

Margins may struggle to hit lower end of band...

About the stock: HCL Technologies (HCLT) offers IT, ER&D and products to BFSI, retail, health, telecommunication, manufacturing, media & hi-tech verticals.

- HCL Tech has 250 Fortune 500 and 650 global 2000 clients
- It has grown organically and inorganically (13% CAGR over FY17-22)

Q1FY23 Results: HCLT reported weak margins.

- The company reported 2.7% QoQ in CC terms, IT services grew 2.0% QoQ in CC terms while P&P grew 5.1% QoQ in CC terms
- EBIT margin of IT services was down 180 bps QoQ while that of the company declined 90 bps
- TCV grew 23.4% on a YoY basis

What should investors do? HCLT's share price has grown by ~2.2x over the past five years (from ~₹ 427 in July 2017 to ~₹ 928 levels in July 2022).

- We maintain **HOLD** rating

Target Price and Valuation: We value HCLT at ₹ 1050 i.e. 19x P/E on FY24E EPS

Key triggers for future price performance:

- The company continues to win multiyear deals in Cloud transformation, cyber security, etc, as new deal bookings continue to be strong
- Maintains revenue guidance of 12-14% revenue growth in CC for FY23E and EBIT margin of 18-20%. However, now it has guided at the lower end of the band of 18% for EBIT margin
- Revival of P&P business is critical as it is a high margin business
- With improvement in large deal wins, expansion in geographies, investment in sales & capabilities, we expect HCLT to register 12.0% CAGR in FY22-24E

Alternate Stock Idea: Apart from HCLT, in our IT coverage we also like TechM.

- Key beneficiary of uptick communication spend
- BUY with target price of ₹ 1,190

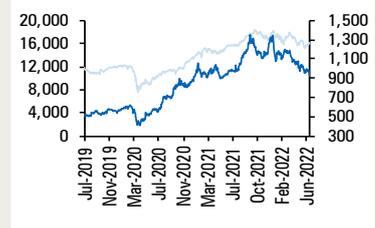
Particulars

Particular	Amount
Market Cap (₹ Crore)	2,51,677.7
Total Debt (₹ Crore)	3,923.0
Cash & Equivalents (₹ Crore)	18,875.0
EV (₹ Crore)	2,36,725.7
52 week H/L	1377 / 944
Equity capital	543.0
Face value	₹ 2

Shareholding pattern

	Jun-21	Sep-21	Dec-21	Mar-22
Promoters	60.3	60.3	60.3	60.7
FII	23.2	22.3	20.4	19.0
DII	11.0	12.2	13.4	12.7
Public	5.5	5.2	5.9	7.6

Price Chart



Recent Event & Key risks

- Revenue & EBIT margin guidance intact
- **Key Risks:** (i) Lower than expected employee costs (ii) Deteriorating TCV

Research Analyst

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Key Financial Summary

Key Financials	FY20	FY21	FY22	5 year		FY23E	FY24E	2 year	
				CAGR (FY17-22)				CAGR (FY22-24E)	
Net Sales	70,678	75,379	85,651	12.9		97,726	1,07,499	12.0	
EBITDA	16,694	19,482	20,041	14.2		21,207	23,381	8.0	
Margins (%)	23.6	25.8	23.4			21.7	21.8		
Net Profit	11,062	12,435	13,516	9.8		13,695	14,965	5.2	
EPS (₹)	40.8	45.8	49.8			50.5	55.2		
P/E	22.8	20.3	18.6			18.4	16.8		
RoNW (%)	21.6	20.8	21.8			21.0	21.9		
RoCE (%)	23.0	23.5	24.2			24.8	26.0		

