

HCL Technologies

HOLD

H2 expected to be better than H1

Summary

HCL Technologies (HCLT) revenues increased 0.8% QoQ of which 0.5% was contributed from acquisition of ASAP. The company has revised its guidance downwards to 5-6% from 6%-8% mainly due to slowdown in discretionary spend and weak Q1. We continue to believe that macro challenges will impact company's near term revenue growth. Hence, we maintain our stance of company's revenue to be at the lower end of the guidance due to slowdown in discretionary spends. In addition, due to headwinds like wage hikes we have assumed margins at the mid-point of guidance (18.5%). We have revised our EPS estimates upwards by 2.1% & 3.8% mainly led by higher margin assumption (considering better Q2 margins). However, we maintain our HOLD rating on the stock with a revised target price of Rs 1,165 (18x PE on FY25E EPS).

Key Highlights and Investment Rationale

- Mega deal win to drive H2 growth:** The company has won net new TCV of US\$ 3.96 bn with 10 in services & 6 in software. The deal win this quarter is higher than the historical US\$2 bn as it includes mega deal of Verizon. This coupled with acquisition of ASAP, stabilization of large deals won in past quarter and higher product revenues will lead to better H2 than H1. This coupled with strong uptick in deal wins in coming quarters could drive long term revenue growth. Hence we have assumed 7.7% (in USd terms) revenue CAGR over FY23-FY25E
- Operating margins to remain range bound:** The company has multiple levers like higher utilisation, pyramid utilisation and offshoring to drive margins. However, wage hike and lower revenues growth prompt us to keep margins in the range of 18.5%-18.65% in FY24E & FY25E, respectively.

TP	Rs 1,165
CMP	Rs 1,224
Potential upside/downside	-5%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	(4.5)	10.3	28.6
Rel to Sensex	(3.3)	8.7	13.4

V/s Consensus

EPS (Rs)	FY24E	FY25E
IDBI Capital	58	63
Consensus	58	65
% difference	(0.1)	(3.6)

Key Stock Data

Bloomberg/Reuters	HCLT IN/ HCLT.BO
Sector	IT Services
Shares o/s (mn)	2,714
Market cap. (Rs mn)	3,321,662
3-m daily avg Trd value (Rs mn)	104.4
52-week high / low	Rs1,311 / 969
Sensex / Nifty	66,408 / 19,794

Shareholding Pattern (%)

Promoters	60.8
FII	19.0
DII	14.6
Public	5.6

Financial snapshot

(Rs mn)

Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	7,53,790	8,56,510	10,14,560	10,92,875	12,11,521
Change (yoy, %)	7	14	18	8	11
EBITDA	2,07,750	2,05,300	2,26,280	2,44,587	2,76,159
Change (yoy, %)	24	(1)	10	8	13
EBITDA Margin (%)	27.6	24.0	22.3	22.4	22.8
Adj. PAT	1,29,410	1,34,990	1,46,870	1,57,007	1,72,114
EPS (Rs)	48	50	54	58	63
Change (yoy, %)	18.5	4.3	8.8	7	10
PE(x)	25.7	24.6	22.6	21	19
Dividend Yield (%)	2.1	3.6	3.9	4	4
EV/EBITDA (x)	15.4	15.5	13.9	12.8	11.2
RoE (%)	23.3	22.2	23.1	23	24
RoCE (%)	25.6	23.7	26	27	29

Source: IDBI Capital Research;

