

BUY

TP: Rs 1,240 | ▲ 20%

HCL TECHNOLOGIES

Technology & Internet

20 April 2023

Software seasonality dampens dollar revenue growth

- Q4 revenue down 0.3% QoQ CC, below our estimates
- Operating margin slipped 140bps QoQ to 18.2% on weakness in ER&D and software segments
- Strong deal win momentum continues; maintain BUY and TP of Rs 1,240, set at 18.7x FY25E EPS

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Flattish Q4: HCLT's Q4FY23 revenue stood at US\$ 3.2bn (-0.3% QoQ, +8.1% YoY CC), 1.7% below our estimate. The company pared FY24 revenue growth guidance to 6-8% YoY CC, with services now likely to grow by 6.5-8.5%. While management pointed to ramp-downs of certain projects by vendors and reprioritisation of client spending, it sees robust growth in the areas of cost optimisation, business model transformation and cloud migration.

Revenue was driven by engineering and research & development (ERD), IT & business services, and HCL Software that rose 11.4%, 7.3% and 8.2% YoY CC respectively. Mode-1 services saw reasonable growth in Q4. Digital revenue rose 16.9% YoY CC and contributed 37.5% of services revenue.

Strong deal wins to buoy growth across geographies: HCLT booked net new TCV of US\$ 2.1bn (-8% YoY), which included 13 large deal wins (10 in services and 3 in software). The technology and telecom segments were soft due to cuts in discretionary spend, but management indicated that the pipeline for large deals remains healthy. These will reflect in Q1FY24 for the most part and the balance in Q2. HCLT indicated that the majority of wins were related to cost takeout and cloud adoption, with positive traction also seen in cloud/hybrid cloud for financial services.

FY24 margin guidance narrowed to 18-19%: EBIT margin for Q4 dipped 140bps to 18.2% mainly due to a seasonality impact of 125bps in the software business. Margins in IT services grew 32bps QoQ, but ERD/software were down 285bps/960bps. Management has guided for an 18-19% EBIT margin in FY24 vs. 18-20% earlier.

Maintain BUY: HCLT is trading at 17.3x/15.7x FY24E/FY25E EPS. Given its deep capabilities in the IMS space and strategic partnerships alongside continued investments in cloud/digital capabilities, we expect the company to emerge stronger on the back of rising demand from enterprises and the US market. Strong sequential growth within IT services, robust headcount addition, healthy deal wins and a solid pipeline indicate an improved outlook. We retain BUY and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	HCLT IN/Rs 1,038
Market cap	US\$ 34.3bn
Free float	38%
3M ADV	US\$ 40.6mn
52wk high/low	Rs 1,157/Rs 877
Promoter/FPI/DII	61%/17%/22%

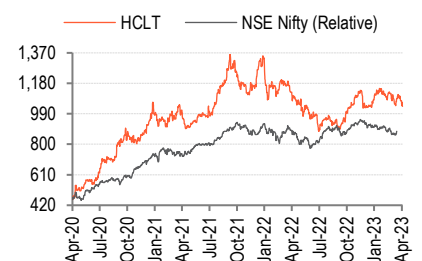
Source: NSE | Price as of 20 Apr 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	10,14,355	11,31,246	12,36,314
EBITDA (Rs mn)	2,24,451	2,59,888	2,82,793
Adj. net profit (Rs mn)	1,41,181	1,62,773	1,79,498
Adj. EPS (Rs)	52.0	60.0	66.1
Consensus EPS (Rs)	52.0	63.5	64.5
Adj. ROAE (%)	21.7	22.3	21.9
Adj. P/E (x)	19.9	17.3	15.7
EV/EBITDA (x)	12.4	10.7	9.7
Adj. EPS growth (%)	4.6	15.3	10.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

