KRChoksey | Institutional

HCL Technologies Limited

Result Update

13th July, 2022

HCL Technologies Limited.

Seasonal impact and margin pressure on Service businesses; yet valuation remains attractive

CMP	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 918	**INR 1,119**	**22%**	**INR 2,493,044**	**BUY**	**Internet Software & Services**

Synopsis:

HCL Technologies Limited (HCLT) Q1FY23 performance was in line with our estimate and posted a steady quarter and grew by 2.7% QoQ, impacted by seasonally weak services businesses. Strong growth in ERS, supported by two large ERS deals (both in the ISV segment), growth in ER&D services, Mode-2 driving IT&BS growth, cross-sell of services into the P&P customer base, integrated/vendor consolidation deals, positive commentary on the deal pipeline & net new bookings, pricing, sub-contracting cost rationalization, fresher/pyramid and utilization are expected to be the key drivers for revenue growth and margin expansion going ahead. Proactive investments in digital competencies, especially on data, cloud and experience did impact margins but have improved the durability of growth. Our target price of INR 1,119 is based on 20x Mar-24E EPS with EPS CAGR of 7.3% over FY22-24E.

MARKET DATA

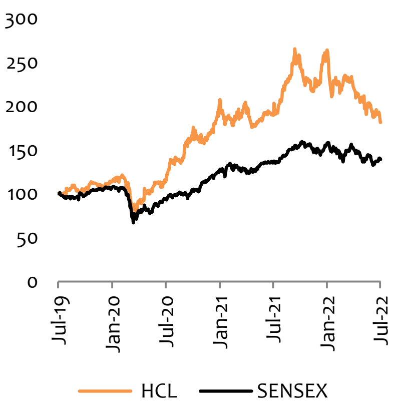
Shares outs (Mn)	2,714
Mkt Cap (INR Mn)	2,493,044
52 Wk H/L (INR)	1,377/905
Volume Avg (3m K)	3320.4
Face Value (INR)	2
Bloomberg Code	HCLT IN

KEY FINANCIALS

(INR Mn)	Q1FY23A	Q4FY22A	Q1FY22A	QoQ	YoY	KRChoksey Est.	Variance (%)
USD Revenue	3,025	2,993	2,720	1.1%	11.2%	3,025	0.0%
Revenue	2,34,640	2,25,970	2,00,680	3.8%	16.9%	2,33,514	0.5%
EBIT	39,920	40,690	39,310	-1.9%	1.6%	41,798	-4.5%
PAT	32,830	35,897	32,159	-8.5%	2.1%	34,012	-3.5%
OPM (%)	17.0%	18.0%	19.6%	-99 bps	-258	17.9%	-89 bps
NPM(%)	14.0%	15.9%	16.0%	-189bps	-203	14.6%	-57

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



Seasonality impacted services business; strength in P&P business (excl. CFT business)

HCLT revenue came in line with our estimate at USD 3,025mn, +2.7/+15.6% QoQ/YoY CC. Total services revenue grew 2.3% QoQ CC, led by ER&D growth of 3.7% QoQ CC, followed by IT & BS growth of 2% QoQ CC. P&P revenue witnessed healthy growth of 5.1% QoQ CC. Overall revenue growth guidance of 12-14% in CC terms and EBIT margin guidance of 18-20% (for FY23) have not been changed but margin has been guided to come in at the lower end of the range. It was indicated that the price increase from clients was taking longer than expected and some unanticipated 3rd party outsourcing and subcontractor costs have hit margins in 1QFY23. P&P vertical saw decent growth and strong margin performance in 1QFY23 due to favorable seasonality. The growth visibility remains low and we expects to see good potential for the business in the long run. Within verticals, growth was led by technology & services (+10.9% QoQ CC) and telecom & media (+4.3% QoQ CC). US grew at a healthy pace, up by 2.8% QoQ CC but Europe witnessed softness (up 1.6% QoQ CC).