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- Reported term:** It reported rupee revenues of ₹ 23,464 crore, up 3.8% QoQ, 16.9% YoY while dollar revenues came in at US\$3,038 million (mn), up 1.5% QoQ, 11.7% YoY. IT business reported increased 0.1% QoQ to US\$2,201 mn, ER&D business reported revenues of US\$503 mn, up 2.7% QoQ & P&P business reported revenue of US\$334 mn, up 9.9% QoQ
- In CC terms:** The company reported 2.7% QoQ revenue growth. IT business reported 2% QoQ growth, ER&D reported growth of 3.7% QoQ & P&P business reported growth of 5.1% QoQ. **The company maintained guidance of 12-14% revenue growth in FY23**
- Vertical wise, in CC terms, technology & services, telecommunications, manufacturing, life sciences reported strong growth of 10.9%, 4.3%, 2.7%, respectively, while BFSI, retail & manufacturing reported weak/muted growth of +0.8%, -1.4%, -0.5% QoQ, respectively. Geography wise America, Europe reported relatively weak growth of 2.8%, 1.6% QoQ, respectively
- At the company level, it reported EBIT margin decline of ~90 bps QoQ to 17%. IT services margin declined ~180 bps. The company indicated that out of these -100 bps was due to higher sub-contractors cost, -50 bps was due to increased retention cost amid high attrition and -35 bps due to increase in travel & visa cost. **The company maintains its guidance 18-20% EBIT margin for FY23 but has indicated that margins could be at the lower end of its guidance of 18%.** We believe the company may struggle to even hit lower end of the margin guidance considering wage hikes in Q2 and continued increase in attrition as well as subcontracting costs
- PAT of the company declined 8.9% QoQ to ₹ 3,281 crore. The company mentioned that the tax expenses increased compared to previous years due to increase in tax rate of SEZ units in India
- The company indicated that it has baked in some price increase in EBIT margin guidance from Q1 onwards. However, it did not get any price hike in Q1 and is now hopeful of getting it from Q2 onwards as client's response was positive on the same citing demand supply mismatch
- HCLT remains confident on the demand environment with new TCV deal wins of US\$2 billion (bn), up 23.4% YoY of which US\$1.9 bn. was in services segment & US\$104 mn was in P&P. The company won 16 new large deals of which 7seven were in services and 9 in P&P. HCLT, so far, did not see any slowdown in tech spending from the clients
- HCLT saw net addition of 2,089 employees taking its overall full-time employee headcount to 210,966. The company hired ~ 6,000 freshers in the quarter ended and plans to hire 10,000 freshers in Q2FY23 with the overall target of 30,000-35,000 of fresher hiring. LTM attrition of the company increased 190 bps to 23.8%. The company indicated that attrition will continue to be high in the next quarter and expects to moderate only in H2FY23. The company also indicated that it is taking a little more time for freshers to become billable. It is working on the strategy to improve the same for incoming freshers for the rest of the year
- The company declared an interim dividend of ₹ 10 per share

Exhibit 1: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
Revenue	23,464	23,423	20,068	16.9	22,597	3.8	Revenue up 2.7% QoQ in CC, P&P business reported 5.1% CC growth while IT services reported 2% QoQ CC growth
Cost of sales (including employee expenses)	15,457	15,365	12,593	22.7	14,672	5.4	
Gross Margin	8,007	8,057	7,475	7.1	7,925	1.0	
Gross margin (%)	34.1	34.4	37.2	-312 bps	35.1	-95 bps	
Selling & marketing costs	3,032	3,045	2,567	18.1	2,872	5.6	
EBITDA	4,975	5,012	4,908	1.4	5,053	-1.5	
EBITDA Margin (%)	21.2	21.4	24.5	-325 bps	22.4	-116 bps	
Depreciation	983	1,007	977	0.6	984	-0.1	
EBIT	3,992	4,005	3,931	1.6	4,069	-1.9	
EBIT Margin (%)	17.0	17.1	19.6	-258 bps	18.0	-99 bps	EBIT margin for IT services down 180 bps QoQ due to impact of i) (-100bps) impact on increase in subcontracting costs ii) (-50 bps) on increase in retention costs amid high attrition iii) (-35 bps) on increase in travel & visa costs
Other income	345	252	194	NA	252	36.9	
PBT	4,337	4,257	4,125	5.1	4,321	0.4	
Tax paid	1,056	937	894	18.1	721	46.5	PAT lower due to weak operating performance and higher tax due to some units moving to higher tax bracket
PAT	3,283	3,311	3,215	2.1	3,594	-8.7	