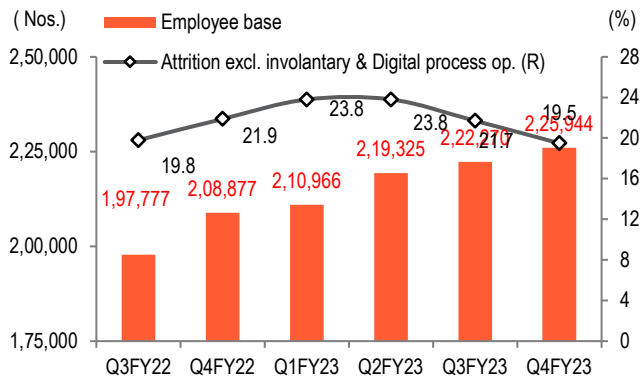


Fig 1 – Quarterly performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	BOBCAPS EST.	Variance (%)
US\$ Revenue (US\$ mn)	3,235	3,244	2,993	(0.3)	8.1	3,290	(1.7)
INR Revenue	2,66,060	2,67,000	2,25,970	(0.4)	17.7	2,72,083	(2.2)
EBIT	48,360	52,280	40,449	(7.5)	19.6	50,880	(5.0)
PAT	39,830	40,960	35,929	(2.8)	10.9	41,629	(4.3)
EBIT Margin (%)	18.2	19.6	17.9	(140bps)	28bps	18.7	(52bps)
PAT Margin (%)	14.9	15.3	15.9	(44bps)	(100bps)	15.3	(40bps)

