

**NOT RATED****HCL TECHNOLOGIES**

| IT Services

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## 1QFY25 broadly in line. No material change in demand

- 1QFY25 revenue and margins were broadly along expected lines. Full-year revenue and growth guidance maintained
- Points to weakness in Auto ERDS space in Europe in EVs. Also indicates irrational competitive intensity in ADM/IMS renewals
- Client breadth is very narrow and like that of TCS. We are in the process of initiating coverage on the sector and on HCLT

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**HCLT's revenue declined less than expected:** HCLT's 1QFY25 revenue decline of 1.6% in constant currency (CC) terms was a tad better than its guidance of 2% decline. EBIT margin at 17.1% came in a tad below our estimate of 17.4%. HCLT's top five clients drove growth in the quarter. PAT beat was driven by other income from the State Street divestment. HCLT held on to its FY25 guidance of 3-5% CC revenue growth and 18-19% EBIT margin growth. Consensus EPS for FY25 will stay put post 1QFY25, in our view.

**Deals got pushed out:** The order inflow at ~US\$ 1.96bn came in at the lower end of our expected range (US\$ 2bn-2.5bn) as it saw some deals being pushed out (like what TCS indicated).

**Seasonal weakness comes into play:** HCLT saw US\$ QoQ weakness in BFSI (-4.7%), Manufacturing (-6.7%) and Life Sciences and Healthcare (-4.3%). The decline in BFSI was driven by the offshoring of a large client. The manufacturing decline was due to productivity gains being passed back to clients (typical during this time of the fiscal year), weakness in the auto segment (European) and asset revenue falling QoQ (US\$ 10mn). Pressure from the Med-tech business led to the decline in the Life Sciences and Healthcare parts of the business.

**Broadbased growth indicated for 2QFY25:** HCLT sees broad-based QoQ revenue growth in 2QFY25 across verticals and geographies. The only vertical that is not likely to grow QoQ will be BFSI because of the impact of the State Street divestiture (80bps impact).

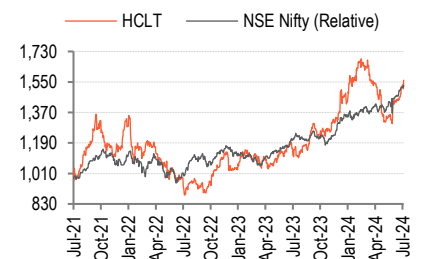
**Demand conditions remain the same:** HCLT indicated the business environment would be like what it was over the last few quarters – echoing the commentary of TCS.

**Discretionary spends still under pressure:** Management indicated discretionary spending would be under pressure, though there were a few pockets where such spends would happen. Especially if that led to cost benefits for the customer.

|                  |                   |
|------------------|-------------------|
| Ticker/Price     | HCLT IN/Rs 1,560  |
| Market cap       | US\$ 51.5bn       |
| Free float       | 38%               |
| 3M ADV           | US\$ 69.8mn       |
| 52wk high/low    | Rs 1,697/Rs 1,087 |
| Promoter/FPI/DII | 61%/17%/22%       |

Source: NSE | Price as of 11 Jul 2024

## Stock performance



Source: NSE



**Pressure in Auto ERDS in Europe:** A key takeaway will be for auto Engineering and R&D Services (ERDS) players where HCLT indicated weak demand from European Auto original equipment manufacturer (OEMs) on the electric vehicle (EV) front. The performance of ASAP (acquired entity in the Auto ERDS space in Germany) was disappointing in the quarter and HCLT believes the EV segment is going through stress due to various factors and that had led to some project rampdowns. HCLT's CEO Mr C Vijayakumar said that this is likely not specific to ASAP but a sector-wide phenomenon. However, he was positive on the Auto ERDS space over the long term. He expects ASAP to return to growth in 2QFY25 as it globalises its capabilities and cross sells its expertise to clients in other geographies.

**Irrational competitive pressure in renewals in ADM and IMS contracts:** On Application Development and Maintenance (ADM) and Infrastructure Management Services (IMS) contract renewals HCL indicated irrational competitive behaviour surrounding Gen AI productivity benefit pass-back to customers. We suspect Mr Vijayakumar was referring to competitors trying to attack HCLT's customer base by promising significant productivity benefits using Gen AI.

**Client breadth is a worry:** Both YoY- and QoQ-basis incremental revenue have been driven by the Telecom, Media, Publishing and Entertainment (TME) verticals. We guess this is largely the Verizon large deal growth playing out. This is akin to the BSNL deal driving growth for TCS in the last couple few quarters. The breadth of revenue growth seems to be missing for both players.

**Benefits of Gen AI:** On the extent of benefits due to Gen AI, HCLT pointed to four areas and the impact it will have:

- In Business Process Outsourcing (BPO) and testing it saw benefits to the extent of 50%, which it has even promised to clients.
- In ADM productivity the improvement can be as much as 10-30% by the adoption of GitHub Copilot. But HCLT said this would be a very gradual journey.
- In infrastructure applications and operations, where there is already considerable use of automation and machine learning, the incremental benefit is to the tune of 10%.
- In business innovation and data-led AI journeys, every existing application needs to be modernised with a Gen-AI kind of approach. Then even to leverage Gen-AI in an effective manner, a lot of customers need to continue their modernisation journey and the streamlining of data. So, there is a lot of opportunity in 'surround' services.

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