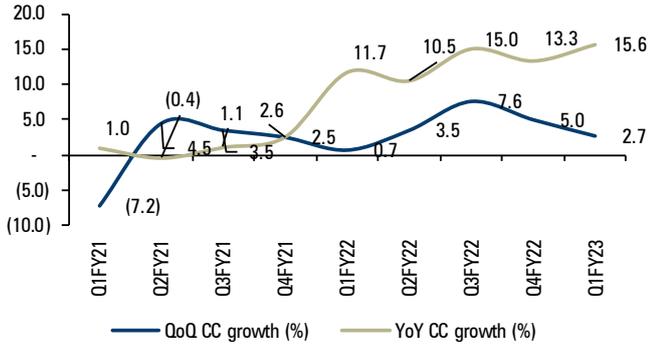
Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	97,726	97,726	0.0	107,499	107,499	0.0	
EBIT	17,255	17,128	-0.7	18,882	19,097	1.1	
EBIT Margin (%)	17.7	17.5	-13 bps	17.6	17.8	20 bps	We cut FY23E margins on further pressure due to high attrition and continued subcontracting costs
PAT	13,791	13,695	-0.7	14,802	14,965	1.1	
EPS (₹)	50.8	50.5	-0.7	54.6	55.2	1.1	

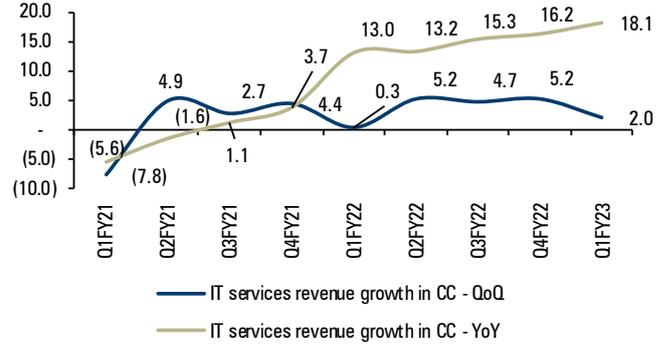
Source: Company, ICICI Direct Research

Exhibit 3: Revenues were up by 15.6% YoY in CC



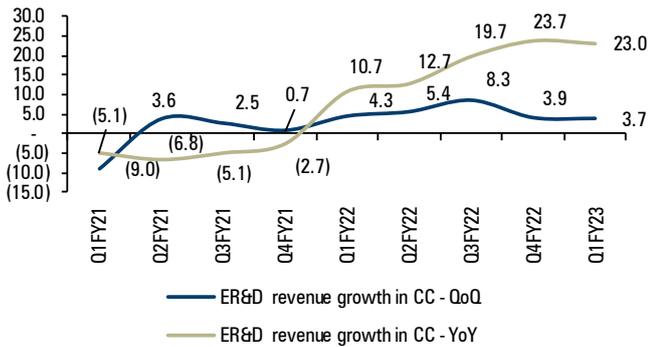
Source: Company, ICICI Direct Research

Exhibit 4: Driven by 18.1% YoY CC growth in IT services



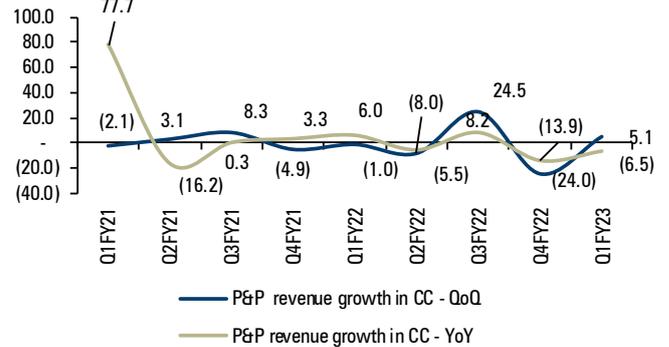
Source: Company, ICICI Direct Research

Exhibit 5: ER&D on YoY witnessed some moderation



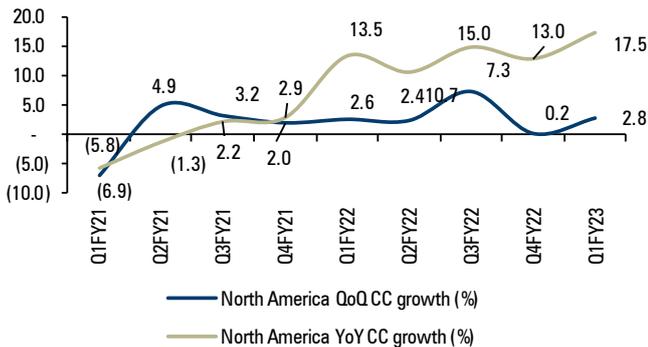
Source: Company, ICICI Direct Research

Exhibit 6: While P&P did revive on re-classification



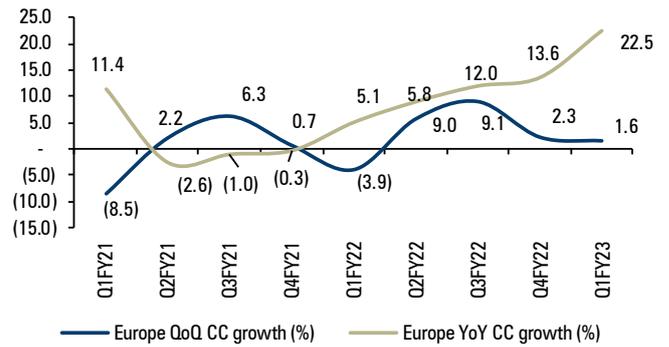
Source: Company, ICICI Direct Research

