

HCL Technologies

Estimate change

TP change

Rating change



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Bloomberg	HCLT IN
Equity Shares (m)	2,714
M.Cap.(INRb)/(USD\$b)	2518.4 / 31.6
52-Week Range (INR)	1377 / 925
1, 6, 12 Rel. Per (%)	-8/-19/-8
12M Avg Val (INR M)	5130

Financials & Valuations (INR b)

Y/E Mar	2022	2023E	2024E
Sales	857	992	1,096
EBIT Margin (%)	18.9	17.5	18.0
PAT	135	140	158
EPS (INR)	49.8	51.8	58.3
EPS Gr. (%)	13.8	3.9	12.6
BV/Sh. (INR)	229	226	223

Ratios

RoE (%)	21.9	22.8	26.0
RoCE (%)	19.6	20.1	23.1
Payout (%)	88.3	90.0	90.0

Valuations

P/E (x)	18.6	17.9	15.9
P/BV (x)	4.1	4.1	4.2
EV/EBITDA (x)	12.1	11.4	10.3
Div Yield (%)	4.7	5.0	5.7

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

CMP: INR928

TP: INR1,100 (+19%)

Buy

Muted IT services drag Q1 performance

Inexpensive valuation and defensive portfolio to support valuation

- HCLT delivered a revenue growth of 2.7% QoQ CC in 1QFY23 (60bp below our estimate) due to weaker growth in IT Services (+2% QoQ CC), partly compensated by better delivery in ER&D services (+3.7% QoQ CC) and a favorable seasonality in P&P (+5.1 QoQ CC). It reported stable new deal TCV of USD2.05b (down 6% QoQ, but up 23% YoY). The company maintained its FY23 USD CC revenue growth guidance of 12-14%.
- EBIT margin at 17% (-90bp QoQ) was 90bp below our estimate, with IT Services/ER&D down 170bp/50bp, partly offset by strong P&P margin, up 340bp QoQ. Though HCLT maintained its margin guidance of 18-20%, it now expects margin to be at the lower end of its guided band.
- While we were disappointed by the weak growth in the IT Services business, adverse seasonality (productivity pass-through), and high base (three straight quarters of strong delivery) indicate limited future read-through. Moreover, the continued strong deal TCV (Services book-to-bill ratio of 0.8x) and pipeline commentary should help them improve growth in 2QFY23. We expect HCLT's Services business to do well in a favorable demand environment for Cloud migration and R&D outsourcing.
- P&P vertical saw decent growth and strong margin performance in 1QFY23 due to favorable seasonality. Though growth visibility remains low, we continue to see good potential for the business in the long run, although it should see marginal growth over FY22-24E.
- HCLT's business has seen a meaningful contribution from relatively defensive work that is focused on cost efficiency and operations, but which should be less impacted in a demand constrained environment, positioning it well v/s its peers.
- On the margin side, we expect HCLT to continue to struggle due to elevated supply-side issues and weak start to FY23, which will result in its EBIT margin missing the lower end of its guidance by 50bp, before recovering in FY24.
- On a combined basis, HCLT should deliver an FY22-24 USD revenue growth of 10% and corresponding PAT CAGR of 8.1% due to lower margin. HCLT is currently trading ~16x FY24E EPS, which we see as inexpensive.
- HCLT generated a FCF of USD144m in 1QFY23, leading to a total cash and investments of USD1.5b at the end of the quarter. It also announced a dividend of INR10/share.
- We tweak down our FY23/FY24 estimate by 1%/3%. We maintain our **Buy** rating with a TP of INR1,110/share (19x FY24E EPS).

1QFY23 miss led by the IT Services business

- In USD terms, revenue grew in line at 2.7% QoQ CC (up 1.1% QoQ reported).
- PAT fell 8.7% QoQ to INR32.8b, missed our estimate by 2.6%.
- On a LTM basis, OCF/FCF stood at USD2b/USD1.8b, leading to a cash conversation of 112%/98% at the net income level.
- Attrition (LTM) in IT Services stood at 23.8%, up 190bp QoQ. Net additions were lower ~2.1k in 1QFY23.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Key highlights from the management commentary

- Digital and Cloud transformation continues to be the central theme for growth. Digital operation services, CX transformation, and Cloud smart led the growth in IT Services.
- The management is not seeing any slowdown in demand. It continued with its FY23 guidance of 12-14% CC growth.
- It expects margins to improve from current levels and guided the margin at the lower end of its guided band of 18-20% for FY23.