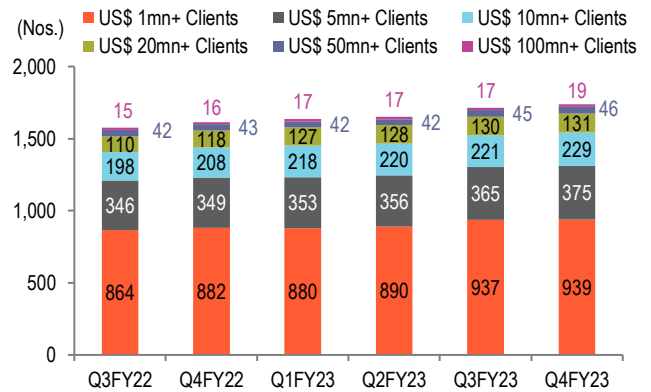
Source: Company, BOBCAPS Research

Fig 2 – Employee base and Attrition



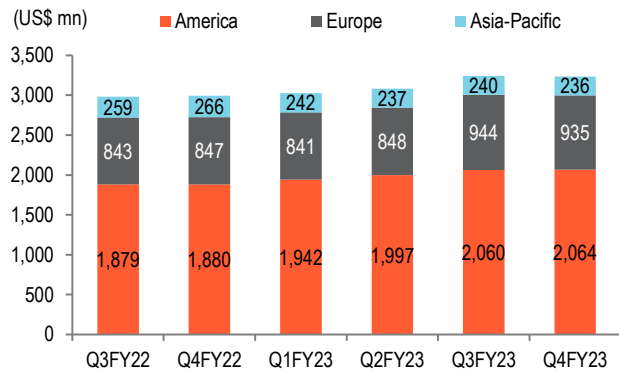
Source: Company, BOBCAPS Research

Fig 3 – Client revenue contribution



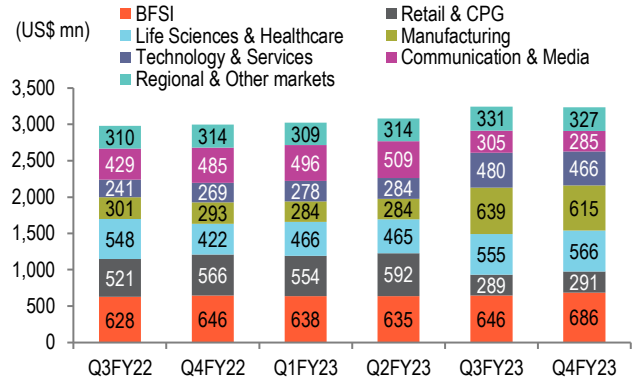
Source: Company, BOBCAPS Research

Fig 4 – Revenue contribution by geography



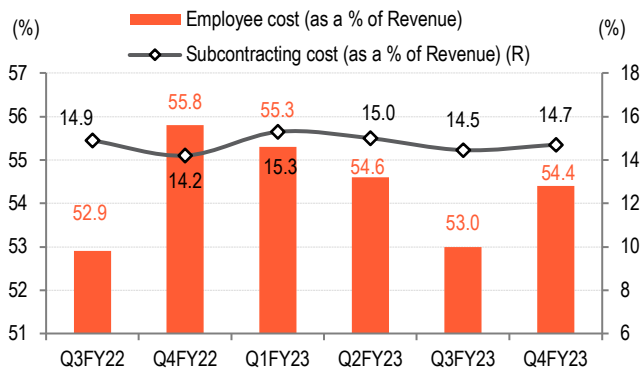
Source: Company, BOBCAPS Research

Fig 5 – Revenue contribution by vertical



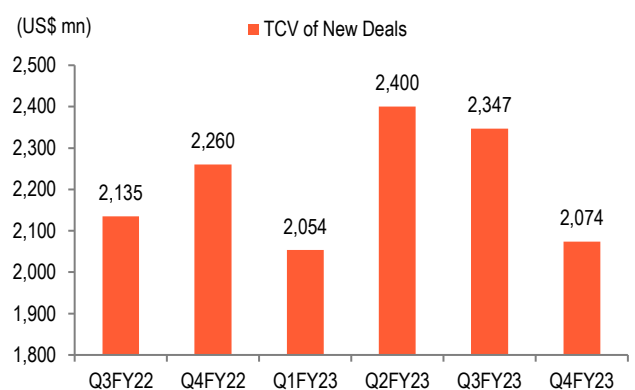
Source: Company, BOBCAPS Research

Fig 6 – Employee and Subcontracting costs



Source: Company, BOBCAPS Research

Fig 7 – Order book (new deal TCV)



Source: Company, BOBCAPS Research

Earnings call highlights

- Deal wins remained strong with HCLT bagging 13 large contracts in Q4FY23: 10 in services and 3 in products. New deal wins totalled ~US\$ 2.1bn with average contract value (ACV) moderating slightly to 8% YoY. The company added a recent deal win of US\$ 300mn in Q4. Financial services, Retail/CPG, Technology and Telecom are going to play key roles in the near term. Deal bookings in USA is stronger than Europe
- IT & business services grew 11.4% YoY CC primarily led by the life science & healthcare (+3.6% QoQ CC) and financial services (+6.9%) verticals. Like its peers, HCLT has less exposure to regional banks in the US as compared to its large cap peers. Within financial services, the capital markets and insurance segments witnessed the highest growth during the quarter.
- Per management, clients are lagging behind in consuming cloud capacity and need to accelerate spends to utilise the same. Faster migration to cloud, cost takeout projects and automation drove the growth in Q4.
- Attrition declined materially by ~220bps QoQ to 19.5% in Q4. As the supply side eases, management expects utilisation to pick up.
- HCLT added over 3,600 staff during the quarter, totaling to ~225,000. It hired 4,500 in FY23, totaling to ~27,000 for the year (against a target of ~30,000). Management plans to recruit ~15,000 freshers and have a higher ratio of fresher to overall hiring in FY24.
- Morocco is the company's new near-shore centre to cater to Europe.
- Operating cash flow stood at 121% of net income and free cash flow at 110%.
- Management declared dividend of Rs 18/sh, totaling to Rs 48/sh in FY23 (payout ratio of 87.5%).