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Other Key Highlights

- Revenue in CC terms is up 1.0% QoQ & up by 3.4% YoY. Services revenue is up by 1.6% QoQ due to large deal ramp up.
- In terms of Segmental performance, IT and Business services increased during the quarter mainly due to acquisition of ASAP which contributed 60 bps to overall growth of 1.6% QoQ.
- EBIT margin up by 150 bps QoQ from 17% to 18.5%. EBIT margins has increased due to 100 bps improvement in utilisation, 70 bps reduction in sub-contracting and 50 bps improvement in discretionary spend like travel & recruitment offset by ASAP acquisition.
- In terms of Industry verticals, Financial services & life sciences reported 1.7% & 1.6% QoQ growth and grew substantially by 12.5% & 9.8% YoY respectively. Technology and Manufacturing were impacted on QoQ basis. In terms of geography, America & Europe reported 1.4% QoQ & 0.8% QoQ growth and grew by 3.9% YoY each. The growth in Europe was mainly due to low base last quarter.
- The company has won net new TCV of US\$ 3.96 bn with 10 in services & 6 in software. This deal win includes mega deal won by Verizon. The company expects deal pipeline to soften mainly due to conversion of mega deal.
- Company guided that despite the demand environment being challenging, it is confident of achieving its FY24E revenue growth guidance of 5%-6% (implied growth of 3.3%-4.5% CQGR). Management expects good second half of the year mainly led by acquisition of ASAP, ramp up of large deals, stabilization of deals won in past quarter, higher product revenues and improvement in discretionary spend (which we believe might not happen)
- The company will give will give wage hikes in October. The impact of this would be 65 bps in Q3 and 25-30 bps in Q4. The company aims to mitigate the same by efficiency in managed solutions and reduce the subcontracting cost same as this quarter. Hence company is confident of achieving EBIT margins of 18-19% in FY24E.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q2FY24	Q1FY24	QoQ (%)	Q2FY23	YoY (%)
Revenues (US\$ mn)	3,225	3,200	0.8	3,082	4.6
Revenues	2,66,720	2,62,960	1.4	2,46,860	8.0
COGS	1,74,170	1,73,300	0.5	1,62,370	7.3
Gross profit	92,550	89,660	3.2	84,490	9.5
SG&A	33,110	35,790	(7.5)	30,240	9.5
EBITDA	59,440	53,870	10.3	54,250	9.6
Depreciation & amortization	10,100	9,270	9.0	9,980	1.2
EBIT	49,340	44,600	10.6	44,270	11.5
Other income	1,940	2,360	(17.8)	650	198.5
PBT	51,280	46,960	9.2	44,920	14.2
Tax	12,950	11,650	11.2	10,960	18.2
Minority interest	10	-30	<i>n.m.</i>	-10	<i>n.m.</i>
Reported net profit	38,320	35,340	8.4	33,970	12.8
Diluted EPS (Rs)	14.2	13.1	8.4	12.9	9.8
As % of net revenue					
Gross profit	34.7	34.1		34.2	34.7
SG&A	12.4	13.6		12.2	12.4
EBITDA	22.3	20.5		22.0	22.3
EBIT	18.5	17.0		17.9	18.5
Reported net profit	14.4	13.4		13.8	14.4
Tax rate	25.3	24.8		24.4	25.3

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

Year-end: March	FY24F			FY25E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	13,210.2	13,334.4	(0.9)	14,596.6	14552.7	0.3
Revenue (Rs bn)	1,092.9	1,096.0	(0.3)	1,211.5	1196.2	1.3
EBIT (Rs bn)	202.5	197.3	2.6	225.9	215.8	4.7
EBIT margin (%)	18.53	18.00	52 bps	18.65	18.04	61 bps
EPS (Rs)	57.8	56.6	2.1	63.4	61.1	3.8

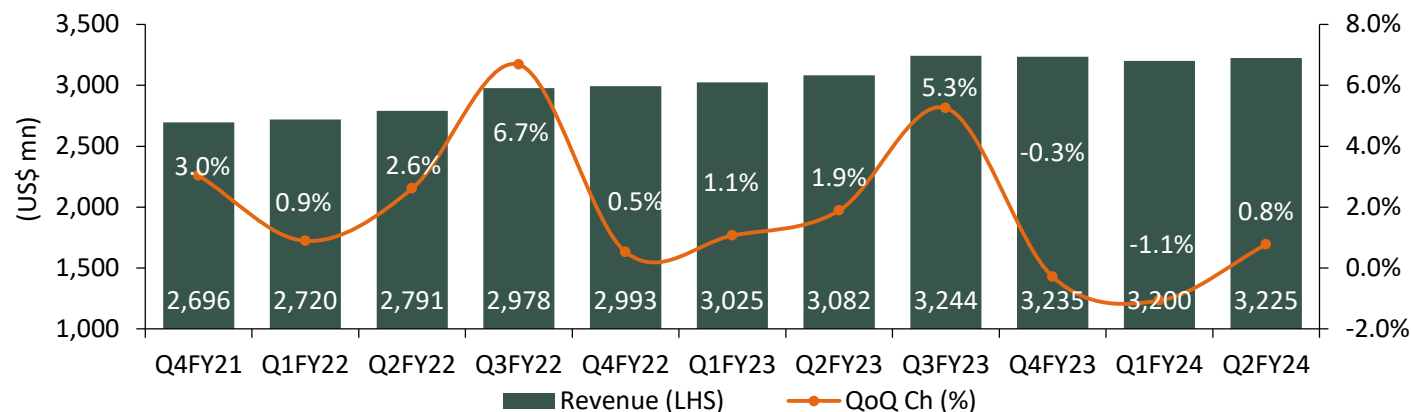
Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

