

# HCL Technologies

## HOLD

### IT & ER&D key growth drivers

#### Summary

We attended HCL Technologies analyst meet. The company reiterated its guidance of 12-14% revenue growth, 18-20% EBIT margins and 24-26% ETR. The company also stated that 75% of net income will be paid out over FY22-FY26. We expect the company to achieve revenue growth to the lower end of guidance given the muted outlook in Product & Platform business (assumed 1% YoY growth) and will be driven by IT & ER&D services (led by digital services). In addition, we expect margins to be near the lower end of guidance due to lower P&P revenues and supply side issues. Further, considering macro headwinds prompt us to maintain HOLD rating on the stock with a target price of Rs 1,055 (PE of 18x on FY24E EPS).

#### Key Highlights and Investment Rationale

- Cloud a key focus for the company:** HCLT expects strong growth in IT services from Cloud and app modernization. Further, the company's HCL Smart will help in providing holistic cloud solution driving cloud migration for enterprise. The company's focus on F200 clients and G500 client will further drive growth. In ER&D the company's focus on digital engineering (growing at 12.3%-12.5%) will drive growth for the company. However, product & platform is expected to be muted in near term considering Horizon 1 products (44% of revenues) will impact near term growth. This coupled with migration to subscription based revenues from license (30% of revenues) will also impact growth.
- Operating margins to improve gradually:** The company sees multiple tailwind for margins like pricing, automation, shift to offshore & nearshore and fresher hiring. However, we expect margins to be near the lower end of guidance due to lower P&P revenues (which have high margins), high inflation and supply side issues.

<b>TP</b>	<b>Rs1,055</b>
<b>CMP</b>	<b>Rs1,059</b>
Potential upside/downside	-0.3%
Previous Rating	HOLD

#### Price Performance (%)

	-1m	-3m	-12m
Absolute	(6.6)	(9.1)	16.7
Rel to Sensex	3.6	(0.1)	9.0

#### V/s Consensus

EPS (Rs)	FY23E	FY24E
IDBI Capital	52.5	60.3
Consensus	54.1	61.9
% difference	(2.9)	(2.6)

#### Key Stock Data

Bloomberg/Reuters	HCLT IN/ HCLT.BO
Sector	IT Services
Shares o/s (mn)	2,714
Market cap. (Rs mn)	2,872,822
3-m daily avg Trd value (Rs mn)	387.4
52-week high / low	Rs1,377 / 895
Sensex / Nifty	52,930 / 15,808

#### Shareholding Pattern (%)

Promoters	60.7
FII	19.0
DII	14.6
Public	5.7

#### Financial snapshot

(Rs mn)

Year	FY20	FY21	FY22	FY23E	FY24E
Revenue	7,06,780	7,53,790	8,56,510	9,69,165	10,84,354
Change (yoy, %)	17	7	14	13	12
EBITDA	1,66,930	2,07,750	2,05,300	2,26,687	2,56,836
Change (yoy, %)	20	24	-1	10	13
EBITDA Margin (%)	23.6	27.6	24.0	23.4	23.7
Adj. PAT	1,09,252	1,29,410	1,34,990	1,42,593	1,63,769
EPS (Rs)	40.3	47.7	49.7	52.5	60.3
Change (yoy, %)	8	18	4	6	15
PE(x)	26	22	21	20	18
Dividend Yield (%)	1	2	4	4	4
EV/EBITDA (x)	17	13	13	12	10
RoE (%)	23.6	23.3	22.2	22.4	24.2
RoCE (%)	27	26	24	25	27

Source: IDBI Capital Research;

## Other Key Analyst Meet Highlights

### FY23 Outlook

- HCL has maintained its revenue and EBIT margins guidance of 12%-14%/18%-20% as it expects the impact of increase in employee costs and travel expenses to be offset by better offshore and near-shore mix, profitable revenue mix, better pricing and increased realization.
- While Cash ETR is expected to be in the range of 20%-22%, ETR is estimated to be in the range of 24%-26%. The difference between both the ETRs is on account of utilization of \$100 mn worth MAT credit out of total of \$313 mn outstanding as at 31<sup>st</sup> March 2022.

