

# HCL Technologies

## HOLD

Subdued performance in products going forward

### Summary

HCL Technologies (HCLT) reported subdued revenue growth (+0.5% QoQ) mainly led by 24% QoQ decline in products & platform (10% of revenues) partially offset by 5.0% QoQ growth in IT services revenues (90% of revenues). The company has guided 12-14% revenue guidance and 18-20% EBIT margins in FY23E. We believe the majority of revenues will be driven by IT services revenues. We expect product revenues to be subdued. Hence we expect the company to register revenue growth at the lower end of guidance. As a result we have revised our revenue and EBIT estimates downwards leading to EPS downgrade of 6.2%/5.5% in FY23E/FY24E. This coupled with macro headwinds prompt us to revise our rating and multiple downwards. We downgrade the stock from Buy to Hold with a target price of Rs 1064 (18x PE on FY24E EPS).

### Key Highlights and Investment Rationale

- Product and macro challenges to impact revenue growth:** HCL has reported robust services TCV at US\$ 2,216 mn enabled by 6 net new large Services deal wins. In addition, we expect traction in cloud, expansion in newer geographies and improvement in ER&D to drive IT services growth. However, we expect subdued performance in product business. This coupled with macro challenges prompt us to lower our revenue estimates downwards by 3.1% and 5.1% in FY23E and FY24E. We now expect US\$ revenue CAGR of 11.4% over FY22-24E Operating.
- Operating margins to improve gradually:** We expect the company to face headwinds to margins mainly led by salary hikes, higher discretionary cost, impact of lower product revenues and investments. Hence, we expect near term margins to remain under pressure. We expect margins to improve by 65 bps in FY24E with easing of supply side pressure, higher product revenues and efficiencies.

<b>TP</b>	<b>Rs1,064</b>
<b>CMP</b>	<b>Rs1,099</b>
Potential upside/downside	-3%
Previous Rating	Buy

### Price Performance (%)

	-1m	-3m	-12m
Absolute	(5.9)	(5.8)	14.4
Rel to Sensex	(7.0)	(3.9)	(7.0)

### V/s Consensus

EPS (Rs)	FY22E	FY23E	FY24E
IDBI Capital	50	53	61
Consensus	49	56	64
% difference	2.1	(5.3)	(4.7)

### Key Stock Data

Bloomberg/Reuters	HCLT IN/ HCLT.BO
Sector	IT Services
Shares o/s (mn)	2,714
Market cap. (Rs mn)	2,983,946
3-m daily avg Trd value (Rs mn)	387.4
52-week high / low	Rs1,377 / 891
Sensex / Nifty	57,912 / 17,393

### 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	6,04,280	7,53,790	8,56,510	9,66,976	10,83,700
Change (yoy, %)	19	7	14	13	12
EBITDA	1,39,690	2,07,750	2,05,300	2,20,906	,251,930
Change (yoy, %)	22	24	(1)	8	14
EBITDA Margin (%)	23	28	24	23	23
Adj. PAT	,101,230	1,29,410	1,34,990	1,42,979	1,65,052
EPS (Rs)	37	48	50	53	61
Change (yoy, %)	18	18	4	6	15
PE(x)	29	23	22	21	18
Dividend Yield (%)	0	2	4	4	5
EV/EBITDA (x)	21	14	14	13	11
RoE (%)	26	23	22	23	26
RoCE (%)	29	26	24	26	28

Source: IDBI Capital Research;

### Other Key Highlights

- Revenue is expected to grow by 12%-14% in FY 23 in Constant Currency terms and the Operating margins are expected to be in the 18%-20% range as the Company is confident of strong demand and would continue to invest in talent.
- During the quarter, services margin grew by 85 bps QoQ due to recovery of seasonal leave in previous quarter (65 bps) and other operational efficiency (20 bps). However, this was offset (-178bps) by seasonality in Products business.
- On the Products business, Management would aim to move revenue from product license sale (28% of product business revenue) to subscription and support service segment as this would lead to better consistency in terms of revenue.
- With an aim to drive accelerated growth in the Software business, Company has put in place a new organizational structure for the Products and Platform business. Company has appointed two senior leaders to bring together all the software businesses under this structure and drive long term growth by investing in building capabilities and invest in those products which have strong momentum.
- Services revenue grew by 5% QoQ led by ITBS (+5.2% QoQ in CC terms); ER&D registered growth of 3.9% QoQ in CC terms.
- Products & Platform business continued to underperform registering negative growth of 24%/13.9% QoQ/YoY and is expected to remain volatile going forward.
- Mode 2 continues to lead the growth momentum growing at 7.8%/31.6% QoQ/YoY in Constant Currency.
- Deal Pipeline continues to remain strong across all geographies and verticals. During the quarter company signed 6 net new large services deals and 4 new products deals.
- With margins being under pressure due to supply side issues, Company would hire increased number of fresh talent.
- Company declared final dividend of Rs 18 per share which leads to total dividend during the FY 22 to Rs 44 per share.

## Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q4FY22	Q3FY22	QoQ (%)	Q4FY21	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>2,993</b>	<b>2,978</b>	<b>0.5</b>	<b>2,696</b>	<b>11.0</b>
<b>Revenues</b>	<b>2,25,970</b>	<b>2,23,310</b>	<b>1.2</b>	<b>1,96,410</b>	<b>15.1</b>
COGS	1,46,720	1,41,790	3.5	1,19,190	23.1
Gross profit	79,250	81,520	(2.8)	77,220	2.6
SG&A	28,720	27,590	4.1	24,460	17.4
<b>EBITDA</b>	<b>50,530</b>	<b>53,930</b>	<b>(6.3)</b>	<b>52,760</b>	<b>(4.2)</b>
Depreciation & amortization	9,840	11,360	(13.4)	12,680	(22.4)
<b>EBIT</b>	<b>40,690</b>	<b>42,570</b>	<b>(4.4)</b>	<b>40,080</b>	<b>1.5</b>
Other income	2,520	1,730	45.7	860	193.0
PBT	43,210	44,300	(2.5)	40,940	5.5
Tax	7,210	9,820	(26.6)	11,860	(39.2)
Minority interest	60	60	0.0	90	n.m.
<b>Reported net profit</b>	<b>35,940</b>	<b>34,420</b>	<b>4.4</b>	<b>28,990</b>	<b>24.0</b>
<b>Diluted EPS (Rs)</b>	<b>13.2</b>	<b>12.7</b>	<b>4.4</b>	<b>10.7</b>	<b>24.0</b>
<b>As % of net revenue</b>					
Gross profit	35.1	36.5		39.3	
SG&A	12.7	12.4		12.5	
EBITDA	22.4	24.2		26.9	
EBIT	18.0	19.1		20.4	
Reported net profit	15.9	15.4		14.8	
Tax rate	16.7	22.2		29.0	

Source: Company; IDBI Capital Research

**Exhibit 2: Earnings Revision**

Year-end: March	FY23F			FY23F		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	12,893.0	13,307.9	(3.1)	14,259.2	15,026.2	(5.1)
Revenue (Rs bn)	967.0	998.1	(3.1)	1,083.7	1,127.0	(3.8)
EBIT (Rs bn)	181.9	194.2	(6.4)	210.9	223.6	(5.7)
<i>EBIT margin (%)</i>	<i>18.81</i>	<i>19.46</i>	<i>(92) bps</i>	<i>19.46</i>	<i>19.84</i>	<i>(89)bps</i>
EPS (Rs)	52.7	56.2	(6.2)	60.8	64.4	(5.5)