Exhibit 7: North America continue to grow strong on YoY



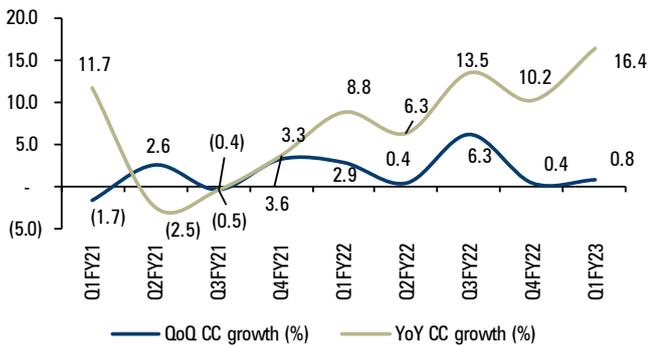
Source: Company, ICICI Direct Research

Exhibit 8: Europe see moderation on QoQ



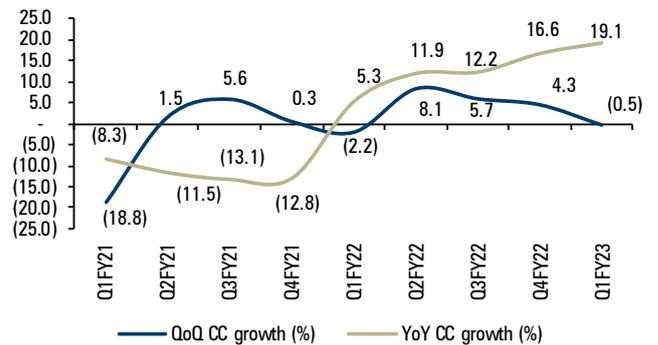
Source: Company, ICICI Direct Research

Exhibit 9: BFSI revenue trend



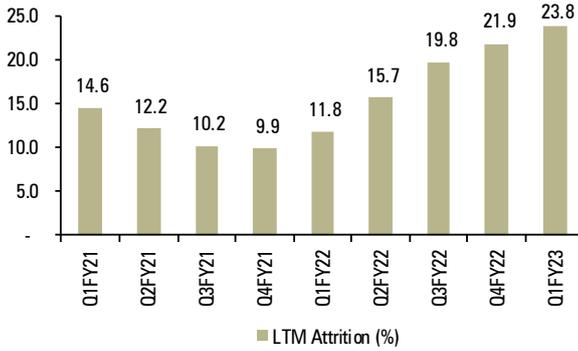
Source: Company, ICICI Direct Research

Exhibit 10: Manufacturing revenue trend



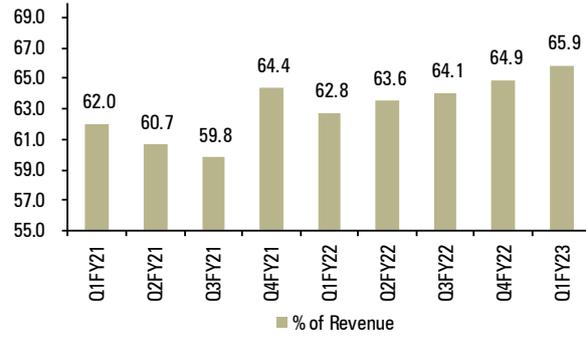
Source: Company, ICICI Direct Research

Exhibit 11: Attrition continue to inch up



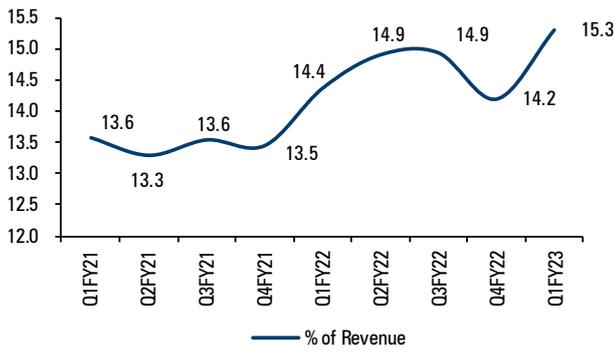
Source: Company, ICICI Direct Research

Exhibit 12: So is employee costs as % of sales



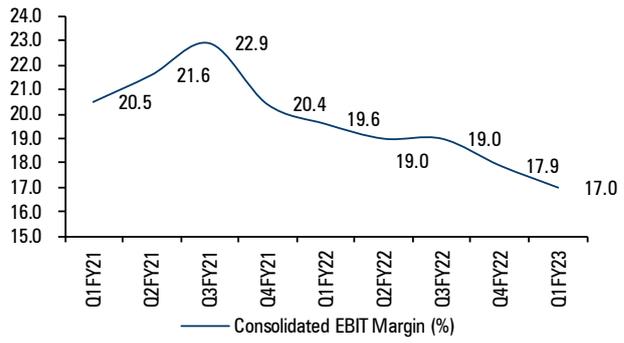
Source: Company, ICICI Direct Research

Exhibit 13: Which along with higher outsourcing costs



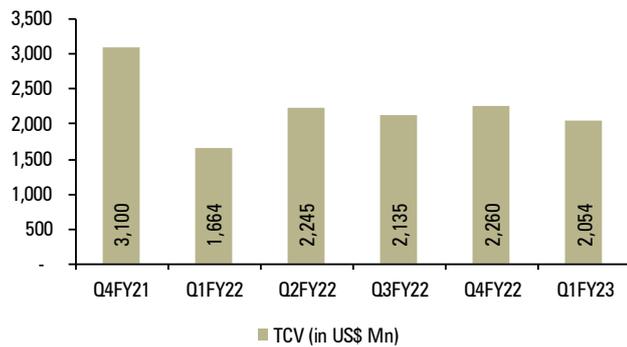
Source: Company, ICICI Direct Research

Exhibit 14: Impacting margins



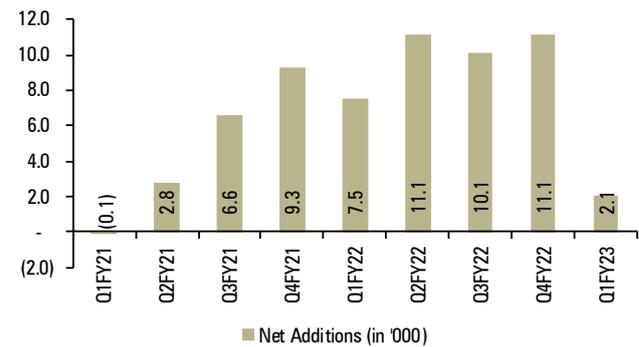
Source: Company, ICICI Direct Research

Exhibit 15: TCV is up 23.4% YoY



