

HCL Technologies

BSE SENSEX 54,088
S&P CNX 16,167



Stock Info

Bloomberg	HCLT IN
Equity Shares (m)	2,714
M.Cap.(INRb)/(USDb)	2876.9 / 37.2
52-Week Range (INR)	1377 / 895
1, 6, 12 Rel. Per (%)	2/1/7
12M Avg Val (INR M)	5310

Financials Snapshot (INR b)

Y/E Mar	2022	2023E	2024E
Sales	857	990	1,121
EBIT Margin (%)	18.9	18.1	18.8
PAT	135	143	169
EPS (INR)	49.8	52.9	62.3
EPS Gr. (%)	13.8	6.1	17.7
BV/Sh. (INR)	229	236	243

Ratios

RoE (%)	21.9	22.8	26.0
RoCE (%)	19.6	20.4	23.3
Payout (%)	75.0	75.0	75.0

Valuations

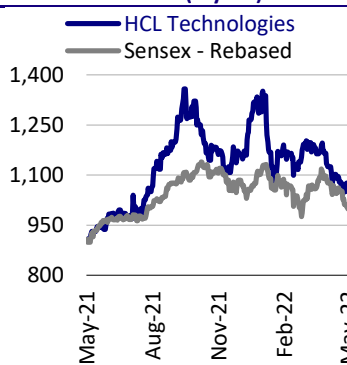
P/E (x)	21.3	20.0	17.0
P/BV (x)	4.6	4.5	4.4
EV/EBITDA (x)	13.9	12.7	10.9
Div Yield (%)	3.5	3.7	4.4

Shareholding pattern (%)

As On	Mar-22	Dec-21	Mar-21
Promoter	60.7	60.3	60.3
DII	14.7	13.8	10.6
FII	19.2	20.6	24.1
Others	5.4	5.3	5.0

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR1,060 TP: INR1,310 (+24%)

Buy

Strong commentary on Services, P&P rebuilding to take time

The stock continues to be attractively valued

We attended HCLT's Analyst Day, where the management reiterated their positive stance on IT Services and ER&D verticals, while detailing the steps being undertaken to return to growth in its struggling Products and Platform (P&P) business. The management reiterated its FY23 guidance of growing revenue by 12-14% and EBIT margin in the 18-20% range, and also introduced its five strategic objectives. We continue to expect strong growth in its Services portfolio in FY23, which should help re-rate the stock.

Five strategic objectives to drive value creation

- The management introduced five strategic objectives, which it will focus on to create value for all stakeholders:
 - Leadership through differentiated services and products: HCLT expects to differentiate its offerings through innovation, Cloud capabilities, integrated solutions, and accelerators.
 - Employer of choice in professional services across geographies: It prides itself on being a company of choice for employees.
 - Preferred Digital partner for global 2000 enterprises, with 70% of Tech spends by these entities. HCLT will focus on these clients selectively to transform brands at scale.
 - EGS is a major focus area of the company, with support at the board level and a desire to continue to increase diversity.
 - Top quartile TSR over the medium term: The management's focus will be to organically grow the business, while maintaining a high capital allocation and sustainability in growth.

Cloud driving spends in IT and business services

- The management is not anticipating any slowdown in technology spends in the current environment, despite an adverse macro-economic environment.
- It sees Cloud as a key growth factor for the industry, with 51% of Tech spends being skewed towards Cloud by CY25.
- It sees significant opportunities in sub-segments like app and data, Digital workspace, and security and compliance.

Continued growth in legacy and Digital Engineering to aid stability

- The management said Digital Engineering constitutes ~30% of its ER&D vertical and is growing rapidly.
- As the company continues to gain from its traditional/legacy exposure, which provides stability in growth in a moderating demand environment, it remains a cash cow to fund growth in Digital Engineering.
- HCLT sees Digital Engineering, high growth verticals, and high potential geographies (Japan, Germany, and France) as their big bets in ER&D.