Valuation methodology

HCLT is trading at 17.3x/15.7x FY24E/FY25E EPS. Given its deep capabilities in the infrastructure management services (IMS) space and strategic partnerships alongside continued investments in cloud/digital capabilities, we expect the company to emerge stronger on the back of rising demand from enterprises and the US market. Strong sequential growth within IT services, robust headcount addition, healthy deal wins and a solid pipeline indicate an improved outlook. We retain BUY and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Key risks

- A further increase in interest rates would be a key downside risk to our estimates as it would induce extended weakness in deal wins in the areas of telecom and technology.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	34.3	1,038	1,240	BUY
Infosys	INFO IN	62.6	1,223	1,760	BUY
Tata Consultancy Services	TCS IN	138.3	3,105	3,580	HOLD
Tech Mahindra	TECHM IN	10.9	1,022	1,160	HOLD
Wipro	WPRO IN	24.2	363	440	HOLD

Source: BOBCAPS Research, NSE | Price as of 20 Apr 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Total revenue	7,53,780	8,56,510	10,14,355	11,31,246	12,36,314
EBITDA	2,02,350	2,01,920	2,24,451	2,59,888	2,82,793
Depreciation	41,360	40,190	45,515	50,511	51,098
EBIT	1,60,990	1,61,730	1,78,936	2,09,378	2,31,695
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	5,540	8,260	6,969	4,797	4,485
Exceptional items	0	0	0	0	1
EBT	1,66,530	1,69,990	1,85,906	2,14,175	2,36,180
Income taxes	36,580	34,430	44,725	51,402	56,683
Extraordinary items	0	0	0	0	1
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	1,29,950	1,35,560	1,41,181	1,62,773	1,79,497
Adjustments	0	0	0	0	1
Adjusted net profit	1,29,950	1,35,560	1,41,181	1,62,773	1,79,498

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	2,17,050	2,30,420	2,33,302	2,60,187	2,84,352
Provisions	0	0	0	0	0
Debt funds	39,070	39,850	39,850	39,850	39,850
Other liabilities	0	0	0	0	0
Equity capital	5,430	5,430	5,430	5,430	5,430
Reserves & surplus	6,15,480	6,09,200	6,82,445	7,66,891	8,60,014
Shareholders' fund	6,20,910	6,14,630	6,87,875	7,72,321	8,65,444
Total liab. and equities	8,77,030	8,84,900	9,61,026	10,72,358	11,89,646
Cash and cash eq.	65,150	79,090	92,168	1,22,470	1,68,381
Accounts receivables	1,75,250	2,06,710	2,22,324	2,47,944	2,70,973
Inventories	0	0	0	0	0
Other current assets	74,290	77,920	91,292	1,24,437	1,35,995
Investments	1,40,220	1,14,850	1,39,850	1,69,850	1,99,850
Net fixed assets	62,450	59,540	38,242	20,570	18,431
CWIP	0	0	0	0	0
Intangible assets	2,91,500	2,90,930	2,90,930	2,90,930	2,90,930
Deferred tax assets, net	0	0	0	0	1
Other assets	68,170	55,860	86,220	96,156	1,05,087
Total assets	8,77,030	8,84,900	9,61,026	10,72,358	11,89,646

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Cash flow from operations	1,26,470	1,56,990	1,23,262	1,66,671	2,06,760
Capital expenditures	(41,370)	(37,280)	(24,217)	(32,839)	(48,958)
Change in investments	34,540	(25,370)	25,000	30,000	30,000
Other investing cash flows	13,367	521	(43,031)	(55,203)	(55,515)
Cash flow from investing	6,537	(62,129)	(42,248)	(58,042)	(74,474)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(2,510)	(600)	0	0	0
Interest expenses	(76,730)	(15,090)	0	0	0
Dividends paid	(62,532)	(65,231)	(67,936)	(78,326)	(86,374)
Other financing cash flows	0	0	0	0	1
Cash flow from financing	(1,41,772)	(80,921)	(67,936)	(78,326)	(86,373)
Chg in cash & cash eq.	(8,765)	13,940	13,078	30,302	45,913
Closing cash & cash eq.	65,150	79,090	92,168	1,22,470	1,68,381