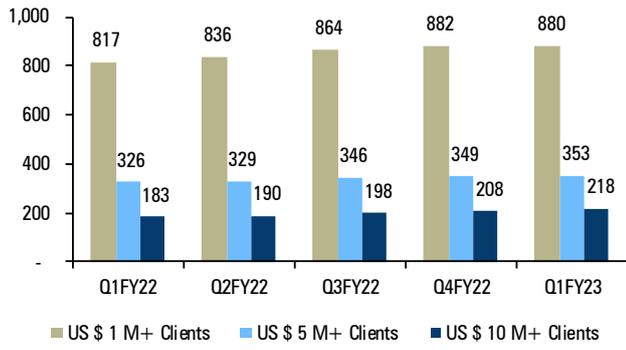
Source: Company, ICICI Direct Research

Exhibit 16: Employee net add moderated for Q1



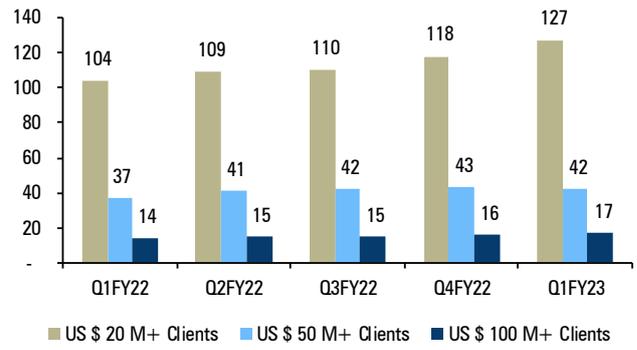
Source: Company, ICICI Direct Research

Exhibit 17: Customer bucket trend



Source: Company, ICICI Direct Research

Exhibit 18: Added 3 clients in US\$100mn on YoY



Source: Company, ICICI Direct Research

Financial Summary

Exhibit 19: Profit and loss statement				
	₹ crore			
	FY21	FY22	FY23E	FY24E
Total operating Income	75,379	85,651	97,726	1,07,499
Growth (%)	6.7	13.6	14.1	10.0
Direct costs	46,550	54,701	63,229	69,552
S,G&A expenses	9,348	10,909	13,291	14,566
Total Operating Expenditure	55,898	65,610	76,520	84,118
EBITDA	19,482	20,041	21,207	23,381
Growth (%)	16.7	2.9	5.8	10.3
Depreciation	3,985	3,874	4,079	4,284
Amortisation	-	-	-	-
Net Other Income	657	856	1,076	724
PBT	16,154	17,023	18,203	19,821
Forex adjustments	-	-	-	-
Total Tax	3,663	3,458	4,460	4,856
PAT	12,435	13,516	13,695	14,965
Growth (%)	12.4	8.7	1.3	9.3
EPS (₹)	45.8	49.8	50.5	55.2
Growth (%)	12.4	8.8	1.3	9.3

