

NOT RATED**HCL TECHNOLOGIES**

| IT Services

| 15 October 2024

Modest beat. Guidance broadly maintained

- **Broad-based and better-than-expected growth. Guidance is broadly left unchanged. HCLT does not want to extrapolate strong 2Q into 2H**
- **Order inflow is the only weak spot, in our view. Believe Verizon likely contributed a large part of the incremental FY25 revenue**
- **2Q performance is unlikely to push up consensus EPS much. Stock unrated currently. Will be initiating coverage soon**

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Revenue growth better than HCLT's own expectation: 1.6% constant currency (CC) QoQ (2.4% US\$ QoQ) was a tad better than our 1.2% estimate. HCLT stated that it was better than its own expectation by US\$ 22mn (~65bps) as it witnessed broad-based strength. There was a 90bps negative impact due to State Street JV divestment QoQ.

Margin a tad better too: EBIT margin at 18.6% was better than our estimate of 18.3%. Of the 149bps increase QoQ, 54bps came from better performance of HCLT Software. The services margin increased by 110bps QoQ driven by operating efficiencies.

Broad-based growth: BFSI growth would have been 4% QoQ had it not been for the State Street divestment. Called out European Auto and Aerospace in general to be areas of worry. Indicated that discretionary spending was a tad better than in 1QFY25.

Guidance increased marginally: HCLT raised its FY25 revenue growth guidance to 3.5-5% from 3-5% due to the better performance in 2Q. This implies 0.7-2.6% CQGR growth for the next two quarters. It held on to its 18-19% EBIT margin guidance.

Cautious in extrapolating 2Q strength into 2H: Sounded cautious due to issues around macro, geopolitics and elections in the US. Indicated existence of client-specific issues in automotive and aerospace sub verticals.

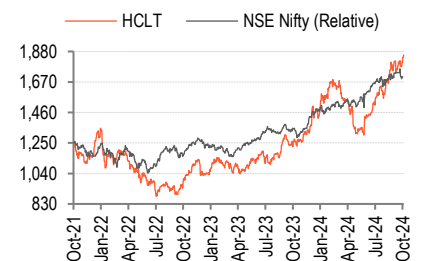
TCV is a bit disappointing: Just as in the case of TCS, we were a bit disappointed by the TCV (all net new) of US\$ 2.23bn as HCLT too had indicated that deals were pushed back from 1QFY25.

Large client impact: Just as the BSNL deal has likely driven growth for TCS in FY25, similarly we believe the Verizon deal has likely contributed to 60% of incremental revenue in FY25 for HCLT.

Ticker/Price	HCLT IN/Rs 1,856
Market cap	US\$ 59.9bn
Free float	39%
3M ADV	US\$ 57.2mn
52wk high/low	Rs 1,866/Rs 1,209
Promoter/FPI/DII	61%/18%/16%

Source: NSE | Price as of 14 Oct 2024

Stock performance



Source: NSE



HCL Software did well. Looks like some of the 3Q demand was brought forward. Despite a very strong performance in 2Q (9.4% YoY growth in CC terms), HCLT insisted that HCL Software would grow only in the mid-single digits in FY25.

Strong wins in GenAI-related programmes. Most of the deals are now getting embedded with AI capabilities. The company's GenAI platform AI force is now getting widely adopted for service transformation.

Management highlighted that 2Q growth was driven by two factors: the ramp-up of deals signed in the past two to three quarters, which includes a balance of efficiency-led deals, and significant opportunities in data, application modernisation and SAP. This mix of discretionary and non-discretionary growth provides confidence going forward.

Management indicated that the manufacturing segment, particularly automotive in Europe, is facing headwinds due to significant cost reductions and programme cancellations among large clients, a trend that began in 2Q. However, strong growth in the SAP business is partially offsetting these challenges.

Management stated that the wage hike (beginning on 1 October) will impact margins by 65 to 80 bps in 3Q, with an additional effect of 50 to 60 bps expected in 4Q.

HCLT noted a slight decline in headcount despite strong growth, explaining that the wage bill has increased. HCLT highlighted ongoing shifts in the workforce pyramid towards more specialised skills. Future hiring will focus on higher-end skills, with the wage bill expected to increase in line with growth. Even in fresher hiring it indicated a preference for specialised skills.

HCLT outlined assumptions for achieving the upper end of the 0-2% guidance for the services business, including expectations of similar furloughs as FY24 and the successful execution of signed deals, with some remaining from the previous quarter. It noted a strong pipeline, close to all-time highs, and anticipated good bookings for the remainder of the year.

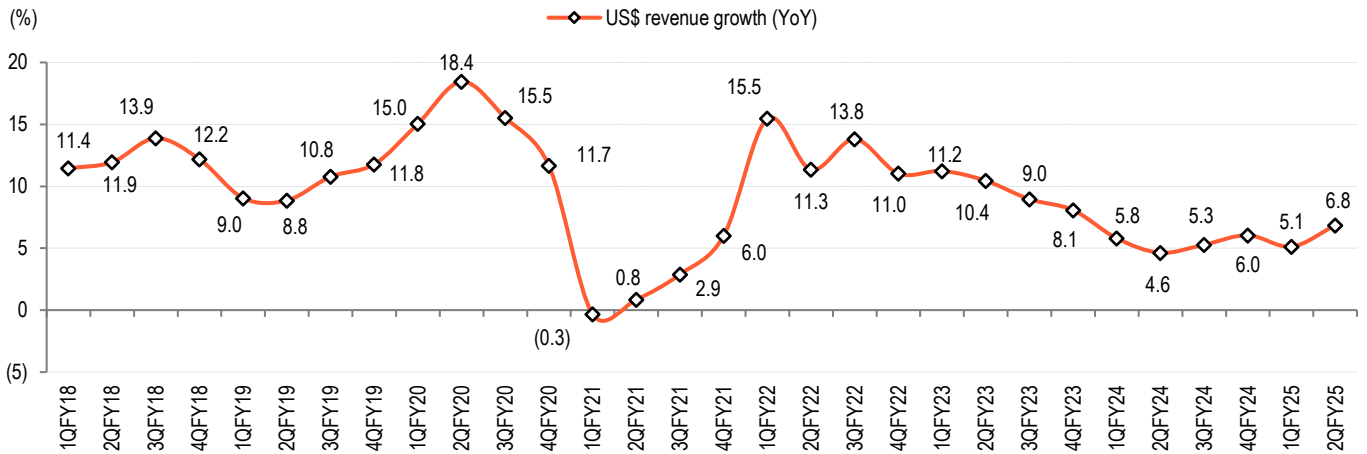
HCLT has not assumed any contribution from the HPE Communication Technology Group (CTG) in the guidance. HCLT thinks that the revenue will be added in 3QFY25.