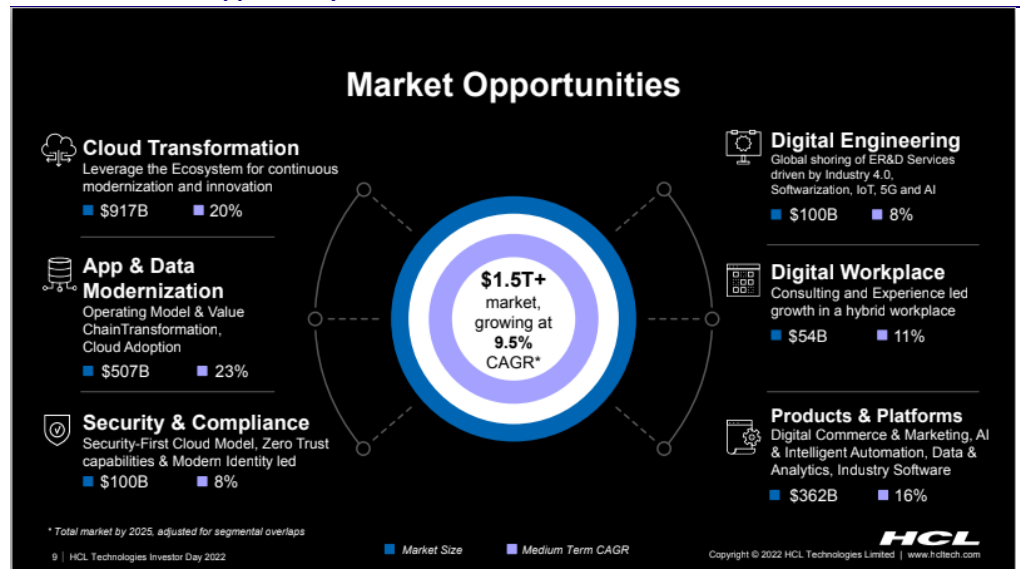
Product stabilization and shift to SaaS to keep P&P muted

- HCLT has seen a big expansion in its client portfolio due to the acquired products in the P&P business. It now has a presence in majority of the Fortune 100/500 customers.
- It also provides categorization of products, with weakness in its core products of Horizon 1 (Domino, Sametime, Connections, etc.) being compensated by growth in Horizon 2 (growth products) and Horizon 3 (explore products).
- The management expects growth in the Horizon 1 business to take time to return due to a shift in focus towards a SaaS-based subscription model and streamlining of product sales.

Valuations offer a margin of safety

- Higher exposure to Cloud, which comprises a larger share of non-discretionary spend, offers a better resilience to its portfolio in the current context, with higher demand for Cloud, Network, Security, and Digital workplace services.
- Strong sequential growth within Services, robust headcount addition, healthy deal wins, and a solid pipeline indicates an improved outlook.
- Given its deep capabilities in the IMS space and strategic partnerships, investments in Cloud, and Digital capabilities, we expect HCLT to emerge stronger on the back of an expected increase in enterprise demand for these services. The stock is trading ~17x FY24E EPS, which offers a margin of safety. Our TP is based on 21x FY24E EPS. We maintain our **Buy** rating.