Source: Company, ICICI Direct Research

Exhibit 20: Cash flow statement				
	₹ crore			
	FY21	FY22	FY23E	FY24E
PBT	16,154	17,023	18,203	19,821
Depreciation & Amortisation	4,611	4,326	4,079	4,284
(Inc)/dec in Current Assets	1,049	(2,383)	(6,344)	(3,551)
Inc/(dec) in CL and Provisions	1,992	1,834	4,075	2,426
Taxes paid	(3,445)	(3,443)	(4,460)	(4,856)
CF from operating activities	19,618	16,900	14,428	17,400
(Inc)/dec in Investments	(2,762)	2,994	1,076	724
(Inc)/dec in Fixed Assets	(1,753)	(1,555)	(1,713)	(1,713)
CF from investing activities	(5,742)	1,477	(637)	(989)
Issue/(Buy back) of Equity	-	-	-	-
Inc/(dec) in loan funds	(251)	(60)	(500)	(500)
Dividend paid & dividend tax	(3,256)	(12,135)	(10,271)	(11,972)
Inc/(dec) in debentures	-	-	-	-
Others	(1,155)	(1,942)	-	-
CF from financing activities	(11,180)	(14,508)	(10,771)	(12,472)
Net Cash flow	2,696	3,869	3,020	3,939
Exchange difference	65	120	-	-
Opening Cash	4,976	8,888	12,636	15,656
Bank bal + unclaimed dvd.	-	-	-	-
Cash & bank c/f to balance	8,888	12,636	15,656	19,595