Fig 1 – Quarterly results: Comparison of actuals with estimates

Y/E March (Rs bn)	2QFY24	1QFY25	2QFY25	YoY (%)	QoQ (%)	2QFY25E	Dev (%)
Net sales (US\$ mn)	3,225	3,364	3,445	6.8	2.4	3,430	0.5
Net sales	267	281	289	8.2	2.9	287	0.4
Employee costs	170	184	188	10.4	2.3	186	1.1
Gross margin % of sales	36.2	34.5	34.9			35.3	
SG&A	37	39	37	(0.3)	(5.0)	39	(5.0)
% of sales	13.9	13.9	12.8			13.6	
Depreciation and amortisation	10	10	10	(0.3)	0.9	10	1.1
% of sales	3.8	3.6	3.5			3.5	
EBIT	49.3	48.0	53.6	8.7	11.8	52.6	1.9
EBIT Margin (%)	18.5	17.1	18.6			18.3	
Other Income	2	8	3	54.1	(61.3)	3	15.0
Forex gain/(loss)	-0	1	0			0	
PBT	51	57	57	10.9	(0.4)	56	2.2
Provision for tax	13	14	15	12.0	0.1	14	2.7
Effective tax rate	25.3	25.4	25.5			25.4	
Minority share in profit / loss	0	0	0			0	
One-time bonus and DTL for Goodwill	0	0	0			0	
PAT (Reported)	38.3	42.6	42.4	10.5	(0.5)	41.5	2.0
NPM (%)	14.4	15.2	14.7			14.4	

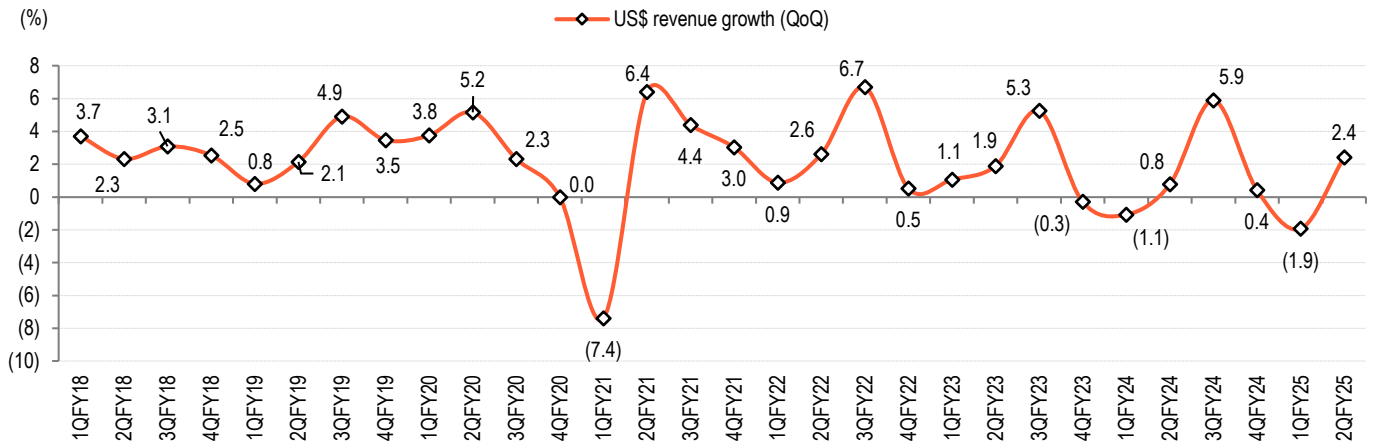
Source: Company, BOBCAPS Research

Fig 2 – US\$ revenue growth (YoY)



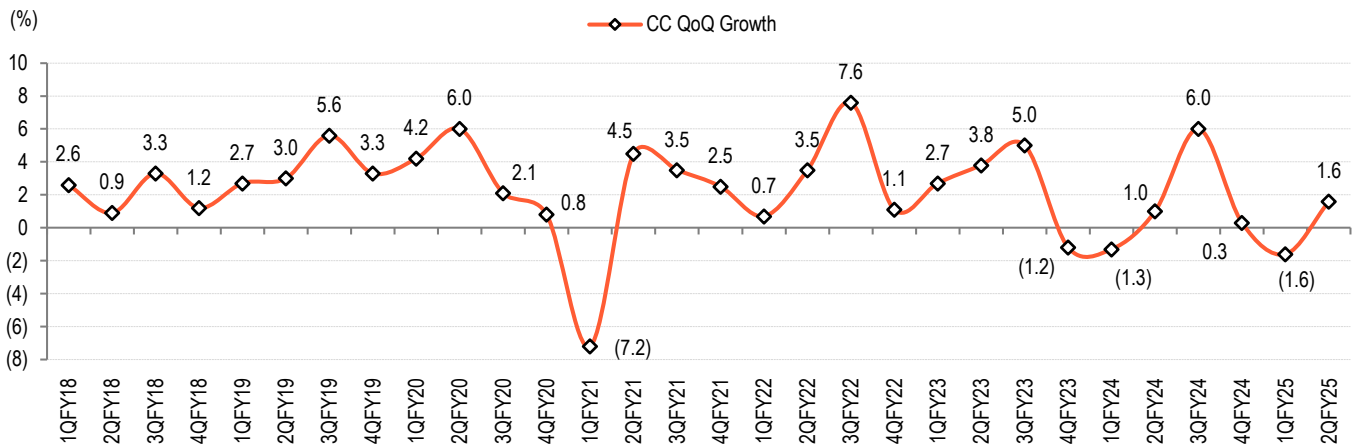
Source: Company, BOBCAPS Research

Fig 3 – US\$ revenue growth (QoQ)