Year to March	Q2FY24	Q2FY24E	Variance (%)
Revenue (US\$ mn)	3,225	3,303	(2.4)
Revenue (Rs mn)	2,66,720	2,73,020	(2.3)
EBIT (Rs mn)	49,340	49,646	(0.6)
EBIT margin (%)	18.5%	18.2%	(30)bps
PAT (Rs mn)	38,320	38,804	(1.2)
PAT margin (%)	14.4%	14.2%	(20bps)
EPS (Rs)	14.2	14.3	-1.2

Source: Company; IDBI Capital Research

Exhibit 4: Q2FY24 revenue growth was up 0.8% on QoQ basis



Source: Company; IDBI Capital Research

Exhibit 5: Growth in large clients improved

Year-end: March	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
US\$100m +	15	16	17	17	17	19	20	20
US\$50m +	42	43	42	42	45	46	48	49
US\$20m +	110	118	127	128	130	131	127	132
US\$10m +	198	208	218	220	221	229	237	243
US\$5m +	346	349	353	356	365	375	390	402
US\$1m +	864	882	880	890	937	939	947	971

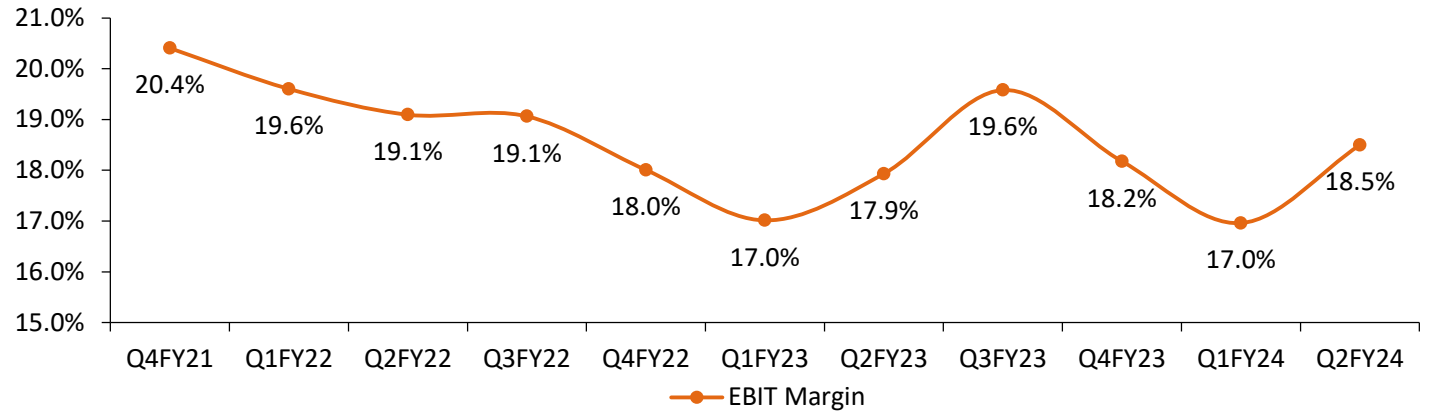
Source: Company; IDBI Capital Research

Exhibit 6: Revenue growth across various segments (%)