### Market Opportunities

- Cloud Transformation – Market size of \$917 bn growing at a medium term CAGR of 20%
- App & Data modernization - Market size of \$507 bn growing at a medium term CAGR of 23%
- Security & Compliance - Market size of \$100 bn growing at a medium term CAGR of 8%
- Digital Engineering - Market size of \$100 bn growing at a medium term CAGR of 8%
- Digital Workplace- Market size of \$54 bn growing at a medium term CAGR of 11%
- Products & Platforms - Market size of \$362 bn growing at a medium term CAGR of 16%

### IT & Business Services

- The total IT spend by 2025 is estimated to be at 1,607 bn led by Infrastructure Implementation & Managed Services (\$377 bn) followed by Application Implementation & Managed Services (\$369 bn), Consulting (\$312 bn), IaaS (\$245 bn), Business Process Services (\$234 bn) and Hardware Support (\$70 bn) providing HCL immense opportunities for growth.
- Digital foundation vertical contributed to 31% of the incremental revenue for the FY22 as digital business continued to see robust demand as digital spend is expected to grow by 12.3%-12.5% in the long term.
- The total IT spends of Digital Foundation is expected to reach \$512 bn by 2025 growing at a CAGR of 5.7%. Infrastructure Implementation and Managed services will lead (\$377 bn, 4.5% CAGR), followed by Managed Security Services (\$93 bn, 7.2% CAGR) and Infrastructure Technology Consulting (\$42 bn, 7.2% CAGR)

- Management aspires to grow the Digital Foundation business 2x – 3x of the average market growth in the mid to long term as following are the opportunities available (a) 40%-50% potential growth in newer locations (b) \$70-80 bn potential market with first time outsourcers (c) \$100 bn renewal market size in next 3 years (d) expanding offerings to existing clients.
- As clients are moving towards multi and hybrid clouds, the business mix between data center and Public Cloud is expected to stand at 61% and 39% by FY25 from current 81% and 19%. By 2025, 51% of the enterprise IT spend is expected to be cloud based thus providing HCL a huge growth opportunity.
- Company is focused to capture market share in Cloud based services by up selling and cross selling its existing services, building strong relationship with hyperscalers which will accelerate its sell to, see with and sell through strategy and focus on big tech spenders in order to increase its wallet share.

#### **ER&D Services**

- ER&D provides immense opportunity as emerging technologies like 5G and Industry 4.0 and increased sourcing of digital engineering are expected to drive growth in this business segment.
- Global Digital Engineering spend will lead the growth as it is expected to grow at a CAGR of 12.3%-12.5% over FY 22-24 and Traditional Engineering Spend is expected to grow at a CAGR of 4.3% over the same period.
- Telecom vertical is expected to see immense traction on the back of 5G technologies and thus HCL is working on building a foundation for \$500-\$600 mn that the telecom companies can capture
- Global Medical devices business is growing at a CAGR of 6%-7%. However, HCL has managed to grow this vertical thrice the industry average as the opportunities have been growing in the past couple of years and are expected to remain the same going forward.
- Aerospace vertical did not do well for HCL during FY 21 and 22 as it grew at industry average growth rate. This vertical has started to recover and is expected to perform better in the near future.
- Company currently has 250+ active customer engagements and has filed 300+ patents on their behalf.

### Products & Platform

- HCL had invested \$3.5 bn in this business vertical since June 2016 and has recovered 2/3<sup>rd</sup> of the invested amount. Revenue breakup of this segment stood as follows – (a) Subscription & Services – 67% (b) License sales – 30% (c) Services – 3%. Going forward, management is focused on increasing the share of subscription and services as it is more profitable.
- There are 4 key markets under this business segment –
  - Digital Transformation Market (TAM - \$17.4 bn growing at a CAGR of 12.5%) – Customer & Digital experience business sub segment with a TAM of \$10.1 bn is growing at a CAGR of 12.2%. Key products of HCL in this segment include Unica, Commerce and Discover. Pro & Low code platform sub segment has a TAM of \$4.7 bn growing at a CAGR of 18.2%. HCL has products like DX, VoltMX and MaxGo in this business segment. Secure Collaboration sub segment has a TAM of \$2.6 bn growing at a CAGR of <1%. HCL has presence in this segment with products like Domino and Sametime.
  - AI & Intelligent Automation Market (TAM - \$21.4 bn growing at a CAGR of 16.5%) – Secure Devops sub segment with TAM of \$4.4 bn is growing at a CAGR of 24.2%. HCL has products like AppScan & Accelerate in this segment. Automation sub segment which has a TAM of \$17 bn is growing at a CAGR of 14.4%. HCL has products like Bigfix in this segment.
  - Data Analytics Market having a TAM of \$34.1 bn is growing at a CAGR of 17,1%. HCL has Avalanche as its key product in this segment.
  - Industry Software having TAM of \$24.4 bn is growing at a CAGR of 16.7%. HCL has products like ANA, X-Haul and Informatics in this segment.
- Products are divided in to 3 categories – (1) Horizon 1 – contributes 44% of the revenue and has seen decline of 12% YoY in FY22. Going forward, Company will focus on driving high renewal rates. (2) Horizon 2 – contributes 54% of revenue and grew 9% YoY in FY22. Going forward, bundled offerings to be provided to clients in order to support their growth. (3) Horizon 3 – contributes to 2% of the revenue and saw immense traction in FY22 growing 24% YoY. Expected to continue healthy growth going forward. All the products will be integrated as one unit. This will be done with increased focus on renewal business, shift to subscription based pricing, focus on indirect channels like hyperscalers, SI, etc, increased profitability for IP ownership and differentiated execution by product mix.

## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Net sales</b>	<b>6,04,280</b>	<b>7,06,780</b>	<b>7,53,790</b>	<b>8,56,510</b>	<b>9,69,165</b>	<b>10,84,354</b>
<i>Change (yoy, %)</i>	19	17	7	14	13	12
Operating expenses	(4,64,590)	(5,39,850)	(5,46,040)	(6,51,210)	(7,42,478)	(8,27,517)
<b>EBITDA</b>	<b>1,39,690</b>	<b>1,66,930</b>	<b>2,07,750</b>	<b>2,05,300</b>	<b>2,26,687</b>	<b>2,56,836</b>
<i>Change (yoy, %)</i>	22	20	24	-1	10	13
<i>Margin (%)</i>	23.1	23.6	27.6	24.0	23.4	23.7
Depreciation	(21,480)	(28,400)	(46,110)	(43,260)	(45,562)	(47,848)
<b>EBIT</b>	<b>1,18,210</b>	<b>1,38,530</b>	<b>1,61,640</b>	<b>1,62,040</b>	<b>1,81,125</b>	<b>2,08,988</b>
Interest paid	-	-	-	-	-	-
Other income	8,050	1,790	4,160	7,470	7,550	7,550
<b>Pre-tax profit</b>	<b>1,26,260</b>	<b>1,40,320</b>	<b>1,65,800</b>	<b>1,69,510</b>	<b>1,88,675</b>	<b>2,16,538</b>
Tax	(24,810)	(30,748)	(36,150)	(34,280)	(45,282)	(51,969)
<i>Effective tax rate (%)</i>	19.6	21.9	21.8	20.2	24.0	24.0
Minority Interest	(220.0)	(320.0)	(240.0)	(240.0)	(800.0)	(800.0)
<b>Net profit</b>	<b>1,01,230</b>	<b>1,09,252</b>	<b>1,29,410</b>	<b>1,34,990</b>	<b>1,42,593</b>	<b>1,63,769</b>
Exceptional items	-	-	-	-	-	-
<b>Adjusted net profit</b>	<b>1,01,230</b>	<b>1,09,252</b>	<b>1,29,410</b>	<b>1,34,990</b>	<b>1,42,593</b>	<b>1,63,769</b>
<i>Change (yoy, %)</i>	15	8	18	4	6	15
EPS	37.3	40.3	47.7	49.7	52.5	60.3
Dividend per sh	4	6	26	44	39	45
<i>Dividend Payout %</i>	13	18	55	88	75	75

**Balance Sheet**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Shareholders' funds</b>	<b>4,13,660</b>	<b>5,12,670</b>	<b>5,99,130</b>	<b>6,19,140</b>	<b>6,54,762</b>	<b>6,96,356</b>
Share capital	5,425	5,427	5,427	5,430	5,430	5,430
Reserves & surplus	4,08,235	5,07,243	5,93,703	6,13,710	6,49,332	6,90,926
<b>Total Debt</b>	<b>37,010</b>	<b>46,930</b>	<b>38,280</b>	<b>39,230</b>	<b>39,230</b>	<b>39,230</b>
Other liabilities	(6,250)	25,900	37,200	31,530	50,417	57,674
<b>Curr Liab &amp; prov</b>	<b>1,15,750</b>	<b>2,18,850</b>	<b>1,73,830</b>	<b>1,87,750</b>	<b>2,26,721</b>	<b>2,53,648</b>
Current liabilities	1,00,650	2,01,100	1,51,370	1,64,820	1,94,185	2,16,434
Provisions	15,100	17,750	22,460	22,930	32,536	37,214
<b>Total liabilities</b>	<b>1,46,510</b>	<b>2,91,680</b>	<b>2,49,310</b>	<b>2,58,510</b>	<b>3,16,369</b>	<b>3,50,552</b>
<b>Total equity &amp; liabilities</b>	<b>5,61,200</b>	<b>8,05,890</b>	<b>8,50,130</b>	<b>8,78,570</b>	<b>9,72,851</b>	<b>10,49,429</b>
Net fixed assets	2,31,230	3,52,420	3,50,470	3,29,010	3,07,573	2,77,725
Investments	850	770	890	1,030	1,030	1,030
Other non-curr assets	31,900	66,700	68,260	68,120	87,623	98,037
<b>Current assets</b>	<b>2,97,220</b>	<b>3,86,000</b>	<b>4,30,510</b>	<b>4,80,410</b>	<b>5,76,625</b>	<b>6,72,636</b>
Inventories	910	910	940	1,610	1,328	1,485
Sundry Debtors	1,17,060	1,41,310	1,36,630	1,54,760	1,75,246	1,96,075
Cash and Bank	1,00,920	1,19,650	1,56,610	1,88,750	2,16,839	2,70,088
Loans and advances	13,120	34,220	48,410	30,080	63,726	71,300
<b>Total assets</b>	<b>5,61,200</b>	<b>8,05,890</b>	<b>8,50,130</b>	<b>8,78,570</b>	<b>9,72,851</b>	<b>10,49,429</b>