Source: Company, ICICI Direct Research

Exhibit 21: Balance sheet				
	₹ crore			
	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	543	543	543	543
Reserve and Surplus	59,370	61,371	64,795	67,788
Total Shareholders funds	59,913	61,914	65,338	68,331
Total Debt	3,828	3,923	3,423	2,923
Other liabilities + Provisions	4,901	4,329	4,642	4,815
Minority Interest / Others	169	92	92	92
Total Liabilities	68,811	70,258	73,495	76,161
Assets				
Net Block+ CWIP	8,364	8,055	7,932	7,718
Intangible assets+ Goodwill	29,093	27,160	24,917	22,560
Investments	89	103	103	103
Liquid investments	6,773	6,239	6,239	6,239
Inventory	94	161	122	134
Debtors	13,663	15,476	17,714	19,485
Loans and Advances	4,841	3,008	6,276	6,904
Other Current Assets	8,792	10,521	11,399	12,538
Cash	8,888	12,636	15,656	19,595
Total Current Assets	43,051	48,041	57,405	64,896
Total Current Liabilities	17,383	18,775	22,536	24,790
Net Current Assets	25,668	29,266	34,869	40,106
Other non current assets	5,597	5,674	5,674	5,674
Application of Funds	68,811	70,258	73,495	76,161

Source: Company, ICICI Direct Research

Exhibit 22: Key ratios				
	₹ crore			
	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	45.8	49.8	50.5	55.2
Cash EPS	60.5	64.1	65.5	71.0
BV	220.8	228.3	240.9	252.0
DPS	24.3	23.6	37.9	44.1
Cash Per Share	32.8	46.6	57.7	72.3
Operating Ratios (%)				
EBIT Margin	20.6	18.9	17.5	17.8
PBT Margin	21.4	19.9	18.6	18.4
PAT Margin	16.5	15.8	14.0	13.9
Debtor days	66	66	66	66
Return Ratios (%)				
RoE	20.8	21.8	21.0	21.9
RoCE	23.5	24.2	24.8	26.0
RoIC	29.2	31.5	33.2	37.9
Valuation Ratios (x)				
P/E	20.3	18.6	18.4	16.8
EV / EBITDA	12.3	11.8	11.0	9.8
EV / Net Sales	3.2	2.8	2.4	2.1
Market Cap / Sales	3.3	2.9	2.6	2.3
Price to Book Value	4.2	4.1	3.9	3.7
Solvency Ratios				
Debt/EBITDA	0.2	0.2	0.2	0.1
Debt/EBITDA	0.2	0.2	0.2	0.1
Current Ratio	1.6	1.6	1.6	1.6
Quick Ratio	1.6	1.5	1.6	1.6

Source: Company, ICICI Direct Research

Exhibit 23: ICICI Direct coverage universe (IT)

Company Name	CMP TP (₹)		Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HCL Tech (HCLTEC)	928	1,050	HOLD	2,51,842	49.8	50.5	55.2	18.6	18.4	16.8	24.2	24.9	25.7	21.8	21.1	21.7
Infosys (INFTEC)	1,439	1,745	BUY	6,05,266	52.1	58.2	67.1	27.6	24.7	21.4	36.0	35.2	37.7	29.2	29.2	31.2
TCS (TCS)	3,085	3,785	BUY	11,28,689	104.7	115.1	130.4	29.4	26.8	23.7	51.4	49.2	48.7	43.0	41.9	41.0
Tech M (TECMAH)	998	1,190	BUY	97,018	63.1	68.5	79.5	15.8	14.6	12.6	22.5	22.5	23.0	20.7	20.0	20.6
Wipro (WIPRO)	409	465	HOLD	2,24,212	22.3	24.5	27.4	18.4	16.7	14.9	18.1	19.8	21.2	18.6	19.6	21.1
LTI (LTINFCL)	3,988	4,480	HOLD	69,872	130.8	140.3	165.9	30.5	28.4	24.0	32.3	29.0	29.6	26.1	24.1	24.4
Mindtree (MINCON)	2,855	3,195	HOLD	47,059	100.3	109.8	127.9	28.5	26.0	22.3	38.0	35.4	34.5	30.2	27.4	26.6
Coforge (NIITEC)	3,517	4,550	BUY	21,417	106.5	147.8	175.0	33.0	23.8	20.1	25.6	31.5	31.8	24.2	28.4	28.3
TeamLease (TEASER)	3,522	4,025	BUY	6,022	22.5	95.0	125.4	156.7	37.1	28.1	15.4	19.2	20.7	(4.7)	18.9	20.2
Infoedge (INFEDG)	3,827	4,575	BUY	48,099	35.8	41.6	45.5	107.0	92.0	84.1	4.2	5.0	5.3	3.2	3.8	4.0

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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