

Tepid Results with Miss on All fronts; Guidance Retained

Est. Vs. Actual for Q3FY23: Revenue – **MISS**; EBITDA Margin – **MISS**; PAT – **MISS**; Deal Wins – **INLINE**

Changes in Estimates post Q1FY24

FY24E/FY25E: Revenue (0.5)%/1%; **EBITDA Margins** 0%/1%; **PAT** (0.5)%/2%

Recommendation Rationale

- The near-term outlook for IT services still remains sceptical due to delayed decision-making and prevailing uncertainties in North America. On the positive side, the long-term demand scenario continues to remain strong and the IT sector is likely to regain its momentum in H2FY24 and onwards.
- The management is also confident of gaining medium-term demand momentum, supported by the deals it has won in the previous quarters. It also foresees improvement on the company's margin front going forward.

Sector Outlook: Cautiously positive

Company Outlook & Guidance: Revenue growth is expected to be in the range of 6%–8% YoY in CC. Moreover, Services revenue is expected to grow between 6.5%–8.5% YoY (in CC). The management has narrowed EBIT margin guidance to 18.0%–19.0%

Current Valuation: 17x FY25E P/E; **Earlier Valuation:** 17x FY25E

Current TP: 1,200/share (Earlier TP: Rs 1,245/share)

Recommendation: Global uncertainties leading to delayed spending decisions pose a challenging environment to HCL Tech and will impact its performance in the near term. Moreover, supply-side constraints will take some more time to ease off. Hence, we recommend a **HOLD** rating on the stock.

Financial Performance

In Q1FY24, HCL Tech Ltd (HCLT) reported revenue of Rs 26,296 Cr, down 1.2% QoQ and below our expectations. The company's operating profit stood at Rs 4,460 Cr, reporting a de-growth of 7.8% on a QoQ basis. Missing our expectations, the company's operating margins, too, declined by 110bps to 17%, which was largely led by higher operating expenses and higher onsite expenses during the quarter. Its net profit for Q1FY24 stood at Rs 3,534 Cr, registering a de-growth of 11.3% QoQ.

Outlook

We believe HCL Tech is well-placed for encouraging growth from a long-term perspective given its multiple long-term contracts with the world's leading brands. Richer revenue visibility gives us confidence in its business growth moving forward. However, rising concerns over business uncertainties in large economies and continuing supply-side constraints are creating challenges for the company's growth prospects moving ahead.

Valuation & Recommendation

We recommend a HOLD rating on the stock and assign a 17x P/E multiple to its FY25E earnings of Rs 71.9/share to arrive at a TP of Rs 1,200/share, implying an upside of 8% from the CMP.

Key Financials (Consolidated)

(Rs Cr)	Q1FY24	QoQ (%)	YoY (%)	Axis Est.	Variance
Net Sales	26,296	0%	17.70%	26950	-2%
EBITDA	5,387	-8%	18.80%	5150	5%
EBITDA Margin	20%	50 bps%	12 bps%	22%	-7%
Net Profit	3,534	-3%	10.80%	3830	-8%
EPS (Rs)	55.7	-3%	10.80%	55	1%

Source: Company, Axis Research

(CMP as of 12 July 2023)

CMP (Rs)	1,110
Upside /Downside (%)	8%
High/Low (Rs)	1,203/876
Market cap (Cr)	3,01,230
Avg. daily vol. (6m)Shrs.	20,41,582
No. of shares (Cr)	271.36

Shareholding (%)

	Mar-22	Jun-22	Sep-22
Promoter	60.7	60.7	60.7
FIIIs	19.0	17.9	17.9
MFs / UTI	9.7	10.2	10.2
Banks / FIs	0.1	0.1	0.1
Others	10.5	11.1	11.1

Financial & Valuations

Y/E Mar (Rs Cr)	FY23E	FY24E	FY25E
Net Sales	1,01,456	1,10,496	1,28,187
EBITDA	24,170	7,978	10,605
Net Profit	14,857	3,248	5,168
EPS (Rs)	57.2	63.7	71.9
PER (x)	19.5	17.1	17.1
P/BV (x)	13.3	11.8	11.8
EV/EBITDA (x)	4.8	4.4	4.4
ROE (%)	21%	24%	27%

Change in Estimates (%)