Strong deal wins to drive growth across geographies

HCLT booked a net-new TCV of USD 2.05bn (+23.4% YoY), which included seven large services deals and nine product deals in the quarter. The continued strong deal TCV (Services book-to-bill ratio of 0.8x) and pipeline commentary should help them improve growth in the second quarter. We expect HCLT's Services business to do well on the back of a favorable demand environment for Cloud migration and ER&D outsourcing. Deal wins are a combination of medium/ large deals across all verticals/geographies especially in CX transformation, IT operating model transformation and consulting. Net additions were ~+2K, taking the headcount to ~210k, supported by ~6k fresher added in Q1FY23. The management intends to add ~10k fresher in Q2 and around ~35k fresher for FY23E.

MARKET INFO

SENSEX	53,886.6
NIFTY	16,058.3

EBIT margin guidance band to 18-20%

EBIT margin came at 17%, led by 130-140 bps QoQ decline in IT Services and 40bps QoQ drop in ER&D segment which was partially offset by Product business. Margin were impacted by 100bps from higher outsourcing costs, 50bps impact from retention/employee addition costs, 35 bps from travel/visa costs which was partially offset by exchange gains of 40bps along with other operational levers. As of now, management finds no significant difference in client spending behavior and has indicated that they will be in line with the lower base of the margin guidance going ahead.

SHARE HOLDING PATTERN (%)

Particulars	Mar-22	Dec-21	Sep-21
Promoters	60.7	60.3	60.3
FIIs	19	20.3	22.3
DIIs	14.7	13.7	12.47
Others	5.6	5.7	4.9
Total	100	100	100

7.8%

Revenue CAGR between FY22 and FY24E

7.3%

PAT CAGR between FY22 and FY24E

ANALYST
Saptarshi Mukherjee, research4@krchoksey.com, +91-22-6696 5555

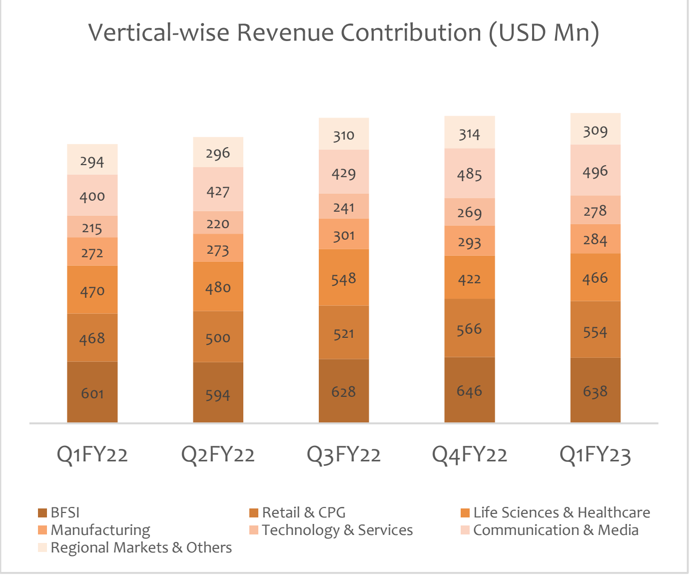
HCL Technologies Limited.

Key Concall Highlights:

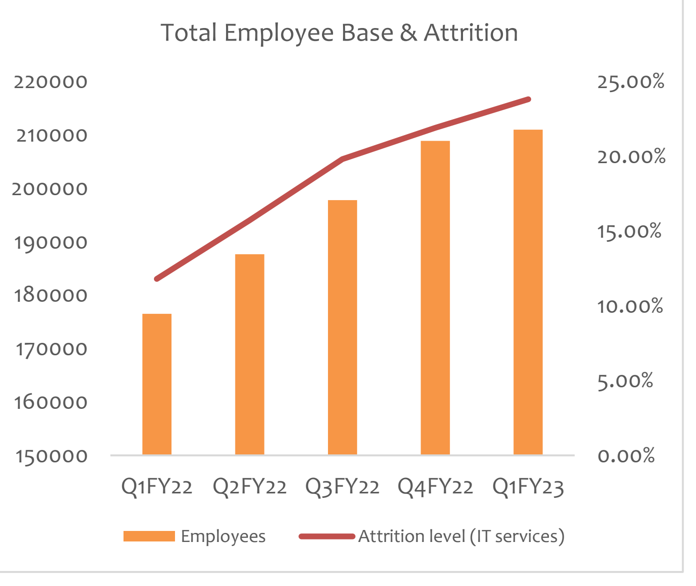
(i) The management is not seeing any slowdown in demand. It continued with its FY23 revenue guidance of 12-14% CC growth (ii) It expects margins to improve from current levels and has guided the margin at the lower end of its guided band of 18-20% for FY23. And it has also indicated that despite salary increases, EBIT margin would improve in 2Q and in 3Q before falling back again in 4Q (iii) Products & Platforms (P&P) grew by ~5% QoQ and ~1% YoY (ex-divested businesses, optically down by 10%) and we think that the June quarter tends to be seasonally the second-best quarter for software business (iv) Net new bookings came in at USD 2.05bn (up by 23.4% YoY) which includes Services TCV at USD 1,950mn, propelled by 7 net new large deal wins and Products TCV at USD 104mn, enabled by 9 net new large deal wins. The pipeline was indicated to be at close to record high and is broad-based across all dimensions with good mix of small-sized deals and large-sized deals.