Exhibit 1: Market opportunity



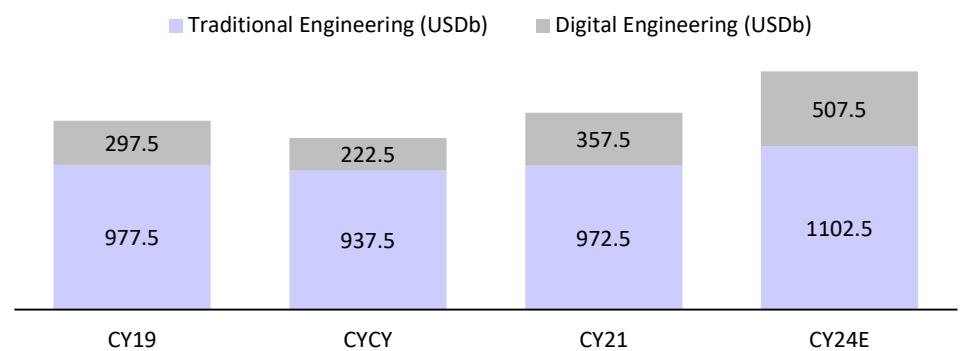
Source: MOSL, Company

Cloud, ER&D, Digital foundation and ecosystem

- There is huge opportunity around Cloud transformation with Cloud native and modern data architectures.
- Industry-specific solutions are creating more opportunities such as telebanking; online banking; KYC modernization; sustainable lending in **Banking** and supply-chain transformation; B2C trends, Industry 4.0 in **Manufacturing** and omnichannel; and hyper-personalization in **Consumer and Retail**.

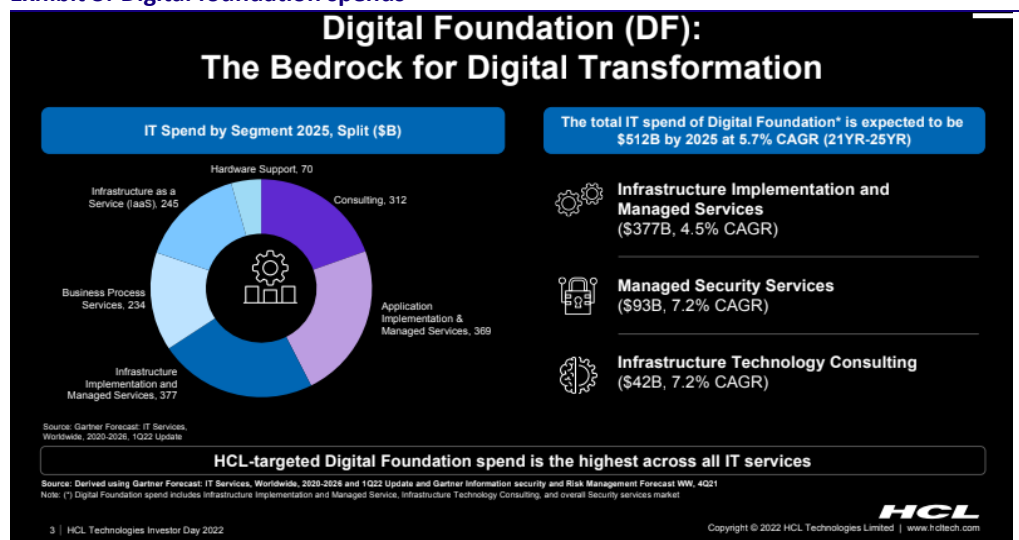
- Share of Digital ER&D is expected to grow to 31% in CY24 from 27% in CY21, with Digital ER&D growing at 12.3-12.5% CAGR over CY21-24 to reach spends of USD505-510b.
- Around 54% of these spends are from the top 100 spenders. About 61 of top 100 R&D spenders are customers of HCLT. It has a team of over 45k personnel, with more than 2,000 patents (300 in Digital).
- The management said cross-selling will help HCLT to grow ahead of the market.
- Growth levers for ERS include: 1) Significant headroom for growth with sourcing set to increase to 12% from 9%, 2) Long-standing relationships with customers, 3) High propensity of customers to buy HCL Transformation services, and 4) Investments in global new vistas.
- Total IT spend for Digital foundation is expected to be USD512b by CY25, with Infrastructure at USD377b (4.5% CAGR over CY21-25), Managed Services at USD93b (7.2% CAGR over CY21-25), and Infrastructure Technology Consulting at USD42b (7.2% CAGR over CY21-25).
- By CY25, more than 51% of Enterprises' IT spends will be Cloud-related.