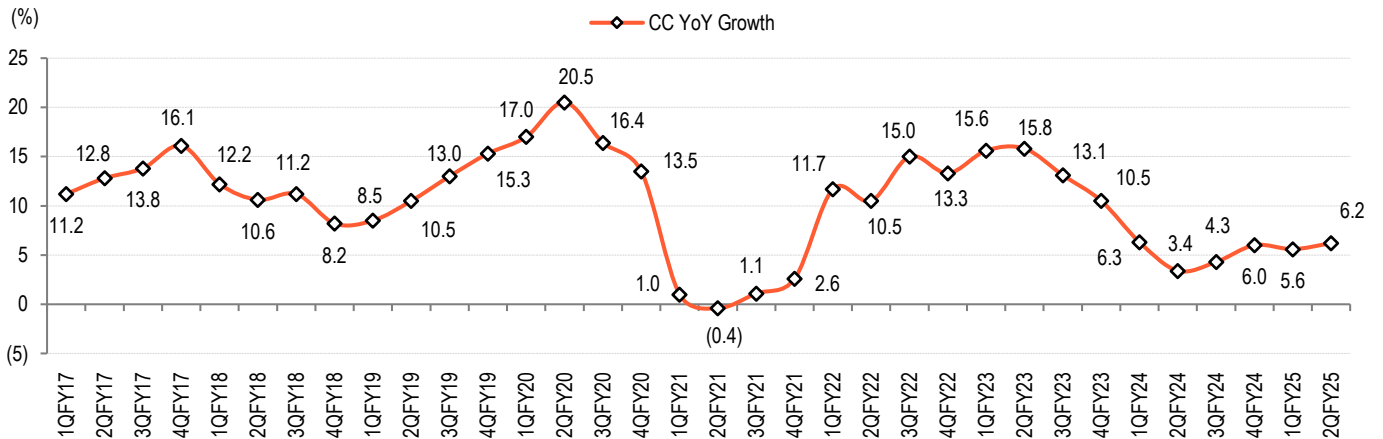
Source: Company, BOBCAPS Research

Fig 4 – QoQ CC revenue growth



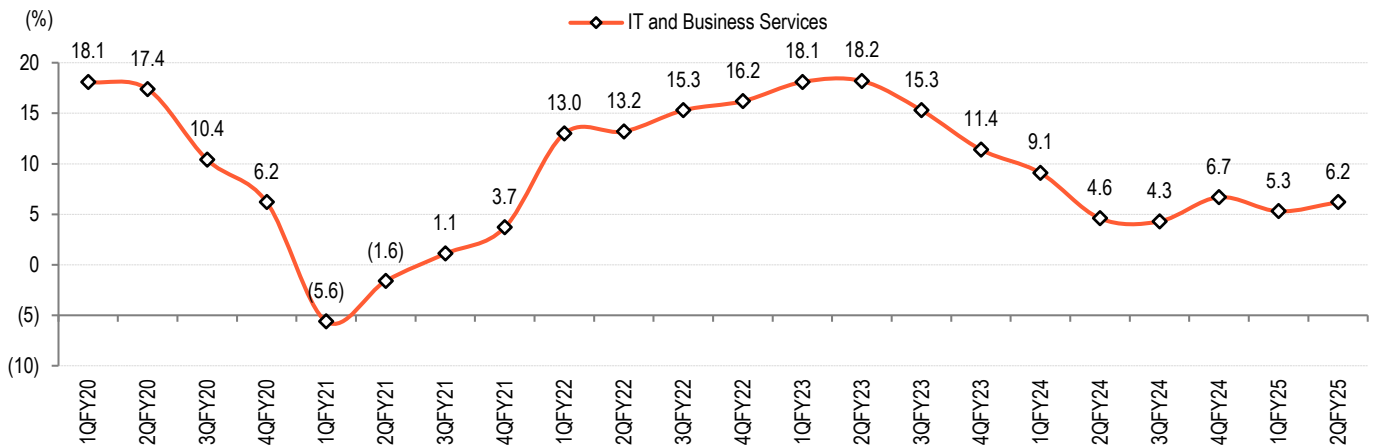
Source: Company, BOBCAPS Research

Fig 5 – Overall revenue growth YoY CC



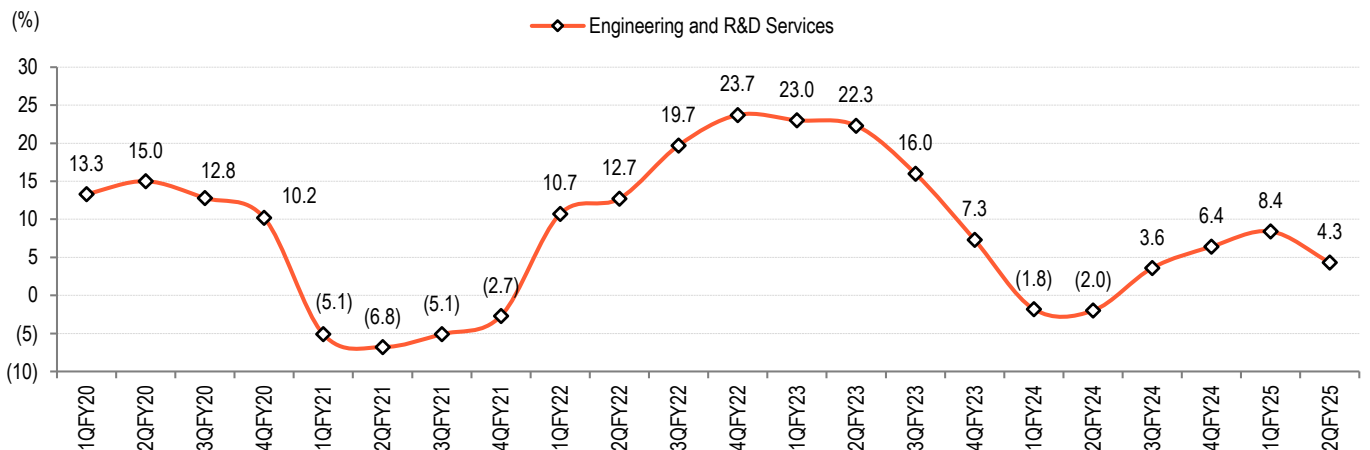
Source: Company, BOBCAPS Research

Fig 6 – ITBS growth YoY CC



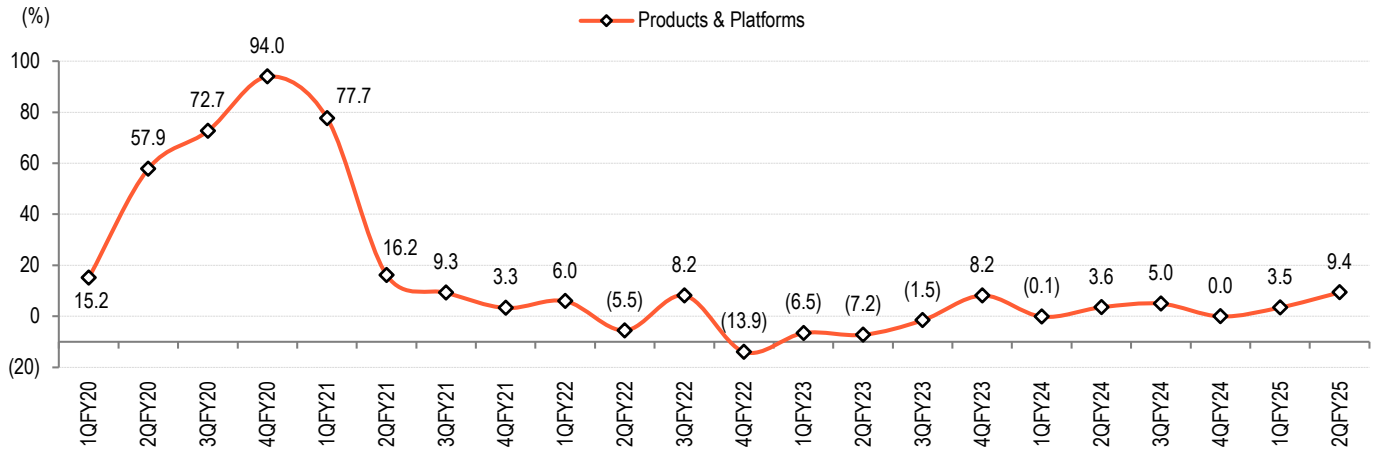