**Cash Flow Statement**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Pre-tax profit	1,26,260	1,40,320	1,65,800	1,69,510	1,88,675	2,16,538
Depreciation	15,268	19,000	46,110	43,260	45,562	47,848
Tax paid	(38,843)	(30,758)	(24,190)	(34,580)	(45,282)	(51,969)
Chg in working capital	(25,398)	57,750	(54,560)	13,450	(14,879)	(1,634)
Other operating activities	(80,893)	(17,980)	27,375	(18,043)	(20,530)	(14,420)
<b>Cash flow from operations (a)</b>	<b>38,617</b>	<b>1,68,331</b>	<b>1,60,535</b>	<b>1,73,597</b>	<b>1,58,977</b>	<b>1,96,364</b>
Capital expenditure	(50,594)	(1,40,190)	(44,160)	(21,800)	(24,125)	(18,000)
Chg in investments	(582)	80	(120)	(140)	-	-
Other investing activities	-	-	-	-	-	-
<b>Cash flow from investing (b)</b>	<b>(51,176)</b>	<b>(1,40,110)</b>	<b>(44,280)</b>	<b>(21,940)</b>	<b>(24,125)</b>	<b>(18,000)</b>
Equity raised/(repaid)	(144)	2	-	3	-	-
Debt raised/(repaid)	32,639	9,920	(8,650)	950	-	-
Dividend (incl. tax)	(13,064)	(19,604)	(70,555)	(1,19,460)	(1,06,971)	(1,22,175)
Chg in minorities	(2,306)	190	(90)	(1,010)	-	-
Other financing activities	-	-	-	-	-	-
<b>Cash flow from financing (c)</b>	<b>17,125</b>	<b>(9,491)</b>	<b>(79,295)</b>	<b>(1,19,517)</b>	<b>(1,06,971)</b>	<b>(1,22,175)</b>
<b>Net chg in cash (a+b+c)</b>	<b>(24,087)</b>	<b>18,730</b>	<b>36,960</b>	<b>32,140</b>	<b>22,451</b>	<b>56,189</b>

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	152	189	221	228	241	256
Adj EPS (Rs)	37.3	40.3	47.7	49.7	52.5	60.3
Adj EPS growth (%)	18	8	18	4	6	15
EBITDA margin (%)	23	24	28	24	23	24
Pre-tax margin (%)	21	20	22	20	19	20
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	28	27	26	24	25	27
ROE (%)	26.0	23.6	23.3	22.2	22.4	24.2

### DuPont Analysis

Asset turnover (x)	1.1	1.0	0.9	1.0	1.0	1.1
Leverage factor (x)	1.3	1.5	1.5	1.4	1.5	1.5
Net margin (%)	16.8	15.5	17.2	15.8	14.7	15.1

### Working Capital & Liquidity ratio

Inventory days	1	0	0	1	1	1
Receivable days	71	73	66	66	66	66
Payable days	10	8	12	13	11	11

### Valuations

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
PER (x)	28.4	26.4	22.2	21.3	20.2	17.6
Price/Book value (x)	7.0	5.6	4.8	4.7	4.4	4.1
EV/Net sales (x)	4.7	4.0	3.7	3.2	2.8	2.4
EV/EBITDA (x)	20	17	13	13	12	10
Dividend Yield (%)	0	1	2	4	4	4

Source: Company; IDBI Capital Research





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**Key to Ratings Stocks:**

**BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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