Valuations offer a margin of safety

- Strong sequential growth within Services, robust headcount addition, healthy deal wins, and a solid pipeline indicates an improved outlook.
- 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.
- **Given its deep capabilities in the IMS space and strategic partnerships, investments in the 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 ~16x FY24E EPS, which offers a margin of safety. Our TP is based on 19x FY24E EPS. We maintain our Buy rating.**

Quarterly performance
Y/E March

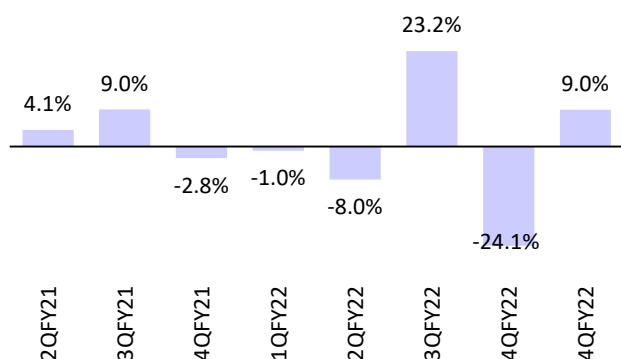
	FY22				FY23				FY22	FY23E	FY23E	(INR b)
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	Var. (%/bp)
Revenue (USD m)	2,720	2,791	2,978	2,993	3,025	3,094	3,237	3,254	11,481	12,610	3,060	-1.2
QoQ (%)	0.9	2.6	6.7	0.5	1.1	2.3	4.6	0.5	12.8	9.8	2.2	-118bp
Revenue (INR b)	201	207	223	226	235	244	256	257	857	992	236	-0.4
YoY (%)	12.5	11.1	15.7	15.0	16.9	18.4	14.5	13.8	13.6	15.8	17.4	-50bp
GPM (%)	39.2	38.2	38.2	36.8	35.8	36.2	36.7	36.0	38.1	36.2	36.3	-51bp
SGA (%)	12.8	13.0	12.4	12.7	12.9	12.8	12.8	12.7	12.7	12.8	12.5	42bp
EBITDA	49	50	54	52	50	53	57	56	202	216	52	-4.4
EBITDA margin (%)	24.5	24.0	24.1	23.1	21.3	21.8	22.3	21.7	23.6	21.8	22.2	-88bp
EBIT	39	39	43	41	40	43	46	45	162	174	42	-5.2
EBIT margin (%)	19.6	19.0	19.1	18.0	17.0	17.5	18.1	17.4	18.9	17.5	17.9	-85bp
Other income	2	2	2	3	3	2	3	3	8	11	2	46.4
ETR (%)	21.7	20.5	22.2	16.7	24.3	24.0	24.0	24.0	20.3	24.1	24.0	35bp
Adjusted PAT	32	33	34	36	33	34	37	36	135	140	34	-2.6
QoQ (%)	34.7	1.5	5.5	4.4	-8.7	4.7	7.8	-2.8			-6.2	-245bp
YoY (%)	10.0	3.9	0.3	50.6	2.1	5.3	7.7	0.2	13.7	3.8	4.9	-274bp
EPS	11.8	12.0	12.7	13.3	12.1	12.7	13.7	13.3	49.8	51.8	12.4	-2.6