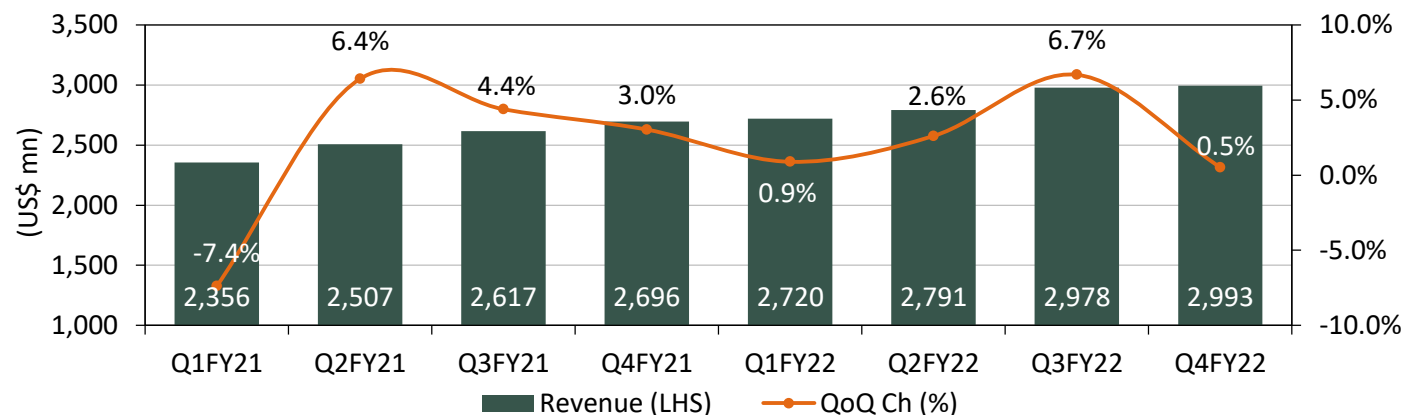
Source: Company; IDBI Capital Research

**Exhibit 3: Actual vs. estimates**

Year to March	Q4FY22	Q4FY22E	Variance (%)
Revenue (US\$ mn)	2,993	3,036	(1.4)
Revenue (Rs mn)	2,25,970	2,28,377	(1.1)
EBIT (Rs mn)	40,690	41,801	(2.7)
<i>EBIT margin (%)</i>	<i>18.0%</i>	<i>18.3%</i>	<i>(30)bps</i>
PAT (Rs mn)	35,940	32,772	9.7
<i>PAT margin (%)</i>	<i>15.9%</i>	<i>14.4%</i>	<i>131bps</i>
EPS (Rs)	13.2	12.1	9.7

Source: Company; IDBI Capital Research

**Exhibit 4: Q4FY22 revenue growth was below our forecast**



Source: Company; IDBI Capital Research

**Exhibit 5: Growth in large clients**

Year-end: March	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
US\$100m +	15	14	15	15	14	15	15	16
US\$50m +	29	29	31	35	37	41	42	43
US\$20m +	93	91	97	96	104	109	110	118
US\$10m +	173	172	173	178	178	190	198	208
US\$5m +	320	317	312	318	326	329	346	349
US\$1m +	848	865	814	809	817	836	864	882

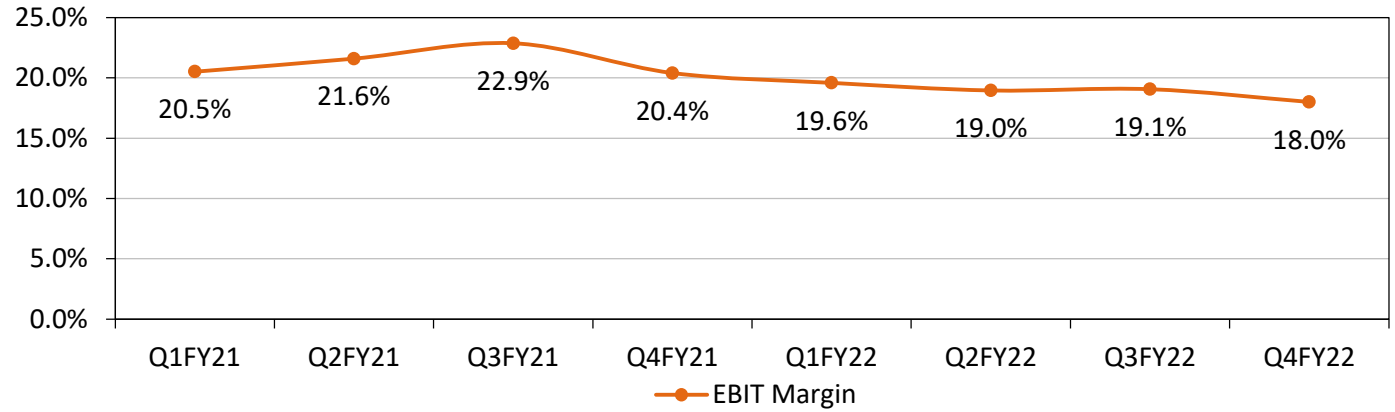
Source: Company; IDBI Capital Research

**Exhibit 6: Revenue growth across various segments (%)**

Parameters	% of revenue	QoQ CC growth	YoY CC growth
Overall revenue growth		1.1	13.3
<b>Geography</b>			
US	62.8	0.2	13.0
Europe	28.3	2.3	13.6
ROW	8.9	3.5	15.0
<b>Service-lines</b>			
IT and Business services	72.1	5.2	16.2
Engineering and R&D Services	15.8	3.9	23.7
Products and Platforms	12.1	(24.0)	(13.9)
<b>Verticals</b>			
Financial Services	20.9	0.4	10.2
Manufacturing	18.0	4.3	16.6
Technology & Services	17.5	(3.8)	14.3
Telecom &Media Publishing	8.6	6.8	20.2
Retail & CPG	9.4	(5.6)	6.0
Life science & Healthcare	14.9	4.1	18.5
Public Services	10.7	3.2	7.8
<b>Mode 1-2-3 solutions</b>			
Mode 1	60.9	3.5	12.7
Mode 2	27.2	7.8	31.6
Mode 3	11.9	(20.1)	(12.10)

