

**HOLD**

TP: Rs 1,449 | ▲ 10%

**HCL TECHNOLOGIES**

Technology &amp; Internet

09 May 2024

## Weak guidance leads to subdued outlook

- Revenue growth guidance of 3-5% for FY25, likely to be similar to FY24
- ER&D Services to remain soft in the near term
- We assume coverage with a HOLD rating and a TP of Rs 1,449 based on 21x P/E of FY26E EPS (5Y average of P/E)

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**Disappointing growth guidance; services to drive growth:** Management guided for 3-5% growth for FY25, implying a decline in revenue in Q1FY25 due to productivity impact in annuity deals and off-shoring impact of large deal wins, coupled with subsequent growth in H2FY25 (1-2.5% CQGR). HCLT posted revenue of US\$ 3.4bn, 0.4% QoQ and 6% YoY, driven by the ramp-up of the Verizon and other large deals. IT&BS grew 4% QoQ while ER&D services declined 1.6% QoQ; software business fell sequentially due to seasonality but was flat YoY. Continued investments in the digital business paid well for HCLT to create a well-diversified portfolio and integrate IT sales. It will also allow ER&D to provide a wide range of services to clients, mine more clients and add new logos.

**Moderate growth in deal wins; product performance likely to continue:** Net new deal total contract value (TCV) during the quarter stood at US\$ 9.8bn, up sequentially by 18% and 10% YoY, including US\$ 2.1bn (Verizon deal). Large deal volumes were higher with 13 deals in services (total of 36 in FY24), aiding visibility, and the deal pipeline remains healthy with mega deals in the mix on the back of increased focus on renewals and cost take-out deals

**Positive changes in leadership team in Q4:** Restructuring through changes in roles/responsibilities worked well for HCLT. Kalyan Kumar is now heading HCL Software as Chief Product Officer. Vijay Guntur became Chief Technical Officer (was head of ER&D Services) and Hari Sadarahalli now heads ER&D /Delivery.

**Weak Q4 margin; guidance stable at 18-19%:** EBITM came in at 17.6%, down sequentially due to software seasonality, wage hikes in the services business, forex fluctuations and other seasonal factors.

**Valuation outlook:** Despite near-term headwinds, HCLT's leadership in infrastructure/engineering services, higher application portfolio, steady margin and healthy cashflow remain intact. The stock is trading at 21.2/19.1x FY25E/FY26E EPS. We assume coverage with a HOLD rating and TP of Rs 1,449 based on 21x P/E on FY26E EPS (5Y average of P/E).

## Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HCLT IN/Rs 1,314
Market cap	US\$ 43.4bn
Free float	38%
3M ADV	US\$ 61.0mn
52wk high/low	Rs 1,697/Rs 1,063
Promoter/FPI/DII	61%/17%/22%

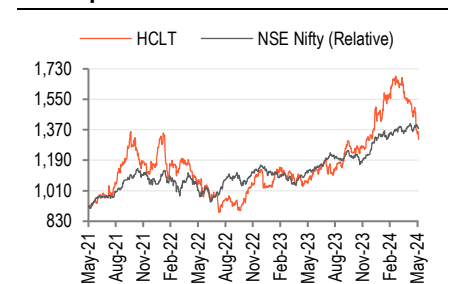
Source: NSE | Price as of 8 May 2024

## Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	10,99,130	11,66,539	12,44,967
EBITDA (Rs mn)	2,42,000	2,56,639	2,80,118
Adj. net profit (Rs mn)	1,57,100	1,68,451	1,87,111
Adj. EPS (Rs)	57.9	62.1	69.0
Consensus EPS (Rs)	57.9	62.5	69.9
Adj. ROAE (%)	23.5	23.9	24.9
Adj. P/E (x)	22.7	21.2	19.1
EV/EBITDA (x)	14.6	13.7	12.5
Adj. EPS growth (%)	5.8	7.2	11.1