Valuation and view

HCLT is currently trading at a valuation with a P/E multiple of 17.4x/16.4x on FY23E/FY24E earnings. Given its deep capabilities in the IMS space and strategic partnerships, continued investments in the cloud/digital capabilities, we expect HCLT to emerge stronger on the back of rising demand for the services from the enterprises. Due to global fear for recession in USA/Europe, continued supply side pressure, higher attrition, lower realization/utilization, we are reducing our target price to INR 1,119 (Earlier target price of INR 1,391 per share) with a P/E multiple of 20x to the FY24 estimated EPS of INR 56, an upside of ~22% over the CMP. Accordingly, we maintain our rating to "BUY" rating to the stock.



Source: Company, KRChoksey Research



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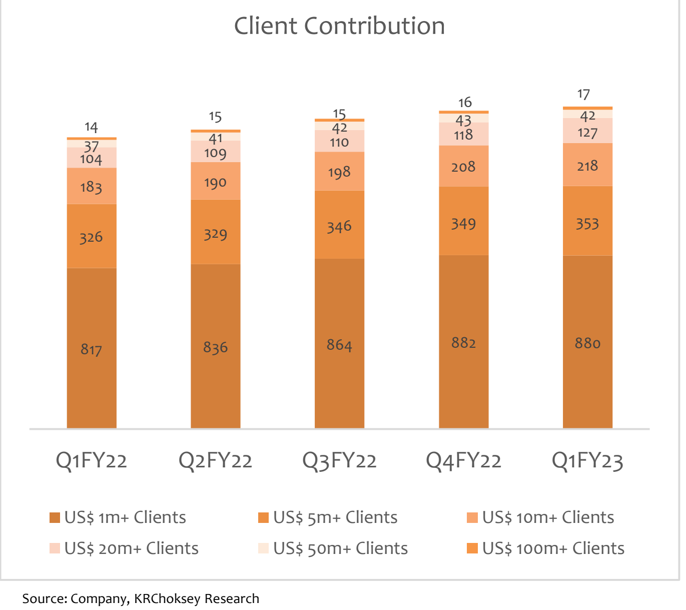

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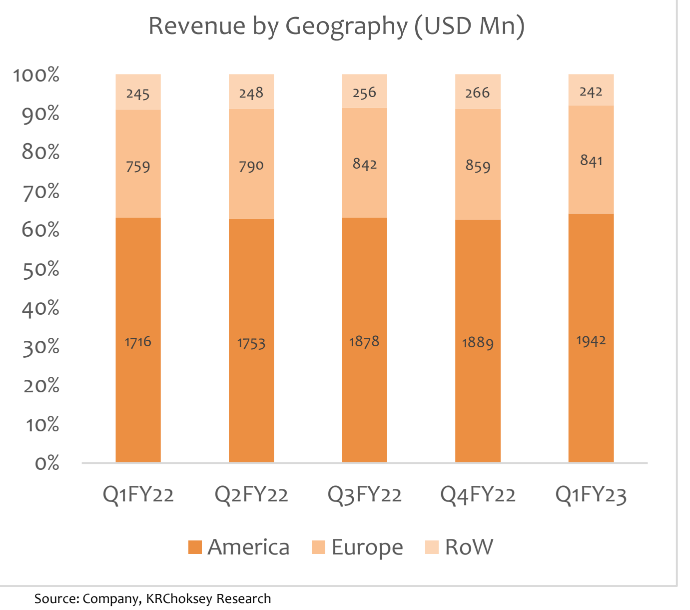

