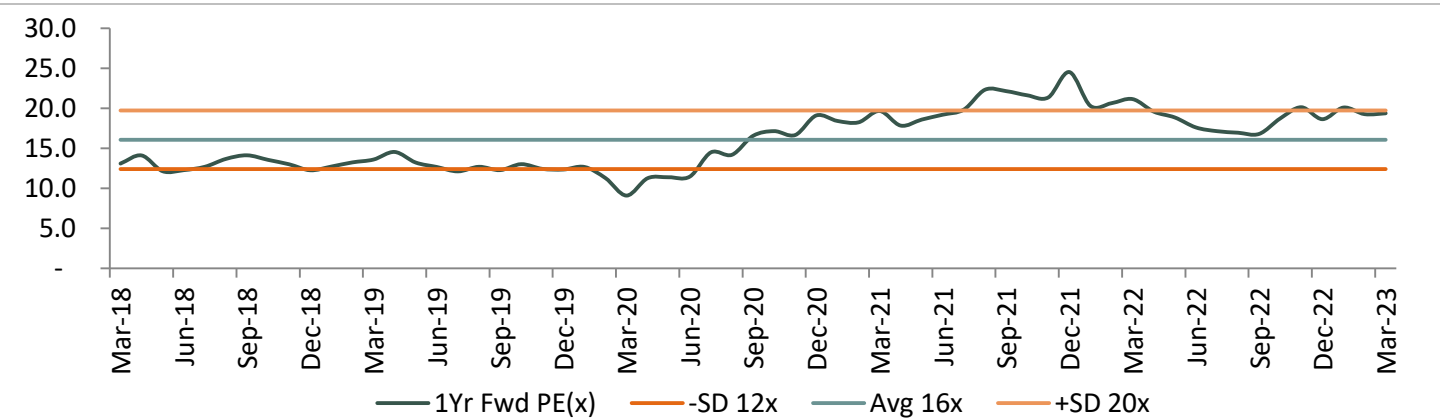
Source: Company; IDBI Capital Research

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	7,06,780	7,53,790	8,56,510	10,14,560	10,96,005	11,96,232
<i>Change (yoy, %)</i>	17	7	14	18	8	9
Operating expenses	(5,39,850)	(5,46,040)	(6,51,210)	(7,88,280)	(8,55,306)	(9,30,196)
EBITDA	1,66,930	2,07,750	2,05,300	2,26,280	2,40,699	2,66,037
<i>Change (yoy, %)</i>	20	24	-1	10	6	11
<i>Margin (%)</i>	23.6	27.6	24.0	22.3	22.0	22.2
Depreciation	(28,400)	(46,110)	(43,260)	(41,450)	(43,383)	(50,251)
EBIT	1,38,530	1,61,640	1,62,040	1,84,830	1,97,316	2,15,786
Interest paid	-	-	-	-	-	-
Other income	1,790	4,160	7,470	8,410	10,210	9,440
Pre-tax profit	1,40,320	1,65,800	1,69,510	1,93,240	2,07,526	2,25,226
Tax	(30,748)	(36,150)	(34,280)	(46,420)	(53,197)	(58,559)
<i>Effective tax rate (%)</i>	21.9	21.8	20.2	24.0	25.6	26.0
Minority Interest	(320.0)	(240.0)	(240.0)	50.0	(570.0)	(800.0)
Net profit	1,09,252	1,29,410	1,34,990	1,46,870	1,53,759	1,65,867
Exceptional items	-	-	-	-	-	-
Adjusted net profit	1,09,252	1,29,410	1,34,990	1,46,870	1,53,759	1,65,867
<i>Change (yoy, %)</i>	8	18	4	9	5	8
EPS	40.3	47.7	49.7	54.1	56.6	61.1
Dividend per sh	6	26	44	48	45	50
<i>Dividend Payout %</i>	18	55	88	89	79	82

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Shareholders' funds	5,12,670	5,99,130	6,19,140	6,54,050	6,85,634	7,15,751
Share capital	5,427	5,427	5,430	5,430	5,430	5,430
Reserves & surplus	5,07,243	5,93,703	6,13,710	6,48,620	6,80,204	7,10,321
Total Debt	46,930	38,280	39,230	21,110	21,110	21,110
Other liabilities	25,900	37,200	31,530	32,190	58,138	64,453
Curr Liab & prov	2,18,850	1,73,830	1,87,750	2,14,310	2,27,974	2,48,562
Current liabilities	2,01,100	1,51,370	1,64,820	1,81,610	1,95,527	2,12,611
Provisions	17,750	22,460	22,930	32,700	32,447	35,951
Total liabilities	2,91,680	2,49,310	2,58,510	2,67,610	3,07,222	3,34,124
Total equity & liabilities	8,05,890	8,50,130	8,78,570	9,21,590	9,93,356	10,51,176
Net fixed assets	3,52,420	3,50,470	3,29,010	3,23,220	3,09,802	2,89,551
Investments	770	890	1,030	1,100	1,100	1,100
Other non-curr assets	66,700	68,260	68,120	61,500	99,091	1,08,152
Current assets	3,86,000	4,30,510	4,80,410	5,35,770	5,83,364	6,52,372
Inventories	910	940	1,610	2,280	1,501	1,639
Sundry Debtors	1,41,310	1,36,630	1,54,760	1,95,720	2,11,394	2,30,725
Cash and Bank	1,19,650	1,56,610	1,88,750	2,01,090	2,22,816	2,58,853
Loans and advances	34,220	48,410	30,080	26,030	28,120	30,691
Total assets	8,05,890	8,50,130	8,78,570	9,21,590	9,93,356	10,51,176

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Pre-tax profit	1,40,320	1,65,800	1,69,510	1,93,240	2,07,526	2,25,226
Depreciation	19,000	46,110	43,260	41,450	43,383	50,251
Tax paid	(30,758)	(24,190)	(34,580)	(46,690)	(53,197)	(58,559)
Chg in working capital	57,750	(54,560)	13,450	(11,020)	(3,321)	(1,453)
Other operating activities	(17,980)	27,375	(18,043)	20,470	(20,525)	(13,678)
Cash flow from operations (a)	1,68,331	1,60,535	1,73,597	1,97,450	1,79,297	2,01,787
Capital expenditure	(1,40,190)	(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)	(1,40,110)	(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)	(1,19,460)	(1,30,320)	(1,22,175)	(1,35,750)
Chg in minorities	190	(90)	(1,010)	(940)	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(9,491)	(79,295)	(1,19,517)	(1,49,380)	(1,22,175)	(1,35,750)
Net chg in cash (a+b+c)	18,730	36,960	32,140	12,340	21,727	36,037

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	189	221	228	241	253	264
Adj EPS (Rs)	40.3	47.7	49.7	54.1	56.6	61.1
Adj EPS growth (%)	8	18	4	9	5	8
EBITDA margin (%)	24	28	24	22	22	22
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	23.1	23.0	23.7

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	14.5	14.0	13.9

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)	27.6	23.3	22.3	20.5	19.6	18.2
Price/Book value (x)	5.9	5.0	4.9	4.6	4.4	4.2
EV/Net sales (x)	4.2	3.8	3.3	2.8	2.6	2.3
EV/EBITDA (x)	18	14	14	13	12	10
Dividend Yield (%)	1	2	4	4	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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