Source: Company, BOBCAPS Research

Fig 7 – ERDS growth YoY CC



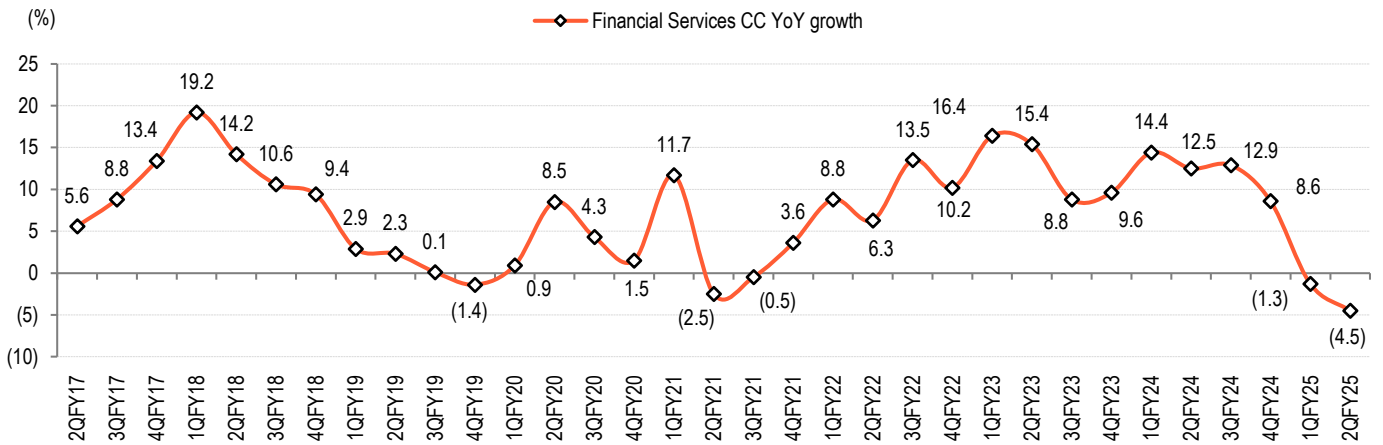
Source: Company, BOBCAPS Research

Fig 8 – Products and Platforms growth YoY CC



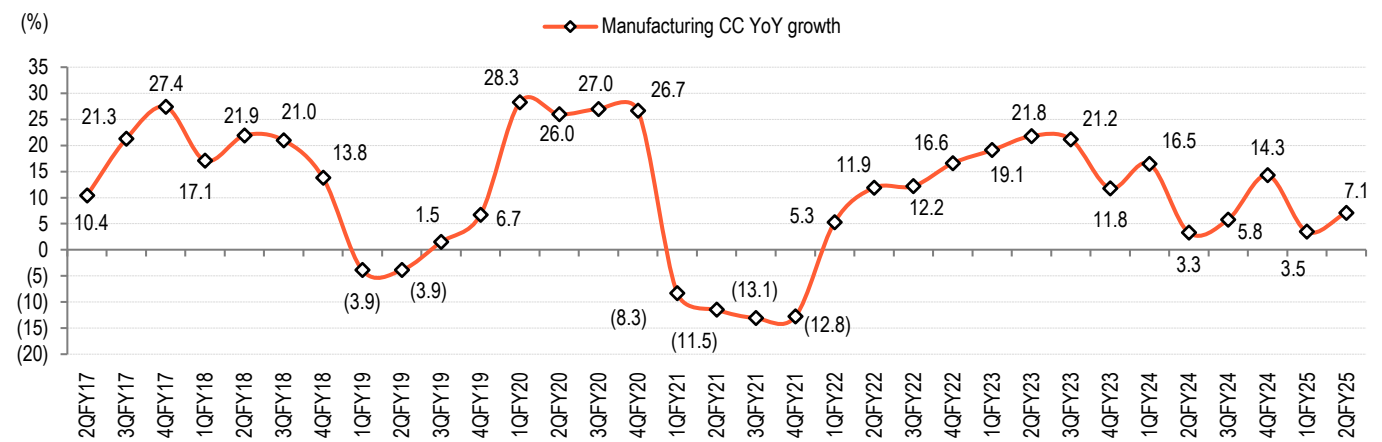
Source: Company, BOBCAPS Research

Fig 9 – BFSI growth YoY CC – impacted by the State street divestment.