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE

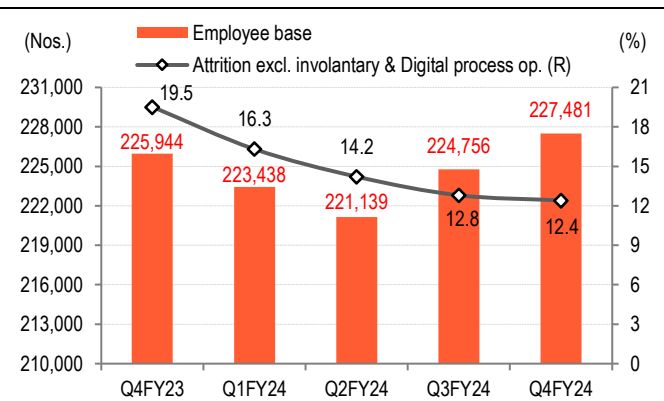


**Fig 1 – Quarterly performance**

(Rs mn)	Q4FY24	Q3FY23	Q4FY23	QoQ (%)	YoY (%)
Revenue (US\$ mn)	3,430	3,415	3,235	0.4	6.0
Revenue (Rs mn)	284,990	284,460	266,060	0.2	7.1
EBIT	50,180	56,150	48,360	(10.6)	3.8
PAT	39,860	43,500	39,830	(8.4)	0.1
EBIT Margin (%)	17.6	19.7	18.2	(213bps)	(57bps)
PAT Margin (%)	14.0	15.3	15.0	(131bps)	(98bps)