Exhibit 2: Global ER&D spends



Source: MOFSL, Company

Exhibit 3: Digital foundation spends

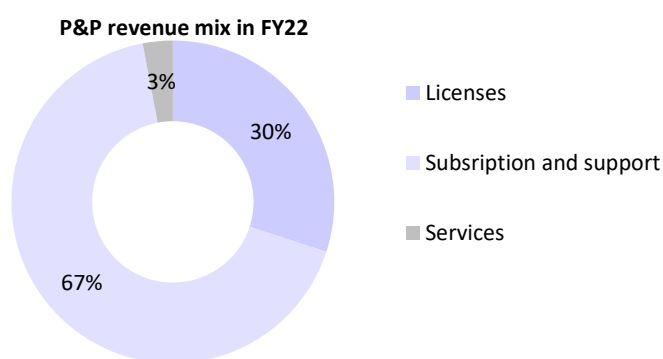


Source: MOFSL, Company

P&P outlook

- HCLT entered the acquired product business to gain access to the products market, with close to 6,800 customers transitioning to HCLT.
- HCLT gained 68 Fortune 100 accounts, 223 Fortune 500 accounts, 221 Global 500 accounts, 540 Global 2000 accounts, 276 public sector accounts, 775 business partners across 132 countries and more than 75 products from the acquisition.
- HCLT has identified four key markets for the products: 1) Digital Transformation market (USD17.4b TAM), 2) AI & Intelligent automation market (USD21.4b TAM), 3) Data and Analytics market (USD34.1b TAM) and 4) Industry software market (USD24.4b TAM)
- It will integrate the offerings by combining related products into seven solutions with four key markets.
- This will provide good cross-selling and up-selling opportunities to the company.
- HCLT has identified 21 products that it wishes to convert to SaaS offerings from current license based sales.
- The shift to a subscription-based model will bring stability and predictability in the business. The management indicated that this is a multi-year journey.
- The management also indicated that it has already recovered about 68% of the investments and stressed that it is good business with 18% IRR in USD terms after tax.
- The management expects margins for this business to improve from current levels in FY23.
- It eluded a six-point strategy for the P&P business: 1) Differentiated Execution by product mix, 2) Increased focus on indirect channels, 3) Increased renewal focus, 4) Increased profitability for IP partnership products, 5) Shift to a subscription model and 6) Leveraging P&P base for service expansion.

Exhibit 4: P&P revenue mix



Source: MOSL, Company

Talent initiatives

- The management highlighted that employee engagement is very curtail to boost productivity and retain talent.
- The company is increasing employee engagement with Wellness programs, driving employee passion, arranging family connect and celebrating the success.
- HCLT is expanding to more geographies, defining skill cohorts and running huge training and upskilling program as some of the talent initiatives.
- Its talent strategy includes external hiring, internal talent development, expanding new Vistas, Glocalisation, and increased fresher talent.
- As a succession planning initiative, it has identified 500/600 current/next leaders and has 3,000 people covered under RSU plans.

Financials and valuations

Income Statement								(INR b)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Sales	467	506	604	707	754	857	990	1,121
Change (%)	14.2	8.2	19.5	17.0	6.7	13.6	15.6	13.3
Cost of Goods Sold	309	332	393	453	467	546	644	724
Gross Profit	158	173	212	254	287	311	346	397
Selling and Admin Exp.	55	59	72	87	93	109	126	140
EBITDA	103	114	140	167	193	202	221	257
As a percentage of Net Sales	22.1	22.6	23.1	23.6	25.6	23.6	22.3	22.9
Depreciation	8	15	21	28	40	40	42	46
EBIT	95	100	118	139	153	162	179	211
As a percentage of Net Sales	20.3	19.8	19.6	19.6	20.4	18.9	18.1	18.8
Other Income	9	11	8	2	7	8	10	11
PBT	104	111	126	140	160	170	189	222
Tax	23	23	25	29	41	34	45	53
Rate (%)	21.7	20.9	19.6	20.9	25.4	20.3	24.0	24.0
PAT	82	88	101	111	119	136	144	169
Net Income	85	88	101	111	119	135	143	169
Change (%)	13.5	3.8	15.3	9.3	7.4	13.7	6.0	17.7