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	47.9	49.8	52.0	60.0	66.1
Adjusted EPS	47.9	49.8	52.0	60.0	66.1
Dividend per share	19.2	20.0	20.8	24.0	26.5
Book value per share	228.8	226.5	253.5	284.6	318.9

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	3.7	3.3	2.7	2.4	2.2
EV/EBITDA	13.8	13.8	12.4	10.7	9.7
Adjusted P/E	21.7	20.9	19.9	17.3	15.7
P/BV	4.5	4.6	4.1	3.6	3.3

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	78.0	79.7	75.9	76.0	76.0
Interest burden (PBT/EBIT)	103.4	105.1	103.9	102.3	101.9
EBIT margin (EBIT/Revenue)	21.4	18.9	17.6	18.5	18.7
Asset turnover (Rev./Avg TA)	88.2	97.2	109.9	111.3	109.3
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.4	1.4	1.4
Adjusted ROAE	22.7	21.9	21.7	22.3	21.9

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
YoY growth (%)					
Revenue	6.6	13.6	18.4	11.5	9.3
EBITDA	21.2	(0.2)	11.2	15.8	8.8
Adjusted EPS	17.1	3.9	4.6	15.3	10.3
Profitability & Return ratios (%)					
EBITDA margin	26.8	23.6	22.1	23.0	22.9
EBIT margin	21.4	18.9	17.6	18.5	18.7
Adjusted profit margin	17.2	15.8	13.9	14.4	14.5
Adjusted ROAE	22.7	21.9	21.7	22.3	21.9
ROCE	22.4	22.0	22.4	24.0	24.7
Working capital days (days)					
Receivables	85	81	77	76	77
Inventory	0	0	0	0	0
Payables	158	125	107	103	104
Ratios (x)					
Gross asset turnover	12.1	14.0	20.7	38.5	63.4
Current ratio	1.8	1.8	2.1	2.3	2.4
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

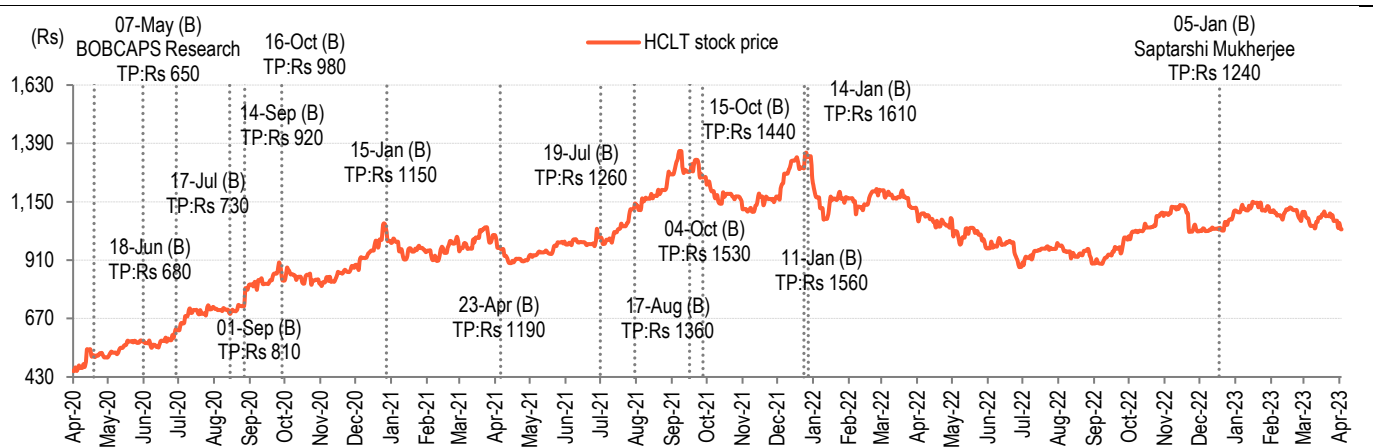
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HCL TECHNOLOGIES (HCLT IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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