Key performance indicators

Y/E March

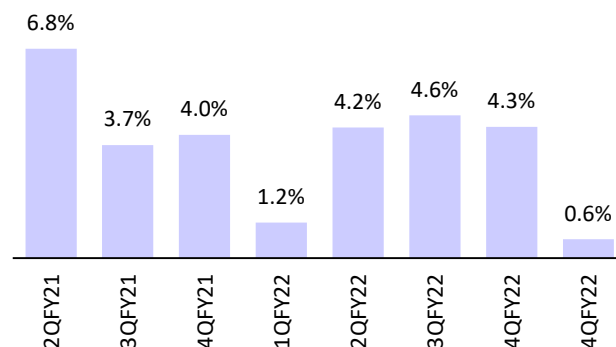
	FY22				FY23				FY22	FY23E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Revenue (QoQ CC %)	0.7	3.5	7.6	1.1	2.7				12.7	
Costs (as a percentage of revenue)										
COGS	60.8	61.8	61.8	63.2	64.2	63.8	63.3	64.0	61.9	63.8
SGA	12.8	13.0	12.4	12.7	12.9	12.8	12.8	12.7	12.7	12.8
Margins										
Gross margin	39.2	38.2	38.2	36.8	35.8	36.2	36.7	36.0	38.1	36.2
EBIT margin	19.6	19.0	19.1	18.0	17.0	17.5	18.1	17.4	18.9	17.5
Net margin	16.0	15.8	15.4	15.9	14.0	14.1	14.5	14.0	15.8	14.1
Operating metrics										
Headcount (k)	176	188	198	209	211				209	
Attrition (%)	11.8	15.7	19.8	21.9	23.8				21.9	
Key verticals (YoY CC %)										
BFSI	8.8	6.3	13.5	10.2	16.4				9.6	
Manufacturing	5.3	11.9	12.2	16.6	19.1				10.8	
Key geographies (YoY CC %)										
North America	13.5	10.7	15.0	13.0	17.5				13.0	
Europe	5.1	9.0	12.0	13.6	22.5				10.1	

Exhibit 1: QoQ growth in the P&P segment



Source: MOFSL, Company

Exhibit 2: QoQ growth in Services



Source: MOFSL, Company



Key highlights from the management commentary

Demand and industry outlook

- HCLT reported a revenue growth of 2.7% QoQ CC in 1QFY23. IT Services/ER&D/P&P grew 2%/3.7%/5.1%.
- In IT Services, growth was led by the US at 2.8% QoQ CC, followed by Europe at 1.6% QoQ CC. Among verticals, growth was led by Technology/Telecom and Media, which grew 10.9%/4.3% QoQ CC, followed by the Life Sciences vertical at 2.7% QoQ CC.
- Digital and Cloud transformation continues to be the central theme for growth. Digital operation services, CX transformation, and Cloud smart led the growth in IT Services.
- New deal TCV (down 9% QoQ, but up 23% YoY) stood at USD2.05b, led by 16 large deal wins, with a good mix of large and small deals.
- Pipeline remains close to a record high and is well diversified across geographies.
- The management is not seeing any slowdown in demand. It continued with its FY23 guidance of 12-14% CC growth.

Margin performance

- Margin fell 90bp QoQ to 17% in 1QFY23, led by a 170bp/50bp drop in IT Services/ER&D margin. The same was partly offset by a 340bp improvement in P&P margin.
- Margin was affected by higher outsourcing and sub-contractor expenses (100bp), greater attrition and employee backfilling costs (50bp), and rising travel and visa costs (35bp). The same was partly offset by a favorable (40bp) forex rate and operational efficiencies.
- Margin levers include increased pricing, fresher deployment, pyramid rationalization, improved utilization, offshoring, automation, and rationalizing outsourcing and sub-contractor expenses.
- It expects margins to improve from current levels and guided the margin at the lower end of its guided band of 18-20% for FY23.
- Delay in securing rate hikes in 1QFY23, higher than expected attrition, and greater outsourcing costs were negative surprises that led to margin guidance at the lower end of its guidance band.

Other highlights

- It hired ~6k freshers in 1Q and plans to hire ~10k freshers in 2QFY23.
- DSO were impacted by a delay in collections, which will reflect in coming quarters.
- Higher other income was on account of profit on disposal of property in 1QFY23.