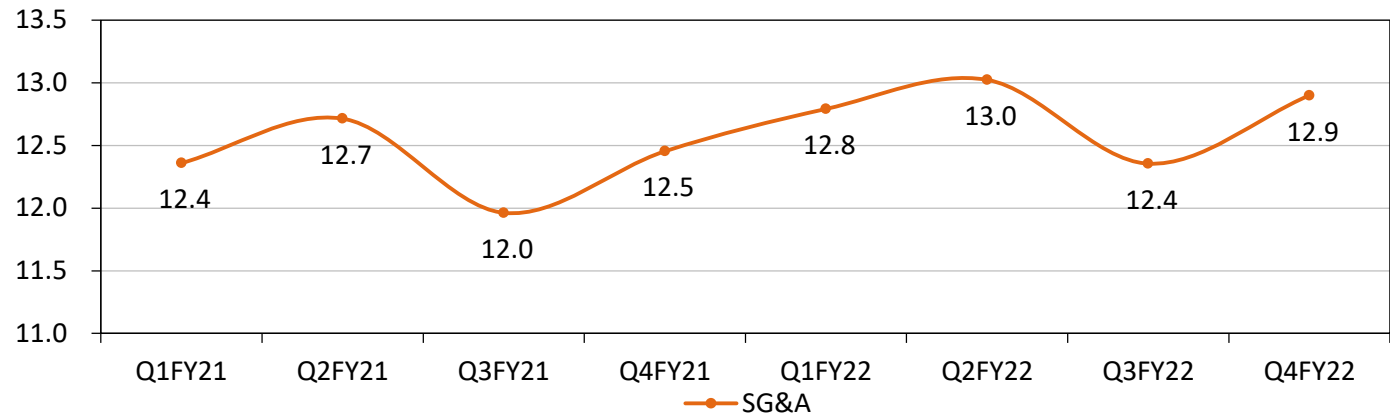
Source: Company; IDBI Capital Research

**Exhibit 7: Q4FY22 EBIT margin was tad below our expectation**



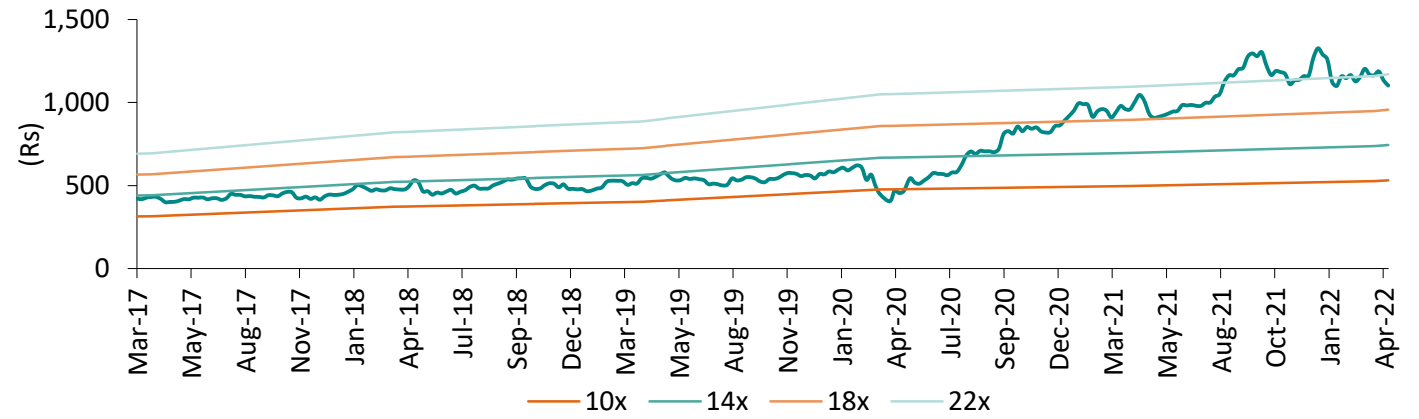
Source: Company; IDBI Capital Research

**Exhibit 8: SG&A saw a QoQ uptick**



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	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Net sales</b>	<b>5,05,700</b>	<b>6,04,280</b>	<b>7,53,790</b>	<b>8,56,510</b>	<b>9,66,976</b>	<b>10,83,700</b>
<i>Change (yoy, %)</i>	8	19	7	14	13	12
Operating expenses	(3,91,300)	(4,64,590)	(5,46,040)	(6,51,210)	(7,46,070)	(8,31,770)
<b>EBITDA</b>	<b>1,14,400</b>	<b>1,39,690</b>	<b>2,07,750</b>	<b>2,05,300</b>	<b>2,20,906</b>	<b>2,51,930</b>
<i>Change (yoy, %)</i>	11	22	24	-1	8	14
<i>Margin (%)</i>	22.6	23.1	27.6	24.0	22.8	23.2
Depreciation	(14,520)	(21,480)	(46,110)	(43,260)	(39,046)	(41,026)
<b>EBIT</b>	<b>99,880</b>	<b>1,18,210</b>	<b>1,61,640</b>	<b>1,62,040</b>	<b>1,81,860</b>	<b>2,10,905</b>
Interest paid	-	-	-	-	-	-
Other income	11,110	8,050	4,160	7,470	7,322	7,322
<b>Pre-tax profit</b>	<b>1,10,990</b>	<b>1,26,260</b>	<b>1,65,800</b>	<b>1,69,510</b>	<b>1,89,182</b>	<b>2,18,227</b>
Tax	(23,160)	(24,810)	(36,150)	(34,280)	(45,404)	(52,374)
<i>Effective tax rate (%)</i>	20.9	19.6	21.8	20.2	24.0	24.0
Minority Interest	-	(220.0)	(240.0)	(240.0)	(800.0)	(800.0)
<b>Net profit</b>	<b>87,830</b>	<b>1,01,230</b>	<b>1,29,410</b>	<b>1,34,990</b>	<b>1,42,979</b>	<b>1,65,052</b>
Exceptional items	-	-	-	-	-	-
<b>Adjusted net profit</b>	<b>87,830</b>	<b>1,01,230</b>	<b>1,29,410</b>	<b>1,34,990</b>	<b>1,42,979</b>	<b>1,65,052</b>
<i>Change (yoy, %)</i>	4	15	18	4	6	15
EPS	31.5	37.3	47.7	49.7	52.7	60.8