Parameters	% of revenue	QoQ CC growth	YoY CC growth
Overall revenue growth		-1.3	6.3
Geography		-1.3	6.3
US	64.5	1.4	3.9
Europe	28.5	0.8	3.9
ROW	7.0	6.1	(3.6)
Service-lines			
IT and Business services	74.6	0.9	4.6
Engineering and R&D Services	16.0	5.0	(2.0)
Products and Platforms	9.9	(4.0)	3.6
Verticals			
Financial Services	22.6	1.7	12.5
Manufacturing	19.3	(1.5)	3.3
Technology & Services	13.1	(0.4)	(9.5)
Telecom & Media Publishing	8.0	6.2	(10.4)
Retail & CPG	9.6	7.5	8.1
Life science & Healthcare	17.5	1.6	9.8
Public Services	9.9	0.9	1.7

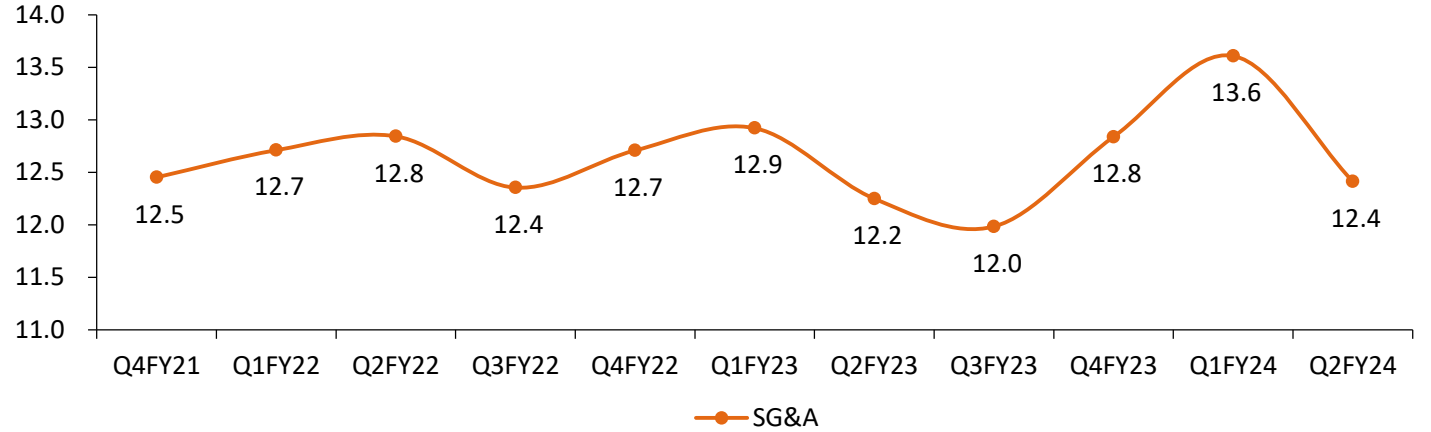
Source: Company; IDBI Capital Research

Exhibit 7: Q2FY24 EBIT margin has increased by 150 bps QoQ



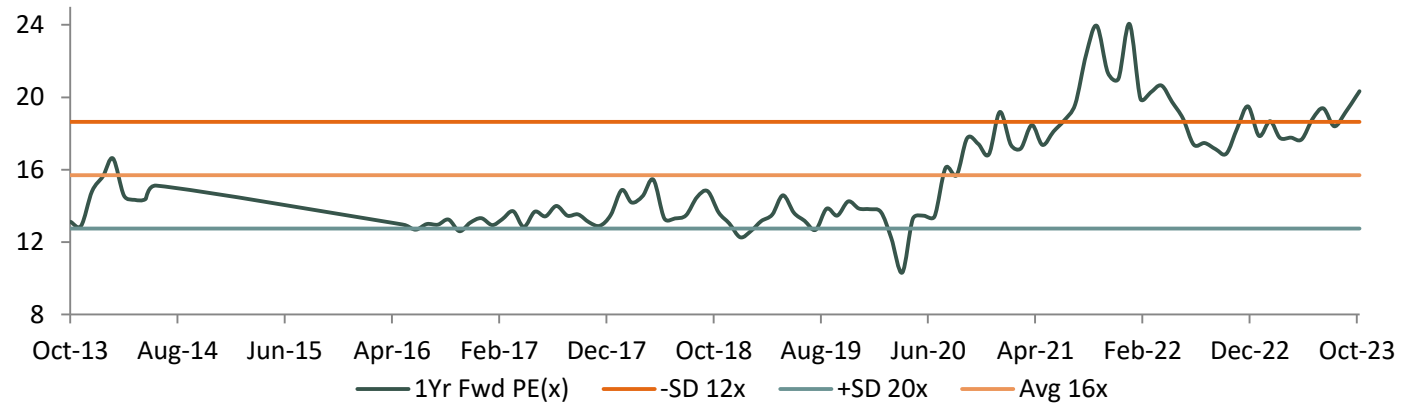
Source: Company; IDBI Capital Research

Exhibit 8: SG&A saw decline on QoQ



Source: Company; IDBI Capital Research

Exhibit 9: One-year forward PER trend



Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Net sales	7,06,780	7,53,790	8,56,510	10,14,560	10,92,875	12,11,521
<i>Change (yoy, %)</i>	<i>17.0</i>	<i>7</i>	<i>14</i>	<i>18</i>	<i>8</i>	<i>11</i>
Operating expenses	(5,39,850)	(5,46,040)	(6,51,210)	(7,88,280)	(8,48,288)	(9,35,362)