Balance Sheet								(INR b)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Reserves	335	368	422	517	615	620	638	658
Net Worth	335	368	422	517	615	620	638	658
Loans	5	4	40	51	39	39	39	39
Other liabilities	13	13	15	55	55	43	69	76
Capital Employed	353	385	477	623	709	703	746	773
Gross Block	225	274	335	511	546	560	600	645
Less: Depreciation	64	78	100	128	168	208	250	296
Net Block	161	196	235	383	378	352	350	349
Other assets	39	40	57	65	69	57	84	91
Investments	114	83	55	105	140	85	85	85
Curr. Assets	151	165	243	279	291	397	418	448
Debtors	108	123	146	178	175	207	240	269
Cash and Bank Balance	13	17	59	38	65	105	112	103
Other Current Assets	30	25	37	64	50	85	66	75
Current Liab. and Prov.	111	99	111	209	168	188	190	199
Net Current Assets	40	66	131	70	123	209	228	249
Application of Funds	353	385	477	623	709	703	746	774

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Diluted (INR)								
EPS	28.9	31.3	36.8	40.7	43.8	49.8	52.9	62.3
Cash EPS	32.9	36.4	44.6	51.2	58.5	64.6	68.2	79.2
Book Value	118.6	131.4	153.5	190.4	226.7	228.6	235.5	243.2
DPS	12.0	6.0	4.0	8.0	26.0	37.4	39.7	46.7
Payout (%)	41.6	23.1	50.4	19.6	59.4	75.0	75.0	75.0
Valuation (x)								
P/E	36.7	33.9	28.8	26.0	24.2	21.3	20.0	17.0
Cash P/E	32.2	29.1	23.8	20.7	18.1	16.4	15.5	13.4
EV/EBITDA	29.0	25.9	20.7	17.3	14.7	13.9	12.7	10.9
EV/Sales	6.4	5.9	4.8	4.1	3.8	3.3	2.8	2.5
Price/Book Value	8.9	8.1	6.9	5.6	4.7	4.6	4.5	4.4
Dividend Yield (%)	1.1	0.6	0.4	0.8	2.5	3.5	3.7	4.4
Profitability Ratios (%)								
RoE	26.5	25.0	25.6	23.6	21.0	21.9	22.8	26.0
RoCE	23.6	22.2	22.8	21.3	18.7	19.6	20.4	23.3
Turnover Ratios								
Debtors (Days)	84	88	88	92	85	88	88	88
Asset Turnover (x)	2.9	2.6	2.6	1.8	2.0	2.4	2.8	3.2

Cash Flow Statement

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
CF from Operations	90	102	123	149	166	174	185	215
Chg. in Working Capital	5	-35	-34	-16	30	-5	-13	-31
Net Operating CF	95	68	88	134	196	169	172	184
Net Purchase of FA	-62	-49	-61	-18	-18	-16	-40	-45
Net Purchase of Invest.	-2	30	29	-105	-40	30	0	0
Net Cash from Inv.	-64	-19	-32	-124	-57	15	-39	-44
Issue of shares/other adj.	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	9	-1	35	-15	-79	-31	0	0
Dividend Payments	-34	-20	-51	-16	-33	-114	-126	-148
Net CF from Finan.	-25	-21	-16	-32	-112	-145	-126	-148
Free Cash Flow	33	18	28	115	179	153	132	139
Net Cash Flow	6	27	41	-22	27	39	7	-9
Forex difference	0	-27	5	0	1	1	0	0
Opening Cash Balance	7	13	13	60	38	66	106	113
Closing Cash Balance	13	13	60	38	66	106	113	104

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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