Source: Company, KRChoksey Research

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Saptarshi Mukherjee, research4@krchoksey.com, +91-22-6696 5555

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KEY FINANCIALS
Exhibit 1: Balance Sheet

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Property, Plant and Equipment	46,538	52,701	58,440	56,420	42,637	41,970	43,261
Right-of-use Asset	0	0	26240	23920	23920	23920	23920
CWIP	5,310	5,310	4,000	3,210	3,210	3,210	3,210
Intangible Assets	1,44,057	1,76,950	2,94,210	2,91,500	2,91,500	2,91,500	2,91,500
Other non current assets	37,675	52,940	64,640	68,160	68,160	68,160	68,160
Investments	5,222	3,900	380	470	470	470	470
Total non current assets	**2,38,801**	**2,91,800**	**4,47,910**	**4,43,680**	**4,29,897**	**4,29,230**	**4,30,521**
Cash & equivalent	74205	91710	83850	137170	197919	227761	280098
Accounts receivable (Net)	96,394	1,17,060	1,41,340	1,36,630	1,51,858	1,72,145	1,90,805
Unbilled revenue	26,181	29,040	36,380	38,620	55,830	61,480	70,871
Investment securities, available for sale	23,572	22,200	69,880	67,730	67,730	67,730	67,730
Other current assets	25,198	37,160	52,800	50,370	50,370	50,370	50,370
Total current assets	**2,45,550**	**2,97,170**	**3,84,250**	**4,30,520**	**5,23,707**	**5,79,485**	**6,59,874**
Total Assets	**4,84,351**	**5,88,970**	**8,32,160**	**8,74,200**	**9,53,604**	**10,08,715**	**10,90,395**
Equity Share Capital	2,803	2,751	5,426	5,427	5,427	5,427	8,141
Other Equity	3,65,365	4,14,949	5,11,434	6,09,633	6,80,457	7,44,541	8,13,869
Equity Attributable to Owners of the Company	3,68,168	4,17,700	5,16,860	6,15,060	6,85,885	7,49,968	8,22,010
Non controlling Interest	0	4,540	5,280	5,850	5,850	5,850	5,850
Total Equity	**3,68,168**	**4,22,240**	**5,22,140**	**6,20,910**	**6,91,735**	**7,55,818**	**8,27,860**
Operating Lease Liability	0	0	24,720	22,670	22,670	22,670	22,670
Other liabilities	12,669	15,390	25,490	26,820	26,820	26,820	26,820
Borrowings	4,371	39,860	50,920	39,070	35,163	31,256	31,256
Total non current liabilities	**17,040**	**55,250**	**1,01,130**	**88,560**	**84,653**	**80,746**	**80,746**
Trade Payables	17,887	18,028	15,816	24,275	23,409	22,111	24,346
Current portion of capital lease obligations	444	1,067	1,639	1,877	1,877	1,877	1,877
Short term loans	1,717	11,262	21,096	824	12,658	8,438	8,438
Accrued employee costs	20,672	27,933	29,931	41,339	39,743	35,327	35,327
Deferred revenues	6,645	10,664	25,378	31,940	34,538	38,034	42,156
Income Tax Liabilities	6,822	9,377	10,089	13,347	13,862	15,235	18,514
Other current liabilities	44,957	33,149	1,04,940	51,129	51,129	51,129	51,129
Total Current Liabilities	**99,143**	**1,11,480**	**2,08,890**	**1,64,730**	**1,77,216**	**1,72,152**	**1,81,789**
Total liabilities	**4,84,351**	**5,88,970**	**8,32,160**	**8,74,200**	**9,53,604**	**10,08,715**	**10,90,395**