EBITDA	1,66,930	2,07,750	2,05,300	2,26,280	2,44,587	2,76,159
<i>Change (yoy, %)</i>	<i>19.5</i>	<i>24</i>	<i>(1)</i>	<i>10</i>	<i>8</i>	<i>13</i>
<i>Margin (%)</i>	<i>23.6</i>	<i>27.6</i>	<i>24.0</i>	<i>22.3</i>	<i>22.4</i>	<i>22.8</i>
Depreciation	(28,400)	(46,110)	(43,260)	(41,450)	(42,112)	(50,251)
EBIT	1,38,530	1,61,640	1,62,040	1,84,830	2,02,475	2,25,908
Interest paid	-	-	-	-	-	-
Other income	1,790	4,160	7,470	8,410	8,740	7,760
Pre-tax profit	1,40,320	1,65,800	1,69,510	1,93,240	2,11,215	2,33,668
Tax	(30,748)	(36,150)	(34,280)	(46,420)	(53,828)	(60,754)
<i>Effective tax rate (%)</i>	<i>21.9</i>	<i>21.8</i>	<i>20.2</i>	<i>24.0</i>	<i>25.5</i>	<i>26.0</i>
Minority Interest	(320.0)	(240.0)	(240.0)	50.0	(380.0)	(800.0)
Net profit	1,09,252	1,29,410	1,34,990	1,46,870	1,57,007	1,72,114
Exceptional items	-	-	-	-	-	-
Adjusted net profit	1,09,252	1,29,410	1,34,990	1,46,870	1,57,007	1,72,114
<i>Change (yoy, %)</i>	<i>7.9</i>	<i>18</i>	<i>4</i>	<i>9</i>	<i>7</i>	<i>10</i>
EPS	40.3	47.7	49.7	54.1	57.8	63.4
Dividend per sh	6.0	26.0	44.0	48.0	45.0	50.0
<i>Dividend Payout %</i>	<i>17.9</i>	<i>54.5</i>	<i>88.5</i>	<i>89</i>	<i>78</i>	<i>79</i>