Dividend per sh	4	4	26	44	46	52
<i>Dividend Payout %</i>	15	13	55	88	87	85

## Balance Sheet

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E*	FY23E	FY24E
<b>Shareholders' funds</b>	<b>3,65,052</b>	<b>4,13,660</b>	<b>5,99,130</b>	<b>6,14,719</b>	<b>6,32,869</b>	<b>6,56,810</b>
Share capital	5,569	5,425	5,427	5,427	5,427	5,427
Reserves & surplus	3,59,483	4,08,235	5,93,703	6,09,291	6,27,441	6,51,383
<b>Total Debt</b>	<b>4,371</b>	<b>37,010</b>	<b>38,280</b>	<b>38,280</b>	<b>38,280</b>	<b>38,280</b>
Other liabilities	4,412	(6,250)	37,200	43,620	50,580	57,933
<b>Curr Liab &amp; prov</b>	<b>99,143</b>	<b>1,15,750</b>	<b>1,73,830</b>	<b>2,05,187</b>	<b>2,30,061</b>	<b>2,57,575</b>
Current liabilities	85,717	1,00,650	1,51,370	1,72,345	1,93,682	2,16,227
Provisions	13,426	15,100	22,460	32,841	36,378	41,347
<b>Total liabilities</b>	<b>1,07,926</b>	<b>1,46,510</b>	<b>2,49,310</b>	<b>2,87,087</b>	<b>3,18,920</b>	<b>3,53,788</b>
<b>Total equity &amp; liabilities</b>	<b>4,76,094</b>	<b>5,61,200</b>	<b>8,50,130</b>	<b>9,03,736</b>	<b>9,54,519</b>	<b>10,14,128</b>
Net fixed assets	1,95,904	2,31,230	3,50,470	3,29,090	3,08,044	2,85,019
Investments	268	850	890	890	890	890
Other non-curr assets	29,418	31,900	68,260	77,438	87,425	97,978
<b>Current assets</b>	<b>2,50,504</b>	<b>2,97,220</b>	<b>4,30,510</b>	<b>4,96,318</b>	<b>5,58,159</b>	<b>6,30,241</b>
Inventories	2,355	910	940	1,173	1,325	1,485
Sundry Debtors	96,394	1,17,060	1,36,630	1,54,876	1,85,448	2,07,833
Cash and Bank	1,02,731	1,00,920	1,56,610	1,83,046	1,88,589	2,16,060
Loans and advances	26,181	13,120	48,410	56,318	63,582	71,257
<b>Total assets</b>	<b>4,76,094</b>	<b>5,61,200</b>	<b>8,50,130</b>	<b>9,03,736</b>	<b>9,54,519</b>	<b>10,14,128</b>