Exhibit 3: Broad-based growth within geographies

Geographies	Contribution to revenue (%)	CC QoQ growth (%)	CC YoY growth (%)
Americas	64.2	2.8	17.5
Europe	27.8	1.6	22.5
RoW	8.0	1.1	18.2

Source: Company, MOFSL

Exhibit 4: Technology led growth in 1QFY23

Verticals	Contribution to revenue (%)	CC QoQ growth (%)	CC YoY growth (%)
Financial Services	21.1	0.8	16.4
Manufacturing	18.0	-0.5	19.1
Technology	17.5	10.9	34.2
Life Sciences and Healthcare	16.4	2.7	15.7
Telecom MP&E	9.2	4.3	29.2
Retail and CPG	9.4	-1.4	5.8
Public Services	10.2	-0.2	15.2

Source: Company, MOFSL

Exhibit 5: P&P led the growth in 1QFY23

Segments	Contribution to revenue (%)	CC QoQ growth (%)	CC YoY growth (%)
IT and Business Services	72.8	2.0	18.1
Engineering and R&D Services	16.6	3.7	23.0
Products and Platforms	11.0	5.1	-6.5

Source: Company, MOFSL

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 the 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 ~16x FY24E EPS, which offers a margin of safety. Our TP is based on 19x FY24E EPS. We maintain our **Buy** rating.

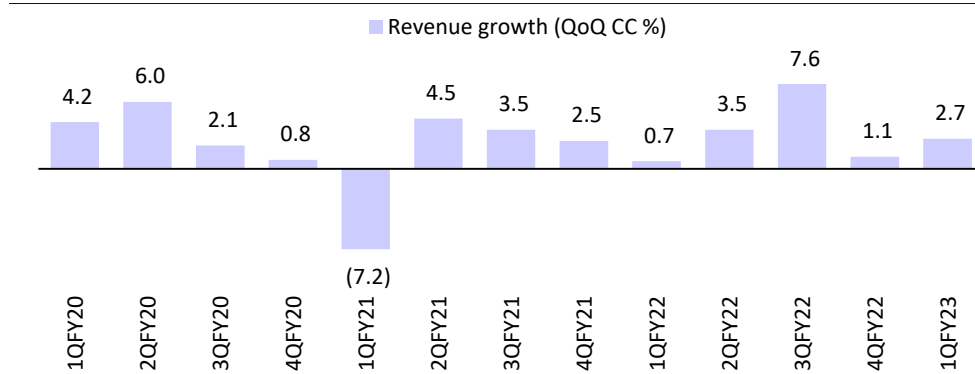
Exhibit 6: Revisions to our estimates

	Revised		Earlier		Change	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
USD:INR	78.7	79.0	78.5	79.0	0.2%	0.0%
Revenue (USD m)	12,610	13,868	12,674	14,109	-0.5%	-1.7%
Growth (%)	9.8	10.0	10.4	11.3	-60bp	-140bp
EBIT margin (%)	17.5	18.0	17.8	18.3	-30bp	-40bp
PAT (INR b)	140	158	142	164	-1.0%	-3.4%
EPS	51.8	58.3	52.3	60.4	-1.0%	-3.4%