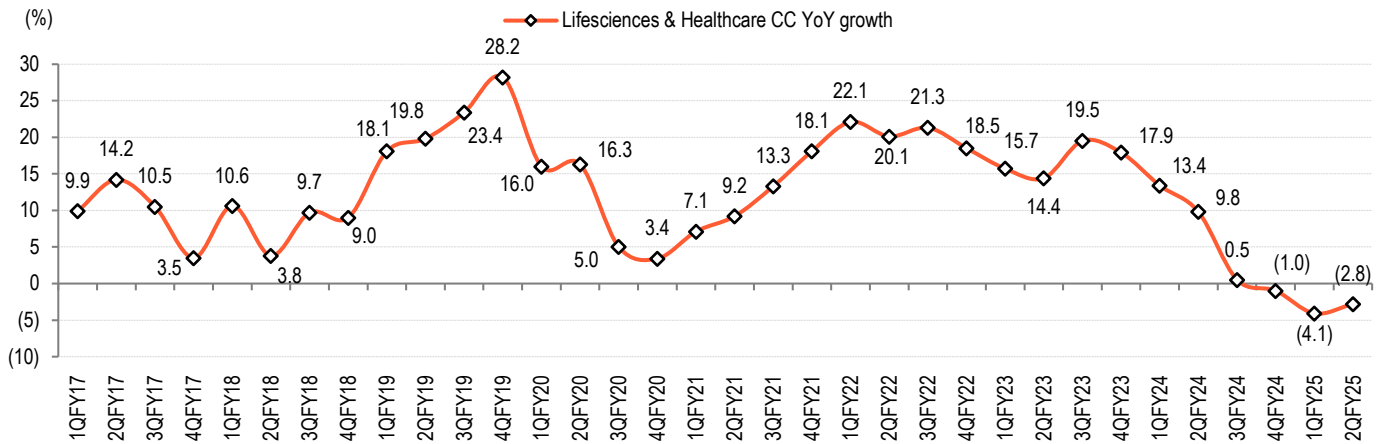
Source: Company, BOBCAPS Research

Fig 10 – Manufacturing growth YoY CC



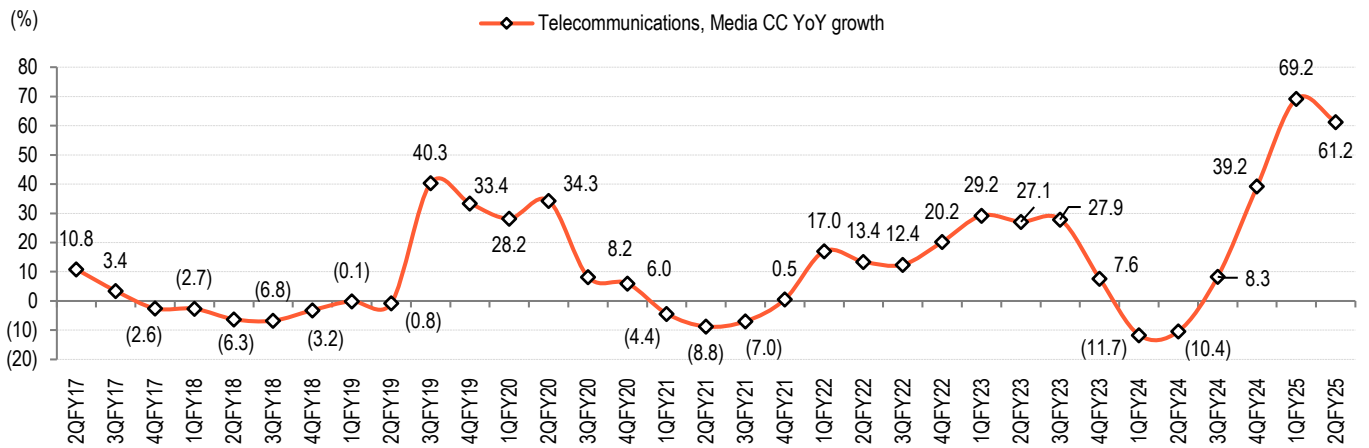
Source: Company, BOBCAPS Research

Fig 11 – Lifesciences and Healthcare growth YoY CC



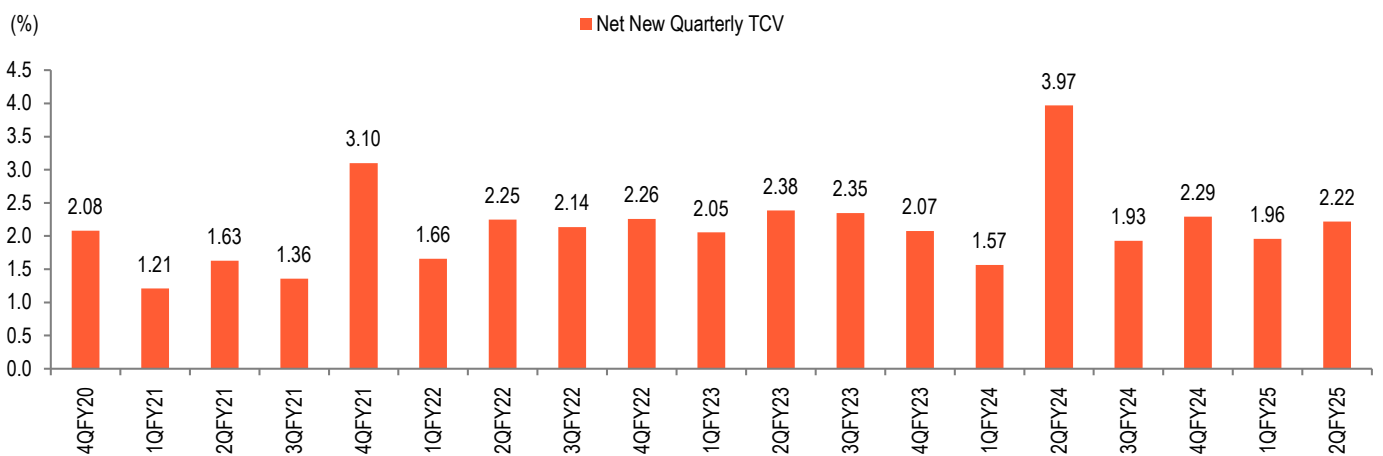
Source: Company, BOBCAPS Research

Fig 12 – Telecom, Media Growth YoY CC – big impact of the Verizon deal



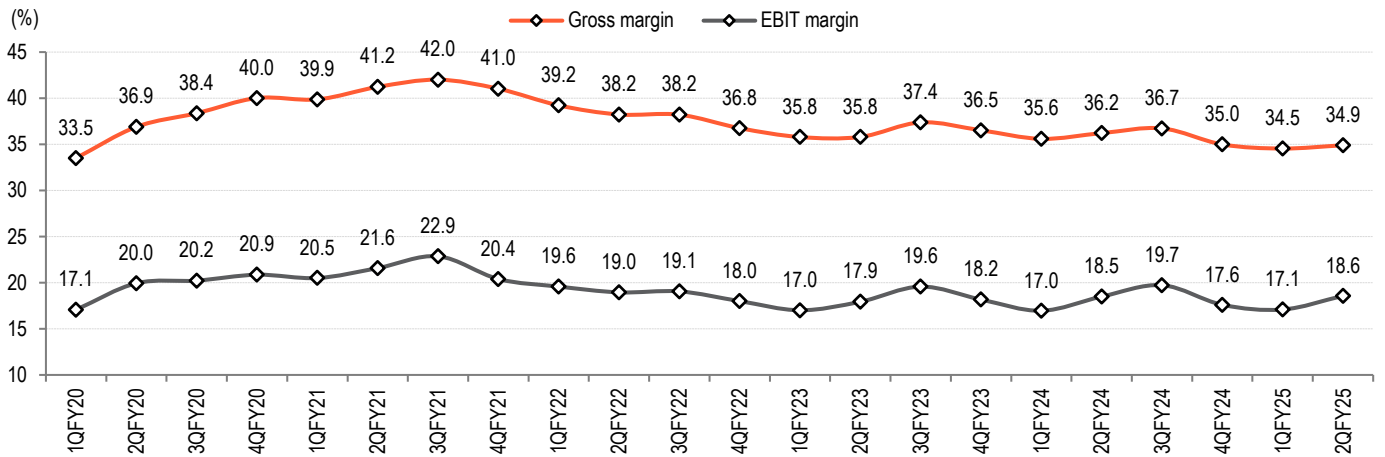
Source: Company, BOBCAPS Research

Fig 13 – Quarterly net new TCV wins (US\$ bn)



