

Strong IT services revenue guidance for FY23...

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)

Q2FY23 Results: HCLT reported strong Q2FY23 numbers.

- The company reported 3.8% QoQ in CC terms. IT services grew 5.3% QoQ in CC terms while P&P declined 7.8% QoQ in CC terms due to seasonality
- EBIT margin of IT services increased 100 bps QoQ while that of the company increased ~90 bps
- TCV grew 16.1% QoQ & 6.2% YoY to US\$2.4 billion

What should investors do? HCLT's share price has grown by ~2.1x over the past five years (from ~₹ 455 in October 2017 to ~₹ 952 levels in October 2022).

- We change our rating on the stock from HOLD to **BUY**

Target Price and Valuation: We value HCLT at ₹ 1115 i.e. 18x P/E on FY25E 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
- Increased revenue guidance from 12-14% to 13.5-14.5% revenue growth in CC for FY23E while IT services guidance given at 16-17% provided visibility for growth.
- 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 11.8% CAGR in revenues over FY22-25E

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 ₹ 1,170

Key Financial Summary

Key Financials	FY21	FY22	5 year			3 year	
			CAGR (FY17-22)	FY23E	FY24E	FY25E	CAGR FY(22-25E)
Net Sales	75,379	85,651	12.9	1,01,552	1,11,707	1,19,638	11.8
EBITDA	19,482	20,041	14.2	22,037	24,408	26,081	9.2
Margins (%)	25.8	23.4		21.7	21.9	21.8	
Net Profit	12,435	13,516	9.8	14,321	15,816	16,797	7.5
EPS (₹)	45.8	49.8		52.8	58.3	61.9	
P/E	20.8	19.1		18.0	16.3	15.4	
RoNW (%)	20.8	21.8		21.9	23.0	23.3	
RoCE (%)	23.5	24.2		25.8	27.4	28.2	

Source: Company, ICICI Direct Research



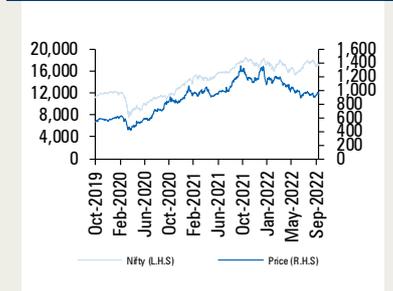
Particulars

Particular	Amount
Market Cap (₹ Crore)	2,58,186.6
Total Debt (₹ Crore)	3,923.0
Cash & Equivalent (₹ Crore)	18,875.0
EV (₹ Crore)	2,43,234.6
52 week H/L	1359 / 878
Equity capital	543.0
Face value	₹ 2

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoters	60.3	60.3	60.7	60.7
FII	22.3	20.4	19.0	17.9
DII	12.2	13.4	12.7	15.5
Public	5.2	5.9	7.6	5.8

Price Chart



Recent Event & Key risks

- IT services revenue guidance of 16-17% CC for FY23
- **Key Risks:** (i) Lower than expected growth ii) Lower than expected margins

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Key takeaways of recent quarter & conference call highlights

- Reported term:** It reported rupee revenues of ₹ 24,686 crore, up 5.2% QoQ & 19.5% YoY while dollar revenues came in at US\$3,082 million (mn), up 1.5% QoQ, 10.4% YoY. IT business reported growth of 3.1% QoQ to US\$2,268 mn, ER&D business reported revenues of US\$524 mn, up 4.2% QoQ while P&P revenue declined to US\$302 mn, down 9.6% QoQ
- In CC terms:** The company reported 3.8% QoQ revenue growth. IT business reported 5.3% QoQ growth, ER&D witnessed growth of 5% QoQ & P&P business declined by 7.8% QoQ
- Guidance:** The company increased the revenue guidance for FY23 on the back of strong order book from 12-14% growth in CC terms to 13.5-14.5% growth. ***The company has given IT Services growth guidance for the first time and is guiding for 16-17% revenue growth in CC for FY23***
- In CC terms: Vertical wise the growth was broad based with manufacturing leading the growth with 10.9% QoQ growth followed by public services, lifesciences, TMPE, BFSI, retail & technology reporting a growth of 6%, 5.1%, 4.1%, 3.7%, 3% & 2.4% QoQ growth, respectively. Geography wise Europe reported strong growth of 6.9% QoQ while America region grew 4.7% QoQ
- At the company level, EBIT margin increased ~90 bps QoQ to 17.9%. IT services margin increased ~100 bps despite implementation of partial wage hikes. The sub-contractor cost declined 30 bps QoQ to 15% in Q2. The company indicated the following levers for improvement in margins a) improved realisations & utilisation benefits of 115 bps, b) operating leverage benefit of 45 bps and c) exchange rate gains due to currency depreciation of 55-60 bps
- The company maintained lower end of the margin band to 18% while upper end has been reduced to 19%, resulting into EBIT margin guidance of 18-19% for FY23. HCLT indicated at the following levers for margin improvement, going forward: Price increase, improved utilisation, pyramid optimisation & operational efficiency
- The company indicated that it has benefited from price revision for both new & existing contracts effective January 2022. It mentioned that it would continue to push price increase, going forward, as well
- HCLT reiterated that the demand environment is strong despite macroeconomic uncertainties. The same is reflected in new TCV win of US\$2.4 billion (bn), up 16.1%QoQ, 6.2% YoY. This was the fifth straight quarter of above US\$2 bn TCV wins. The company won 11 new large deals of which eight were in services and three in P&P. The company also indicated that it aspires to win US\$2-2.5 bn deals every quarter indicating the growth momentum will continue
- The company mentioned that it won a mega deal, which will contribute ~US\$125 mn to revenue from FY24 onwards. HCLT mentioned that the deal was won due the client being an existing client of the acquired P&P business indicating the synergy of P&P business for winning new deals in its services business
- HCLT net addition for the quarter was strong at 8,359 employees taking its overall employee headcount to 219,325. The company continue to guide for freshers in the range of 30,000-35,000 for FY23 but indicated that fresher hiring would be closer to the lower end of that band