Source: MOFSL

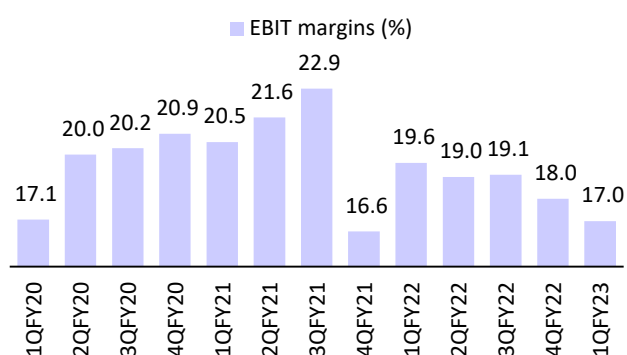
Story in charts

Exhibit 1: HCLT reports 2.7% sequential growth



Source: Company, MOFSL

Exhibit 2: Margin dipped 90bp QoQ in 1QFY23



Source: Company, MOFSL

Exhibit 3: Gross margin fell 100bp QoQ

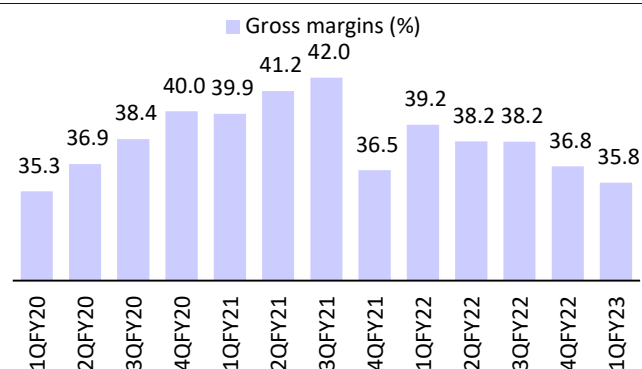
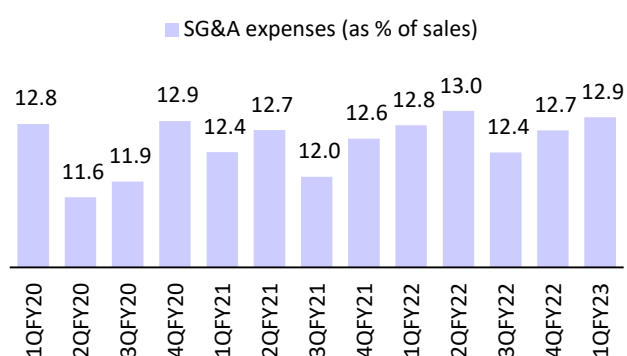
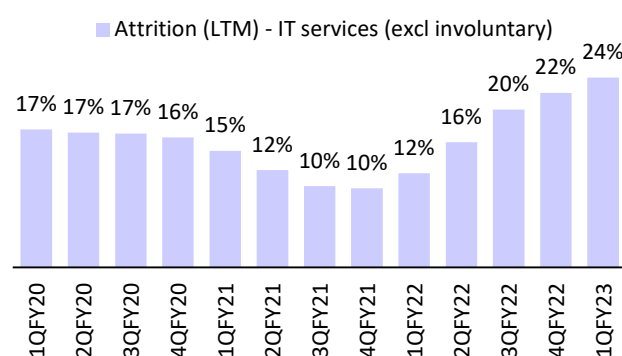


Exhibit 4: SG&A expenses again inch higher in 1QFY23



Source: Company, MOFSL

Exhibit 5: Attrition rises to ~24% in 1QFY23



Source: Company, MOFSL

Operating metrics

Exhibit 6: Operating metrics

	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23
Service-wise (%)									
IT and Business Services	70.2	70.8	70.4	71.9	71.6	72.6	70.6	73.4	72.8
Engineering and R&D Services	16.0	15.7	15.5	14.8	15.3	15.7	15.9	16.4	16.6
Products and Platforms	13.8	13.5	14.1	13.3	13.1	11.7	13.5	10.2	11.0
Vertical-wise (%)									
BFSI	22.4	22.1	21.4	21.6	22.1	21.3	21.1	20.9	21.1
Manufacturing	18.1	17.7	18.1	17.7	17.2	17.9	17.5	18.0	18.3
Technology and Services	17.2	17.3	17.8	17.2	17.3	17.2	18.4	17.5	15.4
Retail and CPG	10.0	10.4	10.5	10.1	10.0	9.8	10.1	9.4	9.4
Telecom MP&E	7.6	7.7	8.3	8.1	7.9	7.9	8.1	8.6	9.2
Life Sciences	13.7	14.1	13.6	14.1	14.7	15.3	14.4	14.9	16.4
Public Services	11.0	10.7	10.4	11.2	10.8	10.6	10.4	10.7	10.2
Geography-wise (%)									
US	63.7	63.1	62.5	62.0	63.1	62.8	63.1	62.8	64.2
Europe	28.3	28.4	29.5	29.1	27.9	28.3	28.3	28.3	27.8
RoW	8.0	8.5	8.0	8.9	9.0	8.9	8.7	8.9	8.0
Client-wise (%)									
Top five clients	13.9	13.7	13.5	13.2	13.0	12.7	12.2	11.6	11.2
Top 10 clients	20.9	20.9	21.0	20.9	20.8	20.7	20.3	19.8	19.4
Top 20 clients	30.8	30.6	30.9	30.8	30.4	29.9	29.4	29.1	28.9