Y/E Mar	FY24E	FY25E
Sales	-1%	1%
EBITDA	0%	1%
PAT	-1%	2%

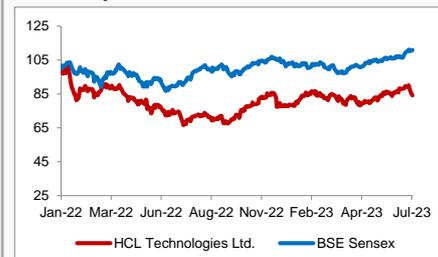
ESG disclosure Score**

Environmental Disclosure Score	46.7
Social Disclosure Score	38.5
Governance Disclosure Score	89.9
Total ESG Disclosure Score	58.4
Sector Average	46.0

Source: Bloomberg, Scale: 0,1-100

**Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

Relative performance



Source: Ace Equity, Axis Securities

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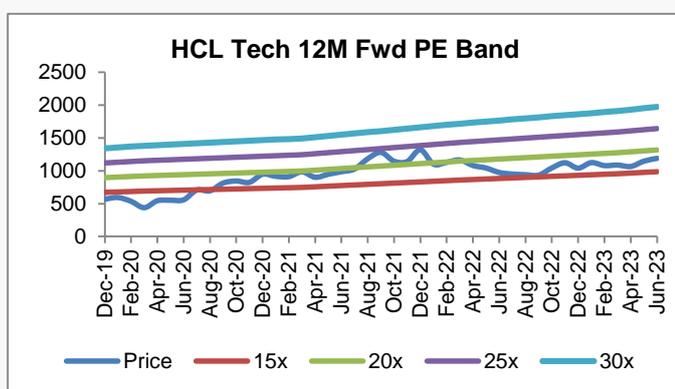
Recommendation Rationale & Key Highlights

- Management confident of continuing demand strength in the medium term:** The US is relatively better placed; the UK is seeing higher cost optimization deals (with faster decision-making) while the European market will remain impacted in the short term. As the macro environment stabilizes, the company expects a pick-up in clients' decision-making.
- BFSI and Manufacturing vertical remain resilient:** On the vertical front, BFSI and Manufacturing verticals delivered an encouraging QoQ growth of 5.1%/3.6% respectively while Technology & Services and Life Sciences de-grew by 7.8% and 1.3% QoQ. Verticals Telecom & Media and Public Services reported de-growth of 14.4% and 2.2% QoQ respectively. The majority of the verticals witnessed moderate growth but are likely to report further growth backed by a strong deal pipeline in the near term.
- Steady geographical performance:** On the geographical front, while North America (63% of revenue) improved by 0.2% QoQ, Europe (28.7% of revenue) and RoW (7.9% of revenue) degrew by 2.4% and 6.2% QoQ (in the CC terms) respectively.
- ER&D remained laggard while IT services & products remained Flat:** IT services (75% of Revenue) remain largely flattish with a marginal degrowth of 0.1% QoQ. However, ER&D services (15% of the revenue) showed a steep decline of 5.1% QoQ due to delayed decisions. IT software (10% of the company's revenue) declined 3.1% QoQ. The near-term outlook remains sceptical but the management is confident about the company's medium to long-term outlook.
- HCL Tech closed 18 large deal wins:** 7 are in services and 11 in software across industry verticals such as Life sciences & Healthcare, Public Services, Technology, Manufacturing, Financial Services, Retail & CPG.

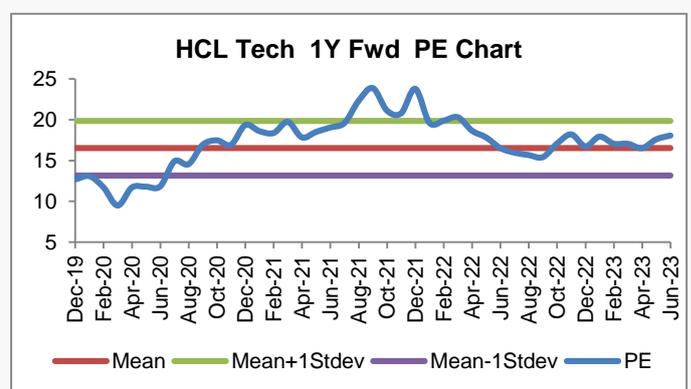
Key Risks to our Estimates and TP

- The demand environment is uncertain because of the potential threat of recession from the world's largest economies.
- The rising subcontracting cost and cross-currency headwinds may impact operating margins negatively.