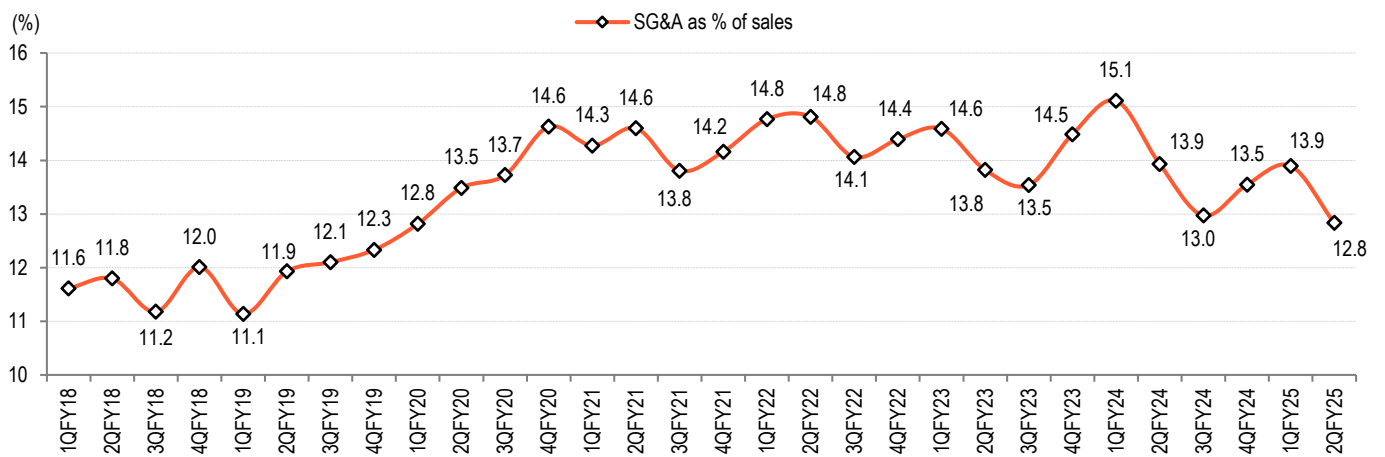
Source: Company, BOBCAPS Research

Fig 14 – Gross margin and EBIT margin



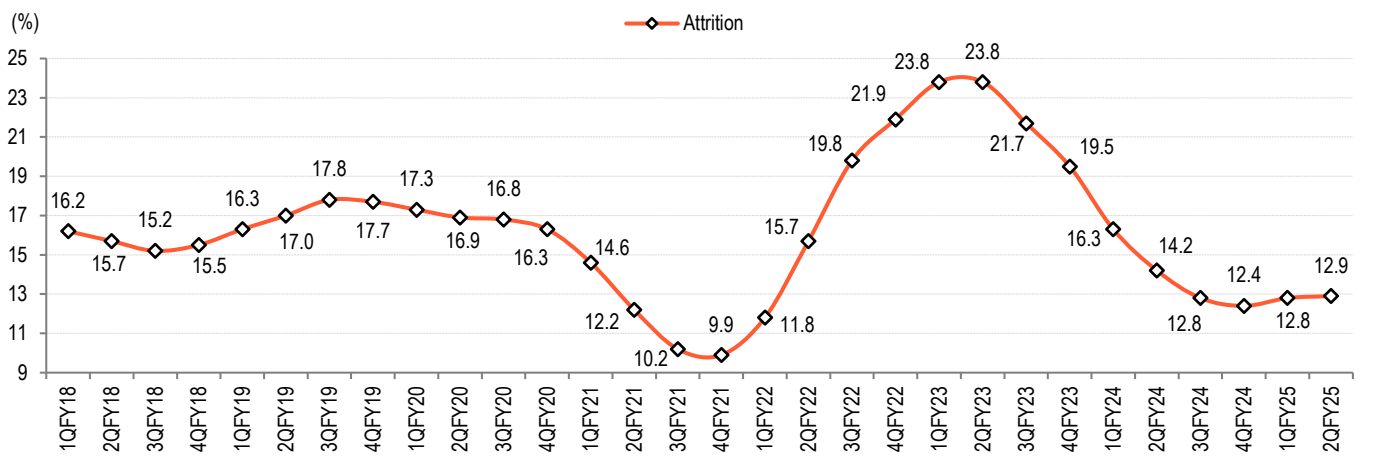
Source: Company, BOBCAPS Research

Fig 15 – SG&A spending

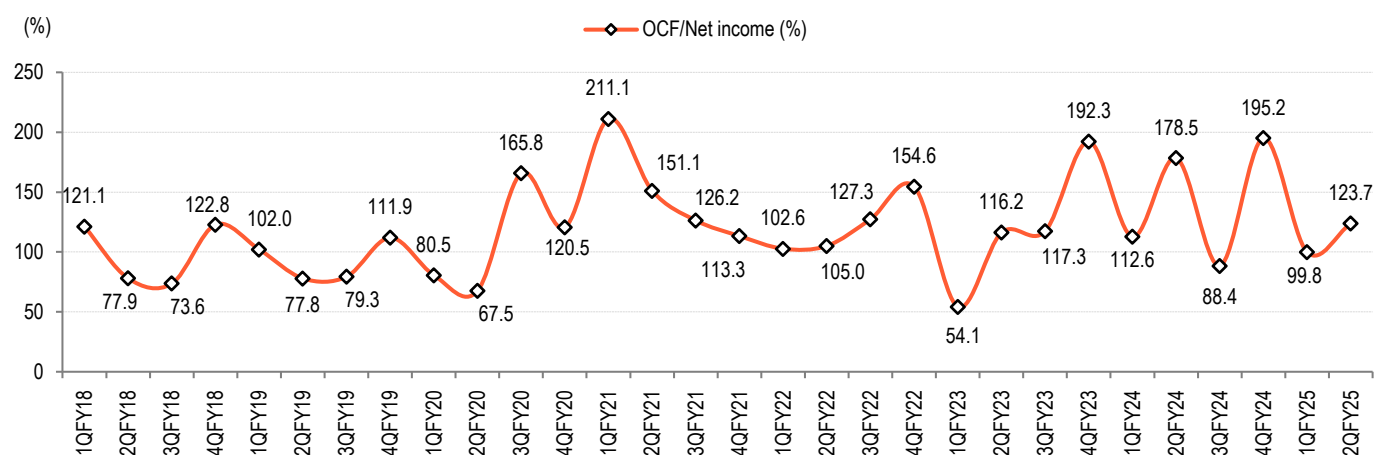


Source: Company, BOBCAPS Research

Fig 16 – Attrition trends



Source: Company, BOBCAPS Research

Fig 17 – OCF/ net income trend

Source: Company, BOBCAPS Research | OCF: Operating cash flow

Fig 18 – Quarterly snapshot

Year to 31 Mar (Rs mn)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
INR/US\$	77.62	79.98	82.34	82.30	82.17	82.72	83.28	83.10	83.40	83.79
US\$ revenue (US\$ mn)	3,025	3,082	3,244	3,235	3,200	3,225	3,415	3,430	3,364	3,445
INR revenue	2,34,640	2,46,860	2,67,000	2,66,060	2,62,960	2,66,720	2,84,460	2,84,990	2,80,570	2,88,620
Gross margin	83,980	88,380	99,800	97,170	93,600	96,590	1,04,480	99,720	96,930	1,00,730
EBITDA	49,750	54,260	63,650	58,630	53,870	59,440	67,580	61,110	57,940	63,690
EBIT	39,920	44,280	52,290	48,360	44,600	49,340	56,150	50,180	47,960	53,620
Other income	3,450	1,570	1,440	3,570	2,360	1,940	2,590	2,510	9,120	3,250
PBT	43,370	45,850	53,730	51,930	46,960	51,280	58,740	52,690	57,080	56,870
Tax	10,560	10,960	12,760	12,120	11,650	12,950	15,230	12,740	14,480	14,500
PAT	32,830	34,900	40,970	39,830	35,340	38,320	43,500	39,860	42,580	42,350
EPS	12.1	12.9	15.1	14.7	13.0	14.1	16.0	14.7	15.7	15.6
YoY growth (%)										
US\$ revenue	11.2	10.4	9.0	8.1	5.8	4.6	5.3	6.0	5.1	6.8
INR revenue	16.9	19.5	19.6	17.7	12.1	8.0	6.5	7.1	6.7	8.2
Gross profit	6.7	11.9	17.0	17.0	11.5	9.3	4.7	2.6	3.6	4.3
EBITDA	1.4	12.2	18.0	16.0	8.3	9.5	6.2	4.2	7.6	7.2
EBIT	1.6	13.1	22.8	18.8	11.7	11.4	7.4	3.8	7.5	8.7
Net profit	2.1	6.9	19.0	10.9	7.6	9.8	6.2	0.1	20.5	10.5
QoQ growth (%)										
US\$ revenue	1.1	1.9	5.3	(0.3)	(1.1)	0.8	5.9	0.4	(1.9)	2.4
INR revenue	3.8	5.2	8.2	(0.4)	(1.2)	1.4	6.7	0.2	(1.6)	2.9
EBITDA	(1.5)	9.1	17.3	(7.9)	(8.1)	10.3	13.7	(9.6)	(5.2)	9.9
EBIT	(1.9)	10.9	18.1	(7.5)	(7.8)	10.6	13.8	(10.6)	(4.4)	11.8