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Shareholders' funds	5,12,670	5,99,130	6,19,140	6,54,050	6,88,882	7,25,247
Share capital	5,427	5,427	5,430	5,430	5,430	5,430
Reserves & surplus	5,07,243	5,93,703	6,13,710	6,48,620	6,83,452	7,19,817
Total Debt	46,930	38,280	39,230	21,110	21,110	21,110
Other liabilities	25,900	37,200	31,530	32,190	57,941	65,416
Curr Liab & prov	2,18,850	1,73,830	1,87,750	2,14,310	2,27,557	2,51,574
Current liabilities	2,01,100	1,51,370	1,64,820	1,81,610	1,94,994	2,15,217
Provisions	17,750	22,460	22,930	32,700	32,564	36,357
Total liabilities	2,91,680	2,49,310	2,58,510	2,67,610	3,06,608	3,38,099
Total equity & liabilities	8,05,890	8,50,130	8,78,570	9,21,590	9,95,800	10,64,456
Net fixed assets	3,52,420	3,50,470	3,29,010	3,23,220	3,11,073	2,90,822
Investments	770	890	1,030	1,100	1,100	1,100
Other non-curr assets	66,700	68,260	68,120	61,500	98,808	1,09,535
Current assets	3,86,000	4,30,510	4,80,410	5,35,770	5,84,820	6,62,999
Inventories	910	940	1,610	2,280	1,497	1,660
Sundry Debtors	1,41,310	1,36,630	1,54,760	1,95,720	2,10,790	2,33,674
Cash and Bank	1,19,650	1,56,610	1,88,750	2,01,090	2,25,302	2,64,451
Loans and advances	34,220	48,410	30,080	26,030	28,039	31,083
Total assets	8,05,890	8,50,130	8,78,570	9,21,590	9,95,800	10,64,456

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Pre-tax profit	1,40,320	1,65,800	1,69,510	1,93,240	2,11,215	2,33,668
Depreciation	19,000	46,110	43,260	41,450	42,112	50,251
Tax paid	(30,758)	(24,190)	(34,580)	(46,690)	(53,828)	(60,754)
Chg in working capital	57,750	(54,560)	13,450	(11,020)	(3,049)	(2,074)
Other operating activities	(17,980)	27,375	(18,043)	20,470	(20,098)	(16,192)
Cash flow from operations (a)	1,68,331	1,60,535	1,73,597	1,97,450	1,76,352	2,04,899
Capital expenditure	(1,40,190)	(44,160)	(21,800)	(35,660)	(29,965)	(30,000)
Chg in investments	80	(120)	(140)	(70)	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(1,40,110)	(44,280)	(21,940)	(35,730)	(29,965)	(30,000)
Equity raised/(repaid)	2	-	3	-	-	-
Debt raised/(repaid)	9,920	(8,650)	950	(18,120)	-	-
Dividend (incl. tax)	(19,604)	(70,555)	(1,19,460)	(1,30,320)	(1,22,175)	(1,35,750)
Chg in minorities	190	(90)	(1,010)	(940)	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(9,491)	(79,295)	(1,19,517)	(1,49,380)	(1,22,175)	(1,35,750)
Net chg in cash (a+b+c)	18,730	36,960	32,140	12,340	24,212	39,149

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	188.9	221	228	241	254	267
Adj EPS (Rs)	40.3	47.7	49.7	54.1	57.8	63.4
Adj EPS growth (%)	7.9	18	4	9	7	10
EBITDA margin (%)	23.6	27.6	24.0	22.3	22.4	22.8
Pre-tax margin (%)	19.9	22.0	19.8	19.0	19.3	19.3
Net Debt/Equity (x)	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3
ROCE (%)	26.8	26	24	26	27	29
ROE (%)	23.6	23	22	23	23	24

DuPont Analysis

Asset turnover (x)	1.0	0.9	1.0	1.1	1.1	1.2
Leverage factor (x)	1.5	1.5	1.4	1.4	1.4	1.5
Net margin (%)	15.5	17.2	15.8	14.5	14.4	14.2

Working Capital & Liquidity ratio

Inventory days	0	0	1	1	1	1
Receivable days	73	66	66	70	70	70
Payable days	8	12	13	12	12	12

Valuations

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
PER (x)	30.4	25.7	24.6	22.6	21.2	19.3
Price/Book value (x)	6.5	5.5	5.4	5.1	4.8	4.6
EV/Net sales (x)	4.6	4.2	3.7	3.1	2.9	2.5
EV/EBITDA (x)	19.5	15.4	15.5	13.9	12.8	11.2
Dividend Yield (%)	0.5	2.1	3.6	3.9	3.7	4.1

Source: Company; IDBI Capital Research



Notes

Dealing	(91-22) 6836 1111	dealing@idbicapital.com
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Key to Ratings Stocks:

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

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