FIRST LIGHT

21 April 2023

RESEARCH

HCL TECHNOLOGIES | TARGET: Rs 1,240 | +20% | BUY

Software seasonality dampens dollar revenue growth

METALS & MINING | FERROUS CHARTBOOK

China's March economic data supportive of steel margins

METALS & MINING

Aluminium market thinly balanced – Alcoa

SUMMARY

HCL TECHNOLOGIES

- 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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METALS & MINING | FERROUS CHARTBOOK

- Macro data from China confirms ongoing recovery in steel demand with scope for pick-up in the peak June quarter
- Run-up in China's steel production in March could pose a risk to near-term operating margins if demand recovery falters
- Steel margins likely to settle at mid-cycle level in FY24; earnings accretion from next expansion wave key to watch. Prefer TATA and JSP

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Daily macro indicators

Ticker	18-Apr	19-Apr	Chg (%)
US 10Y yield (%)	3.58	3.59	2bps
India 10Y yield (%)	7.20	7.20	0bps
USD/INR	82.04	82.23	(0.2)
Brent Crude (US$/bbl)	84.8	83.1	(1.9)
Dow	33,977	33,897	(0.2)
Hang Seng	20,651	20,368	(1.4)
Sensex	59,727	59,568	(0.3)
India FII (US$ mn)	**17-Apr**	**18-Apr**	**Chg ($ mn)**
FII-D	(122.2)	62.9	185.0
FII-E	51.5	(67.3)	(118.8)

Source: Bank of Baroda Economics Research

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METALS & MINING

- Alcoa's Q1CY23 EPS narrowly missed consensus; aluminium posted higher sequential improvement than alumina
- Aluminium market still thinly balanced even after cuts in Yunnan; demand pick-up in China, further Yunnan cuts and restarts key to watch
- Read-across suggests sequential improvement in aluminium margin for Indian players in Q4FY23; price volatility to increase

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BUY
TP: Rs 1,240 | ⮝ 20%

HCL TECHNOLOGIES | Technology & Internet | 20 April 2023

Software seasonality dampens dollar revenue growth

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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%

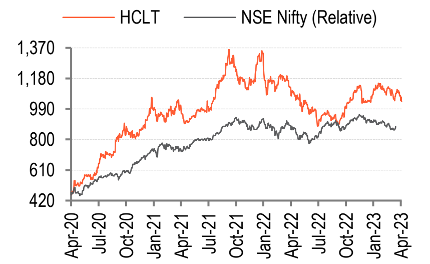
Source: NSE | Price as of 20 Apr 2023

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

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METALS & MINING | Ferrous Chartbook | 20 April 2023

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Global steel demand to recover in CY23 and CY24: In its Short Range Outlook Apr'23, WSA forecasts a modest 2.3% recovery in global steel demand in CY23 from a 3.2% decline in CY22, on the back of revival across China, the US, Japan, Korea and emerging markets supported by India and ASEAN.

Seasonally strong June quarter to support demand in China: March data from China confirms that economic recovery is underway, with industrial production broadly in line with consensus, infrastructure FAI at high levels, and signs of easing of real estate stress. While the recent softening of steel prices suggests a slow start, we expect an uptick in steel demand during the peak season (Apr-Jun) and a sustained revival through CY23 aided by China's infrastructure push, potential for a slight pick-up in real estate in H2CY23 and continuing growth in the auto sector, albeit softer than last year. WSA expects China to clock 2% demand growth this year before flattening out.

Steel margins could come under pressure if demand falters: China's steel production has run up beyond 1.1bnt (annualised) in March, though this was needed to rebuild stocks ahead of the seasonally peak June quarter. Mysteel expects production to climb down from April with the start of maintenance shutdowns. Chinese steel exports have been higher in Q1CY23 at 20mt levels and should ease over Q2 as domestic demand perks up and production softens. However, should demand recovery falter, we could see pressure on regional margins till the market in China rebalances.

Raw material prices to ease after wet season: We believe coking coal and iron ore prices will ease from May/June as supply improves once the rainy season in Australia and Brazil draws to a close. Coking coal prices have eased below US$ 300/t from a peak of US$ 375/t in February. For iron ore, Vale's Q1 production results show that supply could improve in H2CY23 given a build-up of inventories.

Constructive on Indian ferrous players: We expect (i) margins to stabilise at mid-cycle levels in FY24 as recovery in China takes hold, and (ii) investor focus to shift to delivery of the next wave of expansion projects. Retain BUY on TATA (TP Rs 140) and JSP (TP Rs 670). Read our **Q4FY23 Preview** for our earnings outlook.

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	585	670	BUY
JSTL IN	716	715	HOLD
SAIL IN	83	95	HOLD
TATA IN	108	140	BUY

Price & Target in Rupees | Price as of 20 Apr 2023

METALS & MINING

20 April 2023

Aluminium market thinly balanced: Alcoa

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Sequential improvement in EBITDA: Alcoa (AA US, Not Rated) posted a Q1CY23 adj. EPS loss of US$ 0.21 vs. Zacks consensus estimate of US$ 0.05. More importantly, however, aluminium segment EBITDA soared ~US$ 258/t QoQ with a US$ 159/t improvement in realisation and a US$ 98/t decrease in costs. The alumina segment posted a softer US$ 19/t QoQ increase in EBITDA to US$ 35/t.

Near-term demand outlook mixed: AA indicated that improvement in automotive production is supporting flat products, but challenges in the building and construction segment persist given high interest rates. The company also noted improvement in premia. With global aluminium stocks at historical lows of 48 days, price recovery could be faster when demand normalises.

Aluminium market thinly balanced: Management anticipates only a small supply deficit in China even after a net 700kt production cut in Q1, as this will likely be offset by a slight surplus in rest of world (ROW) markets. Outside China, there was a net 20kt capacity cut in Q1. The risk of further cuts in Yunnan vs. restarts in Europe will determine market balance. Lower power cost has not yet resulted in restarts owing to slim margins for smelters. Also, the risk of LME dislocation has increased with Russian metal accounting for 53% of LME stocks (5% prior to the Ukraine war). Per AA, the alumina market is also balanced with a small deficit in China offset by a slight surplus in ROW.

Raw material deflation finally underway: Market indices of all three key raw materials – caustic soda for alumina (-17% from peak), and calcined petroleum coke (-16%) and coal tar pitch (-7%) for aluminium – have come off peaks. Given AA's inventory of 3-6 months, this could take 1-2 quarters to feed through the cost base.

Read-across for Indian aluminium players: AA's results support sequential improvement in Indian aluminium margins in Q4FY23 with higher realisation and lower energy costs. Margins for net long alumina sales may not improve yet though. With a thin balance market, price volatility could rise near term. Upside risks include stronger China demand and further cuts in Yunnan. Downside risks include slower demand recovery in China & the western world and the restart of European capacity.

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

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.

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