HCL Tech 12M Fwd PE Band



HCL Tech 1Y Fwd PE Chart



Source: Company, Axis Securities

Client Parameters	Q1 FY24	Q4 FY23	Q1 FY23	QoQ Change	YoY Change
Top 5 Clients	9%	10%	11%	(70)	(180)
Top 10 Clients	17%	18%	19%	(50)	(220)
Top 20 Clients	27%	28%	29%	(60)	(170)

Source: Company, Axis Research

Client Parameters	Q1 FY24	Q4 FY23	Q1 FY23	QoQ Change	YoY Change
\$1 Mn clients	947	939	880	8	67
\$10 Mn clients	390	375	353	15	37
\$20 Mn clients	237	229	218	8	19
\$50 Mn clients	127	131	127	(4)	-
\$100 Mn clients	49	46	42	3	7

Source: Company, Axis Research

Employee Details	Q1 FY24	Q4 FY23	Q1 FY23	QoQ Change	YoY Change
Total Employees	2,23,448	2,25,944	2,08,877	(2,496)	14,571
Technical	2,09,066	2,11,445	1,95,195	(2,379)	13,871
Sales & Support	14,372	14,499	13,682	(127)	690
Gross Addition	(2,506)	3,674	11,100	(6,180)	(13,606)
Attrition	16%	20%	22%	(0)	(0)

Source: Company, Axis Research

Revenue Analysis	Q1 FY24	Q4 FY23	Q1 FY23	QoQ Change	YoY Change
Americas	65%	64%	64%	70	30
Europe	29%	29%	28%	(20)	90
RoW	7%	7%	8%	(50)	(120)

Source: Company, Axis Research

Vertical Mix

Revenue Analysis	Q1 FY24	Q4 FY23	Q1 FY23	QoQ Change	YoY Change
Financial Services	23%	21%	22%	140	100
Manufacturing	20%	19%	19%	90	100
Technology and Services	18%	18%	16%	-	130
Retail & CPG	9%	14%	10%	(530)	(70)
Telecom, Media, Publishing & Entertainment	8%	9%	9%	(120)	(140)
Life Sciences & Healthcare	18%	18%	16%	-	130
Public Services	10%	10%	11%	(20)	(50)

Source: Company, Axis Research

Segment Mix	Q1 FY24	Q4 FY23	Q1 FY23	QoQ Change	YoY Change
IT and Business Services	75%	74%	73%	90	130
Engineering and R&D services	15%	16%	16%	(70)	(100)
Product And Platform	10%	11%	11%	(20)	(40)

Source: Company, Axis Research

Results Review
(Rs Cr)

In Cr	Q1 FY24	Q4 FY23	Q1 FY23	% change (YoY)	% change (QoQ)
Total Revenue	26,296	26,606	23,464	12%	5%
Total Cost of Sales	16,936	16,889	15,066		
Gross Profit	9,360	9,717	8,398	11%	-4%
Margin(%)	36%	37%	36%	-20	-93
Research & Development	394	439	391		
SG &A	3,579	3,416	3,932		
Total Operating Expenses	3,973	3,855	4,323		
EBITDA	5,387	5,862	4,075	23%	7%
Margin(%)	20%	22%	17%		
Depreciation	927	1,027	983		
Operating Income	4,460	4,835	3,092	44%	-8%
Margin(%)	17%	18%	13%	378	-121
Total Other Income/(Expense)	258	397	263		
Income Before Income Taxes	4,202	4,438	4,341		
Total Taxes	1,165	1,214	1,056		
ETR (%)	28%	27%	24%	340	37
Net Profit After Taxes	3,537	3,983	3,285	8%	-11%
Non Controlling Interest	-3	-1	-2		
Net Income After Extraordinary Items	3,534	3,983	3,283	8%	-11%
Margin(%)	13%	20%	21%	-794	-671
EPS	55.7	54.9	50.0	11%	2%

Source: Company, Axis Securities

Financials (consolidated)