Note: \*Awaiting Annual Report

**Cash Flow Statement**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E*	FY23E	FY24E
Pre-tax profit	1,10,990	1,26,260	1,65,800	1,69,510	1,89,182	2,18,227
Depreciation	14,520	15,268	46,110	43,260	39,046	41,026
Tax paid	(23,160)	(38,843)	(24,190)	(34,280)	(45,404)	(52,374)
Chg in working capital	(25,398)	10,447	(54,560)	4,969	(13,113)	(2,706)
Other operating activities	(38,335)	(80,893)	32,445	(14,021)	(20,530)	(14,420)
<b>Cash flow from operations (a)</b>	<b>38,617</b>	<b>32,240</b>	<b>1,65,605</b>	<b>1,69,439</b>	<b>1,54,609</b>	<b>1,89,752</b>
Capital expenditure	(49,362)	(50,594)	(44,160)	(21,880)	(18,000)	(18,000)
Chg in investments	1,198	(582)	(120)	-	-	-
Other investing activities	-	-	-	-	-	-
<b>Cash flow from investing (b)</b>	<b>(48,164)</b>	<b>(51,176)</b>	<b>(44,280)</b>	<b>(21,880)</b>	<b>(18,000)</b>	<b>(18,000)</b>
Equity raised/(repaid)	(84)	(144)	-	-	-	-
Debt raised/(repaid)	(1,046)	32,639	(8,650)	-	-	-
Dividend (incl. tax)	(13,410)	(13,064)	(70,555)	(1,19,401)	(1,24,829)	(1,41,111)
Chg in minorities	-	(2,306)	(90)	-	-	-
Other financing activities	-	-	-	-	-	-
<b>Cash flow from financing (c)</b>	<b>(14,540)</b>	<b>17,125</b>	<b>(79,295)</b>	<b>(1,19,401)</b>	<b>(1,24,829)</b>	<b>(1,41,111)</b>
<b>Net chg in cash (a+b+c)</b>	<b>(24,087)</b>	<b>(1,811)</b>	<b>42,030</b>	<b>28,157</b>	<b>6,353</b>	<b>30,641</b>

Note: \*Awaiting Annual Report

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	131	152	221	227	233	242
Adj EPS (Rs)	31.5	37.3	47.7	49.7	52.7	60.8
Adj EPS growth (%)	5	18	18	4	6	15
EBITDA margin (%)	23	23	28	24	23	23
Pre-tax margin (%)	22	21	22	20	20	20
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	28	29	26	24	26	28
ROE (%)	25.2	26.0	23.3	22.2	22.9	25.6
<b>DuPont Analysis</b>						
Asset turnover (x)	1.1	1.2	0.9	1.0	1.0	1.1
Leverage factor (x)	1.3	1.3	1.5	1.4	1.5	1.5
Net margin (%)	17.4	16.8	17.2	15.8	14.8	15.2
<b>Working Capital &amp; Liquidity ratio</b>						
Inventory days	2	1	0	1	1	1
Receivable days	70	71	66	66	70	70
Payable days	8	10	12	11	11	11

### Valuations

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
PER (x)	34.9	29.5	23.1	22.1	20.9	18.1
Price/Book value (x)	8.4	7.2	5.0	4.9	4.7	4.5
EV/Net sales (x)	5.9	4.8	3.8	3.3	2.9	2.6
EV/EBITDA (x)	26	21	14	14	13	11
Dividend Yield (%)	0	0	2	4	4	5

Source: Company; IDBI Capital Research



# Notes

Dealing

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**Key to Ratings Stocks:****BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

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