Source: Company, KRChoksey Research

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KEY FINANCIALS

Exhibit 2: Profit & Loss Statement

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenue	5,05,700	6,04,270	7,06,780	7,53,790	8,56,510	8,97,611	9,94,913
Employee Cost	3,32,370	3,83,160	4,40,180	4,45,910	5,27,600	5,53,168	6,08,198
SG&A and Other Cost	58,930	81,100	99,660	1,07,310	1,23,610	1,19,382	1,32,323
EBITDA	**1,14,400**	**1,40,010**	**1,66,940**	**2,00,570**	**2,05,300**	**2,25,060**	**2,54,392**
Depreciation	14,530	21,470	28,410	39,850	43,260	54,524	66,363
EBIT	**99,870**	**1,18,540**	**1,38,530**	**1,60,720**	**1,62,040**	**1,70,536**	**1,88,029**
Other income, net	11,796	9,463	5,429	9,407	7,470	17,618	17,717
Finance costs	696	1,743	3,649	2,837	2,840	2,325	2,495
Pre-tax Income	**1,10,970**	**1,26,260**	**1,40,310**	**1,67,290**	**1,66,670**	**1,85,830**	**2,03,251**
Income tax expense	23,160	24,810	29,380	36,630	34,280	41,812	50,813
Net profit Before EI & MI	**87,810**	**1,01,450**	**1,10,930**	**1,30,660**	**1,32,390**	**1,44,018**	**1,52,439**
Minority Interest, MI	**10**	**220**	**310**	**560**	**560**	**560**	**560**
Net profit after MI	**87,800**	**1,01,230**	**1,10,620**	**1,30,100**	**1,31,830**	**1,43,458**	**1,51,879**
Diluted EPS (INR)	63.81	73.58	40.76	47.94	48.58	52.87	55.97
Shares in Million	1,402	1,376	2,714	2,714	2,714	2,714	2,714

Source: Company, KRChoksey Research

Exhibit 3: Free Cash Flow Analysis

Particulars (INR Mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Net Cash Generated From Operations	91,061	1,25,952	1,71,190	1,72,852	1,86,971	2,13,011	2,50,641
Net Cash Flow from/(used in) Investing Activities	-27,195	-41,576	-41,020	-37,940	-32,605	-53,857	-67,654
Net Cash Flow from Financing Activities	2,330	47,703	33,670	-30,791	7,927	-8,126	2,714
Others	82,543	75,815	1,63,024	69,190	1,01,544	1,21,186	1,33,363
Net Inc/Dec in cash equivalents	-16,347	56,264	816	34,931	60,749	29,842	52,338
Opening Balance	1,52,019	1,35,672	1,91,937	1,92,753	1,37,170	1,97,919	2,27,761
Closing Balance Cash and Cash Equivalents	1,35,672	1,91,937	1,92,753	2,27,684	1,97,919	2,27,761	2,80,098

Source: Company, KRChoksey Research

Exhibit 4: Ratio Analysis

Key Ratio	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
EBIT Margin (%)	19.7%	19.6%	19.6%	21.3%	18.9%	19.0%	18.9%
Tax rate (%)	20.9%	19.6%	20.9%	21.9%	20.6%	22.5%	25.0%
Net Profit Margin (%)	17.4%	16.8%	15.7%	16.5%	15.4%	16.0%	15.3%
RoE (%)	25.0%	25.8%	23.7%	22.0%	20.3%	20.0%	19.3%
RoCE (%)	22.1%	22.6%	20.7%	20.2%	18.6%	17.4%	17.1%
EV/EBITDA (x)	20.8	17.1	14.2	11.5	11.0	9.8	8.5
EPS (INR per share)	32.4	73.6	40.8	47.9	48.6	52.9	56.0

Source: Company, KRChoksey Research

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HCL Technologies Limited.

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Date	CMP (INR)	TP(INR)	Recommendation
13-Jul-22	918	1119	BUY
22-Jan-22	1102	1391	BUY
17-Jan-22	1268	1391	ACCUMULATE

Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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KR Choksey Shares and Securities Pvt. Ltd
Registered Office:
1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai – 400 001.
Phone: +91-22-6633 5000; Fax: +91-22-6633 8060.
Corporate Office:
ABHISHEK, 5th Floor, Link Road, Andheri (W), Mumbai – 400 053.
Phone: +91-22-6696 5555; Fax: +91-22-6691 9576.