Net profit	(8.6)	6.3	17.4	(2.8)	(11.3)	8.4	13.5	(8.4)	6.8	(0.5)
Margins (%)										
Gross margin	35.8	35.8	37.4	36.5	35.6	36.2	36.7	35.0	34.5	34.9
EBITDA	21.2	22.0	23.8	22.0	20.5	22.3	23.8	21.4	20.7	22.1
EBIT	17.0	17.9	19.6	18.2	17.0	18.5	19.7	17.6	17.1	18.6
PAT	14.0	14.1	15.3	15.0	13.4	14.4	15.3	14.0	15.2	14.7
SGA	14.6	13.8	13.5	14.5	15.1	13.9	13.0	13.5	13.9	12.8

Source: Company, BOBCAPS Research

Fig 19 – Key metrics

Key Metrics	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
P&L (Rs mn)										
Revenue	2,34,640	2,46,860	2,67,000	2,66,060	2,62,960	2,66,720	2,84,460	2,84,990	2,80,570	2,88,620
EBITDA	49,750	54,260	63,650	58,630	53,870	59,440	67,580	61,110	57,940	63,690
PAT	32,830	34,900	40,970	39,830	35,340	38,320	43,500	39,860	42,580	42,350
Vertical mix (%)										
Banking, FS & Insurance (BFSI)	21.1	20.6	19.9	21.2	22.6	22.6	21.7	21.6	21.0	20.5
Hi-tech - Manufacturing	18.3	19.2	19.7	19.0	19.9	19.3	20.1	20.4	19.4	19.5
Telecom	9.2	9.2	9.4	8.8	7.6	8.0	9.7	11.5	12.2	12.1
Retail & CPG	9.4	9.2	8.9	9.0	9.1	9.6	9.6	9.1	9.4	9.6
Life Sciences	16.4	16.5	17.1	17.5	17.5	17.5	16.4	16.3	15.9	16.0
Energy-Utilities-Public Sector	10.2	10.2	10.2	10.2	10.0	9.9	9.7	8.8	9.1	9.2
Technology and Services	15.4	15.1	14.8	14.4	13.4	13.1	12.8	12.3	13.0	13.1
Geographical mix (%)										
US	64.2	64.8	63.5	63.8	64.5	64.5	64.5	65.2	66.0	65.1
Europe	27.8	27.5	29.1	28.9	28.7	28.5	29.0	28.9	27.9	28.4
Asia Pacific	8.0	7.7	7.4	7.3	6.8	7.0	6.4	5.9	6.1	6.5
Employees	2,10,966	2,19,325	2,22,270	2,25,944	2,23,438	2,21,139	2,24,756	2,27,481	2,19,401	2,18,621
Net new addition	2,089	8,359	2,945	3,674	(2,506)	(2,299)	3,617	2,725	(8,080)	(780)
Attrition (%)	23.8	23.8	21.7	19.5	16.3	14.2	12.8	12.4	12.8	12.9
Segmental revenue mix										
IT and Business Services	72.8	73.7	71.6	73.7	74.7	74.6	71.7	74.4	74.5	74.6
Engineering and R&D Services	16.6	17	16.6	16.1	15.4	16	16.4	16.1	15.9	15.8
Products & Platforms	11	9.8	12.3	10.6	10.4	9.9	12.3	10	9.9	9.9
Inter Segment	(0.4)	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)	(0.4)	(0.5)	(0.3)	(0.3)