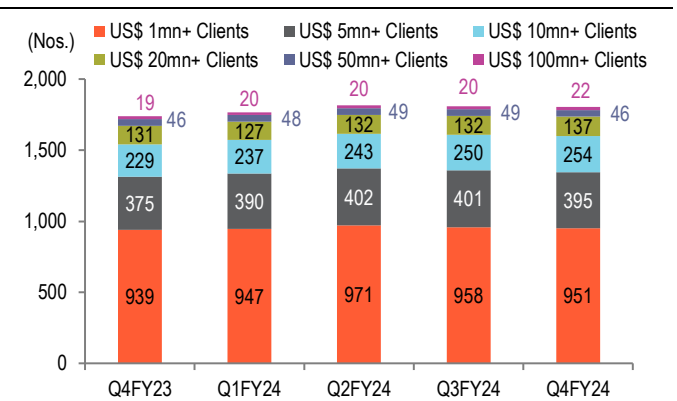
Source: Company, BOBCAPS Research

**Fig 2 – Employee base & attrition**



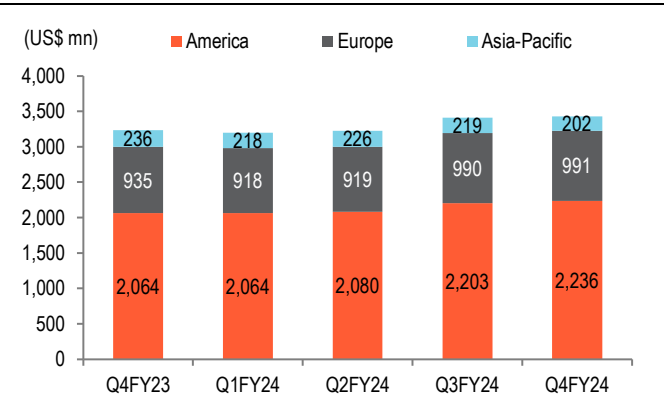
Source: Company, BOBCAPS Research

**Fig 3 – Client categories**



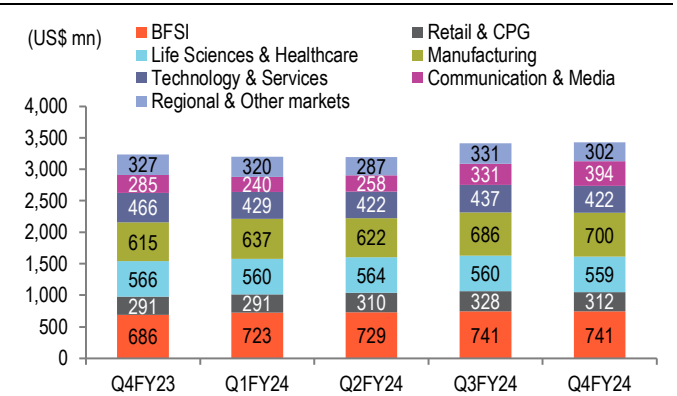
Source: Company, BOBCAPS Research

**Fig 4 – Revenue by geography**



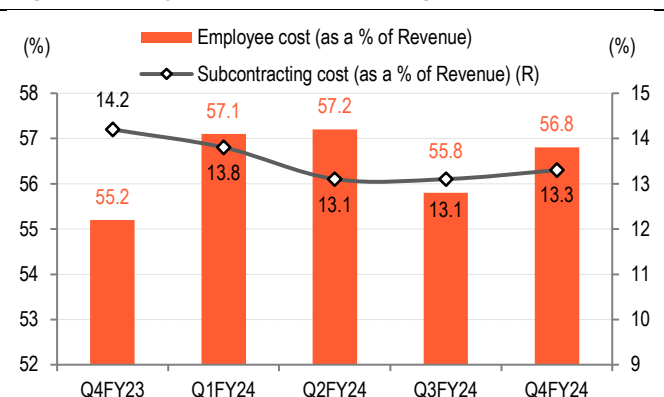
Source: Company, BOBCAPS Research

**Fig 5 – Revenue by vertical**



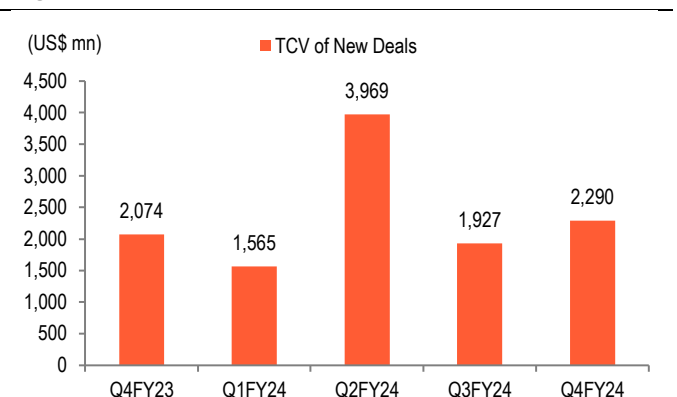
Source: Company, BOBCAPS Research

**Fig 6 – Employee and subcontracting cost**



Source: Company, BOBCAPS Research

**Fig 7 – Order book**



Source: Company, BOBCAPS Research

## Earnings call takeaways

- Management guided for FY25 revenue growth in at 3-5% YoY constant currency (CC), and the same for services. EBIT margin for FY25 is stable at 18-19%.
- Digital business contributed 37.3% of revenue, up 5.3% CC YoY. Cloud transformation and cyber grew well followed by SaaS.
- ER&D decline in Q4 was temporary and will grow in H1FY25.
- Gen AI opportunities exist in two directions (1) efficiency and (2) scalability.
- New deal wins TCVs stood at US\$ 2.3mn, up 10% YoY. For the whole year, new deal wins TCVs stood at US\$ 9.8bn. The company bagged 73 large deals in total for the whole year and 21 in Q4FY24. The pipeline is better and likely to grow, aided by ER&D opportunities.
- Europe and America grew by 4.2%/ 2.3% CC QoQ and the Rest of the World declined 5.9% CC QoQ.
- During the quarter, the Manufacturing vertical grew 4.1%, BFSI 2.8%, Healthcare 2% and Telecom 21.6%.
- Attrition stood at 12.4%. Net headcount additions during the quarter stood at 2,725, total freshers hired were 3,096 and total headcount stood at 227,481. Management expects to hire 10k freshers in 2025.
- Q4FY24 operating cash flow (OCF) and free cash flow (FCF) stood at US\$ 2.7bn/2.6bn and came in at 142%/135% of net income (on an LTM basis), respectively. Net cash balance was US\$ 3.1bn, up by 22.6%YoY.
- Interim dividend was Rs18 and the total dividend for FY24 was Rs 52.

### Valuation methodology

Despite near-term headwinds, HCLT's leadership in infrastructure/engineering services, higher application portfolio, steady margin and healthy cashflow remain intact. The stock is trading at 21.2/19.1x FY25E/FY26E EPS. We assume coverage with a HOLD rating and TP of Rs 1,449 based on 21x P/E on FY26E EPS (5Y average of P/E).