Source: Company, MOFSL:

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	992	1,096
Change (%)	14.2	8.2	19.5	17.0	6.7	13.6	15.8	10.5
Cost of Goods Sold	309	332	393	453	467	546	649	713
Gross Profit	158	173	212	254	287	311	343	383
Selling and Admin Exp.	55	59	72	87	93	109	127	140
EBITDA	103	114	140	167	193	202	216	243
As a percentage of Net Sales	22.1	22.6	23.1	23.6	25.6	23.6	21.8	22.2
Depreciation	8	15	21	28	40	40	42	46
EBIT	95	100	118	139	153	162	174	197
As a percentage of Net Sales	20.3	19.8	19.6	19.6	20.4	18.9	17.5	18.0
Other Income	9	11	8	2	7	8	11	11
PBT	104	111	126	140	160	170	185	208
Tax	23	23	25	29	41	34	44	50
Rate (%)	21.7	20.9	19.6	20.9	25.4	20.3	24.1	24.0
PAT	82	88	101	111	119	136	140	158
Net Income	85	88	101	111	119	135	140	158
Change (%)	13.5	3.8	15.3	9.3	7.4	13.7	3.8	12.6

Balance Sheet							(INR b)	
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Reserves	335	368	422	517	615	620	613	604
Net Worth	335	368	422	517	615	620	613	604
Loans	5	4	40	51	39	39	39	39
Other liabilities	13	13	15	55	55	43	69	74
Capital Employed	353	385	477	623	709	703	721	718
Gross Block	225	274	335	511	546	560	600	644
Less: Depreciation	64	78	100	128	168	208	250	296
Net Block	161	196	235	383	378	352	349	347
Other assets	39	40	57	65	69	57	84	89
Investments	114	83	55	105	140	85	85	85
Curr. Assets	151	165	243	279	291	397	394	391
Debtors	108	123	146	178	175	207	240	263
Cash and Bank Balance	13	17	59	38	65	105	87	55
Other Current Assets	30	25	37	64	50	85	66	73
Current Liab. and Prov.	111	99	111	209	168	188	191	194
Net Current Assets	40	66	131	70	123	209	203	197
Application of Funds	353	385	477	623	709	703	721	718

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	51.8	58.3
Cash EPS	32.9	36.4	44.6	51.2	58.5	64.6	67.4	75.3
Book Value	118.6	131.4	153.5	190.4	226.7	228.6	226.3	223.2
DPS	12.0	6.0	4.0	8.0	26.0	44.0	46.6	52.5
Payout (%)	41.6	23.1	50.4	19.6	59.4	88.3	90.0	90.0
Valuation (x)								
P/E ratio	32.2	29.7	25.2	22.8	21.2	18.6	17.9	15.9
Cash P/E ratio	28.2	25.5	20.8	18.1	15.9	14.4	13.8	12.3
EV/EBITDA ratio	25.3	22.6	18.1	15.2	12.9	12.1	11.4	10.3
EV/Sales ratio	5.6	5.1	4.2	3.6	3.3	2.9	2.5	2.3
Price/Book Value	7.8	7.1	6.0	4.9	4.1	4.1	4.1	4.2
Dividend Yield (%)	1.3	0.6	0.4	0.9	2.8	4.7	5.0	5.7
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	20.1	23.1
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	183	204
Chg. in Working Capital	5	-35	-34	-16	30	-5	-13	-27
Net Operating CF	95	68	88	134	196	169	169	177
Net Purchase of FA	-62	-49	-61	-18	-18	-16	-40	-44
Net Purchase of Invest.	-2	30	29	-105	-40	30	0	0
Net Cash from Inv.	-64	-19	-32	-124	-57	15	-39	-43
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	-148	-166
Net CF from Finan.	-25	-21	-16	-32	-112	-145	-148	-166
Free Cash Flow	33	18	28	115	179	153	130	133
Net Cash Flow	6	27	41	-22	27	39	-18	-33
Forex difference	0	-27	5	0	1	1	0	0
Opening Cash Balance	7	13	13	60	38	66	106	88
Closing Cash Balance	13	13	60	38	66	106	88	56

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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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