Profit & Loss

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Net sales	85,651	1,01,456	1,10,496	1,28,187
Growth, %	14%	18%	9%	16%
Other income	419	914	259	257
Total income	86,070	10,237	11,075	12,844
Employee expenses	52,760	64,523	88,153	1,00,918
Other Operating expenses	10,835	12,763	14,364	16,664
EBITDA	20,530	24,170	7,978	10,605
Growth, %	34%	18%	-67%	33%
Margin, %	24%	24%	7%	8%
Depreciation	4,326	4,145	3,779	3,845
EBIT	16,204	20,025	4,199	6,760
Growth, %	26%	24%	-79%	61%
Margin, %	19%	20%	4%	5%
Interest paid	328	91	134	134
Pre-tax profit	3,428	4,643	4,323	6,883
Tax provided	3,482	1,161	1,081	1,721
Profit after tax	13,499	14,851	3,242	5,162
Net Profit	13,499	14,857	3,248	5,168
Growth, %	34%	10%	-78%	59%
Net Profit (adjusted)	13,499	14,857	3,248	5,168

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Cash & bank	565	-4,555	-7,695	-12,357
Debtors	18,019	21,345	23,246	26,968
Other current assets	5,188	5,188	5,188	5,188
Total current assets	36,611	35,895	35,275	35,544
Goodwill and Intangible Assets	0	0	0	0
Net fixed assets	-276	-1,884	-2,901	-3,541
CWIP	531	531	531	531
Other Non-current assets	0	0	0	0
Total Non-Current Assets	3,080	3,080	3,080	3,080
	0	0	0	0
Total assets	1,10,420	1,10,420	1,10,420	1,10,420
	0	0	0	0
Creditors	1,911	2,323	3,081	3,534
Provisions	7,500	7,500	7,500	7,500
Total current liabilities	17,506	19,148	21,717	23,632
Other liabilities	2,548	2,548	2,548	2,548
Paid-up capital	543	543	543	543
Reserves & surplus	69,636	81,953	82,661	85,289
Total equity & liabilities	1,10,420	1,10,420	1,10,420	1,10,420

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Pre-tax profit	3,429	4,644	4,325	6,884
Depreciation	4,326	4,145	3,779	3,845
Chg in working capital	-5,315	-2,762	49	-3,015
Total tax paid	348	116	108	172
Cash flow from operating activities	3,218	6,804	8,931	8,491
Capital expenditure	2,141	2,536	2,762	3,205
Cash flow from investing activities	-7,829	-8,224	-8,450	-8,892
Free cash flow	-675	-396	-228	-361
Dividend (incl. tax)	2,540	2,540	2,540	2,540
Cash flow from financing activities	-1,339	0	0	0
Net chg in cash	-9,346	-5,120	-3,140	-4,662

Source: Company, Axis Securities

Ratio Analysis

(%)

Y/E March	FY22A	FY23E	FY24E	FY25E
Per Share data				
EPS (INR)	49.78	57.25	63.66	71.93
Growth, %	8%	15%	14%	15%
Book NAV/share (INR)	510.1	599.6	604.7	623.8
FDEPS (INR)	46	46	46	46
CEPS (INR)	128.8	137.5	50.5	64.9
CFPS (INR)	42.8	47.9	53.7	60.1
DPS (INR)	27	30.2	33.9	37.9
Return ratios				
Return on assets (%)	21%	19%	4%	6%
Return on equity (%)	19%	21%	24%	27%
Return on capital employed (%)	16%	17%	4%	5%
Turnover ratios				
Asset turnover (x)	1.0	1.2	1.2	1.3
Sales/Total assets (x)	1.3	1.5	1.6	1.8
Receivables Days	70.4	70.4	70.4	70.4
Cash conversion cycle	35	39.2	43.9	49.2
Liquidity ratios				
Current ratio (x)	2.8	3.136	3.5	3.9
Interest cover (x)	132	147.84	166	186

Source: Company, Axis Securities

HCL Technologies Price Chart and Recommendation History



Date	Reco	TP	Research
20-Jul-21	BUY	1,088	Result Update
01-Aug-21	BUY	1,150	Top Picks
01-Sep-21	BUY	1,300	Top Picks
01-Oct-21	BUY	1,410	Top Picks
18-Oct-21	BUY	1,390	Result Update
01-Nov-21	BUY	1,390	Top Picks
03-Jan-22	BUY	1,520	Top Picks
17-Jan-22	BUY	1,600	Result Update
22-Apr-22	BUY	1,345	Result Update
13-Jul-22	HOLD	975	Result Update
13-Oct-22	BUY	1,065	Result Update
12-Dec-22	HOLD	1,090	Company Update
13-Jan-23	BUY	1,245	Result Update
21-Apr-23	BUY	1,245	Result Update
12-Jul-23	HOLD	1,200	Result Update

Source: Axis Securities

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