### Key risks

- Lower services deal wins may lead to downside risk, and
- further increase in interest rate may impose upside risk.

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24A	FY25E	FY26E
<b>Total revenue</b>	<b>8,56,510</b>	<b>10,14,560</b>	<b>10,99,130</b>	<b>11,66,539</b>	<b>12,44,967</b>
EBITDA	2,01,920	2,26,290	2,42,000	2,56,639	2,80,118
Depreciation	40,190	41,440	41,730	44,328	44,819
EBIT	1,61,730	1,84,850	2,00,270	2,12,310	2,35,299
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	8,260	10,030	9,400	11,100	11,550
Exceptional items	0	0	0	0	0
EBT	1,69,990	1,94,880	2,09,670	2,23,410	2,46,849
Income taxes	34,430	46,420	52,570	54,959	59,737
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>1,35,560</b>	<b>1,48,460</b>	<b>1,57,100</b>	<b>1,68,451</b>	<b>1,87,111</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>1,35,560</b>	<b>1,48,460</b>	<b>1,57,100</b>	<b>1,68,451</b>	<b>1,87,111</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24A	FY25E	FY26E
Accounts payables	6,278	6,428	5,853	6,247	7,059
Other current liabilities	1,96,452	2,23,052	2,45,807	2,38,726	2,54,384
Provisions	23,700	24,350	29,490	34,996	37,349
Debt funds	68,460	50,580	63,480	63,480	63,480
Other liabilities	0	0	0	0	0
Equity capital	5,430	5,430	5,430	5,430	5,430
Reserves & surplus	6,13,710	6,48,620	6,77,200	7,19,313	7,75,446
Shareholders' fund	6,19,140	6,54,050	6,82,630	7,24,743	7,80,876
<b>Total liab. and equities</b>	<b>9,14,030</b>	<b>9,58,460</b>	<b>10,27,260</b>	<b>10,68,192</b>	<b>11,43,148</b>
Cash and cash eq.	1,05,100	90,650	94,560	1,34,087	1,83,687
Accounts receivables	2,19,040	2,64,150	2,63,300	2,55,680	2,72,870
Inventories	0	0	0	0	0
Other current assets	1,38,870	1,31,060	1,27,460	1,39,985	1,49,396
Investments	84,680	1,11,540	1,78,310	1,78,310	1,78,310
Net fixed assets	80,550	77,480	79,090	75,590	74,345
CWIP	1,290	400	1,080	1,080	1,080
Intangible assets	2,85,790	2,83,580	2,84,540	2,84,540	2,84,540
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>9,14,030</b>	<b>9,58,460</b>	<b>10,27,260</b>	<b>10,68,192</b>	<b>11,43,148</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24A	FY25E	FY26E
<b>Cash flow from operations</b>	<b>1,69,000</b>	<b>1,80,090</b>	<b>2,24,480</b>	<b>1,95,595</b>	<b>2,12,602</b>
Capital expenditures	(15,550)	(14,440)	(10,160)	(40,829)	(43,574)
Change in investments	25,030	(22,430)	(44,230)	0	0
Other investing cash flows	5,290	(2,440)	(12,840)	0	0
<b>Cash flow from investing</b>	<b>14,770</b>	<b>(39,310)</b>	<b>(67,230)</b>	<b>(40,829)</b>	<b>(43,574)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(600)	(18,480)	(1,810)	0	0
Interest expenses	(11,360)	(10,070)	(12,120)	11,100	11,550
Dividends paid	(1,13,910)	(1,29,950)	(1,40,730)	(1,26,338)	(1,30,978)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(1,25,870)</b>	<b>(1,58,500)</b>	<b>(1,54,660)</b>	<b>(1,15,238)</b>	<b>(1,19,428)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>57,900</b>	<b>(17,720)</b>	<b>2,590</b>	<b>39,527</b>	<b>49,600</b>
<b>Closing cash &amp; cash eq.</b>	<b>1,05,100</b>	<b>90,650</b>	<b>94,560</b>	<b>1,34,087</b>	<b>1,83,687</b>

### Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24A	FY25E	FY26E
Reported EPS	49.8	54.7	57.9	62.1	69.0
Adjusted EPS	49.8	54.7	57.9	62.1	69.0
Dividend per share	20.0	21.9	23.2	24.8	27.6
Book value per share	228.2	241.0	251.6	267.1	287.8

### Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24A	FY25E	FY26E
EV/Sales	4.1	3.5	3.2	3.0	2.8
EV/EBITDA	17.5	15.6	14.6	13.7	12.5
Adjusted P/E	26.4	24.0	22.7	21.2	19.1
P/BV	5.8	5.5	5.2	4.9	4.6

### DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24A	FY25E	FY26E
Tax burden (Net profit/PBT)	79.7	76.2	74.9	75.4	75.8
Interest burden (PBT/EBIT)	105.1	105.4	104.7	105.2	104.9
EBIT margin (EBIT/Revenue)	18.9	18.2	18.2	18.2	18.9
Asset turnover (Rev./Avg TA)	95.6	108.4	110.7	111.3	112.6
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
<b>Adjusted ROAE</b>	<b>21.9</b>	<b>23.3</b>	<b>23.5</b>	<b>23.9</b>	<b>24.9</b>

### Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24A	FY25E	FY26E
<b>YoY growth (%)</b>					
Revenue	13.6	18.5	8.3	6.1	6.7
EBITDA	(0.2)	12.1	6.9	6.0	9.1
Adjusted EPS	3.9	10.0	5.8	7.2	11.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	23.6	22.3	22.0	22.0	22.5
EBIT margin	18.9	18.2	18.2	18.2	18.9
Adjusted profit margin	15.8	14.6	14.3	14.4	15.0
Adjusted ROAE	21.9	23.3	23.5	23.9	24.9
ROCE	21.9	23.5	23.7	24.5	27.1
<b>Working capital days (days)</b>					
Receivables	84	87	88	81	77
Inventory	0	0	0	0	0
Payables	115	97	100	97	93
<b>Ratios (x)</b>					
Gross asset turnover	12.0	12.8	14.0	15.1	16.6
Current ratio	2.0	1.9	1.7	1.9	2.0
Net interest coverage ratio	NA	NA	NA	NA	NA
<b>Adjusted debt/equity</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>0.0</b>	<b>(0.1)</b>	<b>(0.2)</b>

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

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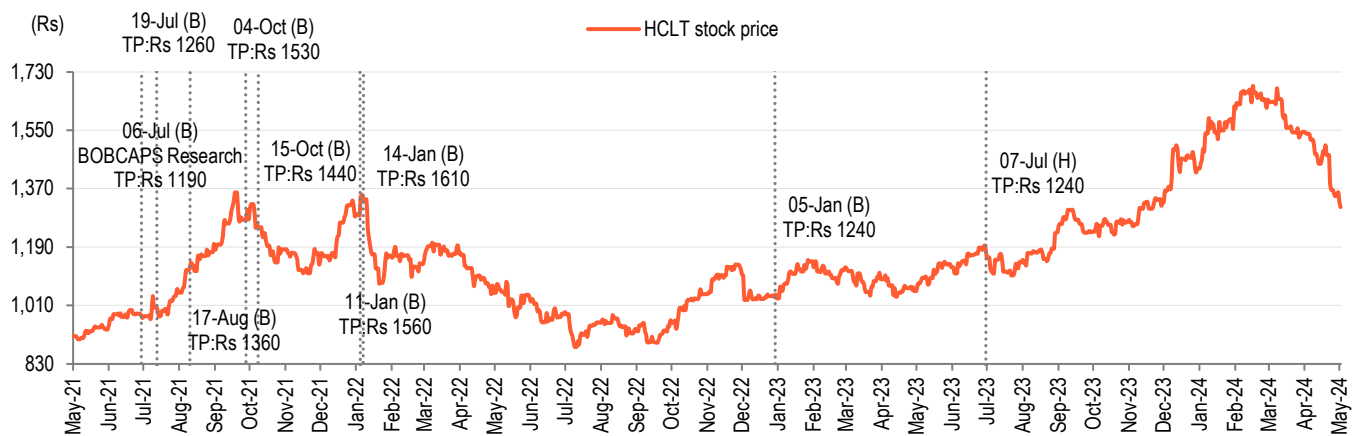
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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

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