Source: Company, BOBCAPS Research

Fig 20 – YoY and QoQ performance on various parameters

	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
QoQ growth (%)										
Geography wise										
US	3.3	2.8	3.1	0.2	0.0	0.8	5.9	1.5	(0.7)	1.0
Europe	(0.7)	0.8	11.4	(1.0)	(1.8)	0.1	7.8	0.1	(5.3)	4.3
Asia Pacific	(9.2)	(1.9)	1.2	(1.6)	(7.8)	3.7	(3.2)	(7.4)	1.4	9.1
Total	1.1	1.9	5.3	(0.3)	(1.1)	0.8	5.8	0.5	(1.9)	2.4
Non-US	(2.7)	0.2	9.1	(1.1)	(3.0)	0.8	5.6	(1.3)	(4.2)	5.1
Vertical wise										
Banking, FS & Insurance (BFSI)	2.0	(0.5)	1.7	6.2	5.5	0.8	1.7	(0.0)	(4.7)	(0.0)
Hi-tech - Manufacturing	2.7	6.9	8.0	(3.8)	3.6	(2.3)	10.3	1.9	(6.7)	2.9
Telecom	8.1	1.9	7.5	(6.7)	(14.6)	6.1	28.4	19.1	4.0	1.6
Retail	1.1	(0.3)	1.8	0.8	0.0	6.3	5.9	(4.8)	1.3	4.6
Life Sciences	11.2	2.5	9.1	2.0	(1.1)	0.8	(0.8)	(0.2)	(4.3)	3.1
Energy-Utilities-Public Sector	(3.7)	1.9	5.3	(0.3)	(3.0)	(0.2)	3.8	(8.9)	1.4	3.5
Technology & Services	(11.1)	(0.1)	3.2	(3.0)	(7.9)	(1.5)	3.5	(3.5)	3.7	3.2
Client concentration										
Top 5 clients	(2.4)	(2.7)	1.3	(2.2)	(4.0)	0.8	5.9	0.4	14.1	8.7
Top 10 clients	(1.0)	(1.3)	1.9	(3.0)	(3.9)	0.8	9.0	0.4	8.6	5.0
Top 20 clients	0.4	0.8	3.8	(1.7)	(3.2)	1.1	8.6	0.4	5.4	4.8
Segment wise										
IT and Business Services	0.2	3.2	2.3	2.6	0.3	0.6	1.8	4.2	(1.8)	2.6
Engineering and R&D Services	2.5	4.3	2.8	(3.3)	(5.4)	4.7	8.5	(1.4)	(3.1)	1.8
Products & Platforms	3.3	(9.2)	32.1	(14.1)	(2.9)	(4.1)	31.6	(18.3)	(2.9)	2.4
YoY growth (%)										
Geography wise										
US	13.2	14.0	9.8	9.8	6.3	4.1	6.9	8.4	7.6	7.8
Europe	10.8	7.3	12.0	10.4	9.2	8.4	4.9	6.0	2.2	6.5
Asia Pacific	(1.1)	(4.4)	(7.3)	(11.4)	(10.1)	(4.9)	(9.0)	(14.3)	(5.7)	(0.8)
Total	11.2	10.4	9.0	8.1	5.8	4.6	5.2	6.0	5.1	6.8
Non-US	7.9	4.5	7.5	5.2	4.9	5.5	2.1	1.9	0.7	5.0
Vertical wise										
Banking, FS & Insurance (BFSI)	6.2	6.8	2.8	9.6	13.3	14.8	14.8	8.0	(2.3)	(3.1)
Hi-tech - Manufacturing	18.3	18.5	22.6	14.1	15.0	5.2	7.4	13.9	2.5	7.9
Telecom	29.5	28.6	26.4	10.6	(12.6)	(9.0)	8.6	38.6	68.7	61.6
Retail	4.6	3.7	(4.0)	3.5	2.4	9.2	13.6	7.2	8.6	6.8
Life Sciences	24.1	19.1	29.4	26.9	12.9	11.0	1.0	(1.2)	(4.5)	(2.3)
Energy-Utilities-Public Sector	5.0	6.3	6.9	3.0	3.7	1.5	0.1	(8.5)	(4.3)	(0.7)
Technology & Services	(1.0)	(3.0)	(12.4)	(11.1)	(8.0)	(9.2)	(9.0)	(9.4)	2.0	6.8
Client concentration										
Top 5 clients	(4.2)	(7.0)	(8.0)	(5.9)	(7.4)	(4.2)	0.2	2.9	22.3	31.9
Top 10 clients	3.7	0.3	(2.3)	(3.4)	(6.2)	(4.3)	2.4	6.0	19.8	24.9
Top 20 clients	5.7	5.6	4.5	3.2	(0.4)	(0.1)	4.5	6.8	16.3	20.5
Segment wise										
IT and Business Services	13.2	12.1	10.5	8.5	8.5	5.9	5.4	7.0	4.8	6.8
Engineering and R&D Services	20.5	19.6	13.8	6.3	(1.9)	(1.5)	4.0	6.0	8.5	5.5
Products & Platforms	(9.9)	(11.0)	(4.1)	6.4	0.0	5.7	5.3	0.0	0.1	6.8

Source: Company, BOBCAPS Research

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Note: Recommendation structure changed with effect from 21 June 2021

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