- LTM attrition remained constant at 23.8% but the company indicated that it is witnessing a decline in quarterly attrition and expects attrition to moderate from H2FY23 onwards
- The company indicated that clients continue to accelerate their digital transformation journey as it is simplifying their business operating models and simplifying some its processes. The clients continue to benefit from revenue enhancement as well as cost optimisation programs where technology is an enabler
- The company during the quarter restructured its organization. As per the new structure, Rahul Singh, former President Global Financial Services Business was appointed as COO - Corporate Functions. Srinivasan Sheshadri, former Financial Head of Americas region, has been appointed as head of Global Financial service. Ramchandran Sundarajan, former America region HR head, has been appointed as Global HR Head. Appa Rao, former CHRO, has been appointed as Delivery Head – Near Shore
- The company declared an interim dividend of ₹ 10 per share

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	24,686	24,428	20,655	19.5	23,464	5.2	Reported 3.8% QoQ CC growth aided by IT services, which reported 5.3% QoQ CC growth
Cost of sales (including employee expenses)	16,236	16,074	13,127	23.7	15,457	5.0	
Gross Margin	8,450	8,354	7,528	12.2	8,007	5.5	
Gross margin (%)	34.2	34.2	36.4	-222 bps	34.1	11 bps	
Selling & marketing costs	3,024	3,176	2,690	12.4	3,032	-0.3	
EBITDA	5,426	5,179	4,838	12.2	4,975	9.1	
EBITDA Margin (%)	22.0	21.2	23.4	-144 bps	21.2	78 bps	
Depreciation	998	977	922	8.2	983	1.5	
EBIT	4,428	4,202	3,916	13.1	3,992	10.9	
EBIT Margin (%)	17.9	17.2	19.0	-102 bps	17.0	92 bps	EBIT margin for IT services was up 100 bps QoQ. Gross margin improvement was aided by realisation & utilisation benefits (115 bps), operating leverage 45 bps, exchange rate 55bps
Other income	157	350	207	NA	345	-54.5	
PBT	4,585	4,552	4,123	11.2	4,337	5.7	
Tax paid	1,096	1,092	846	29.6	1,056	3.8	PAT was higher due to strong operating performance
PAT	3,490	3,464	3,264	6.9	3,283	6.3	

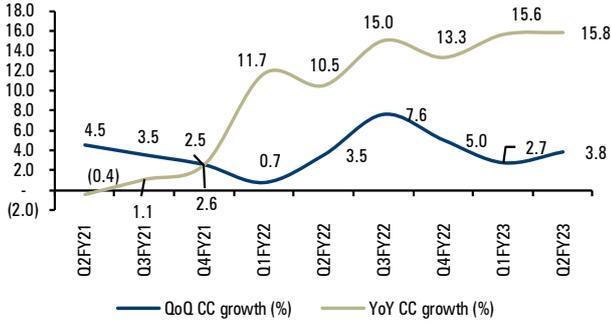
Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY23E			FY24E			FY25E		Comments
	Old	New	% Change	Old	New	% Change	Introduced		
Revenue	97,726	101,552	3.9	107,499	111,707	3.9	119,638	We revise numbers upwards based on guidance	
EBIT	17,128	17,958	4.8	19,097	20,224	5.9	21,692		
EBIT Margin (%)	17.5	17.7	16 bps	17.8	18.1	34 bps	18.1	We bake in margin expansion on price increase,	
PAT	13,695	14,321	4.6	14,965	15,816	5.7	16,797		
EPS (₹)	50.5	52.8	4.6	55.2	58.3	5.7	61.9		

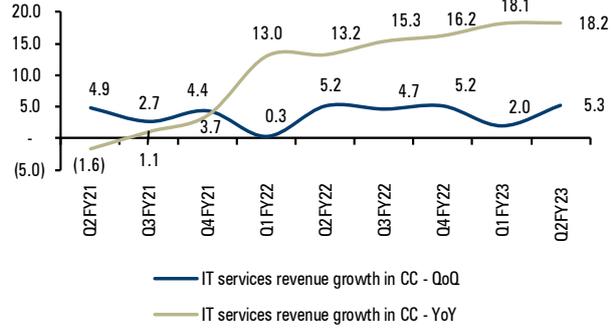
Source: Company, ICICI Direct Research

Exhibit 3: Revenues up 15.8% YoY in CC



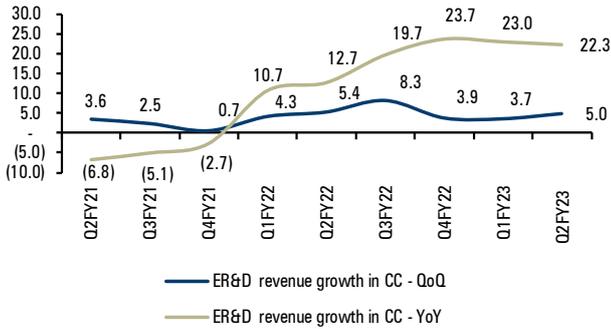
Source: Company, ICICI Direct Research

Exhibit 4: Driven by 18.2% YoY CC growth in IT services



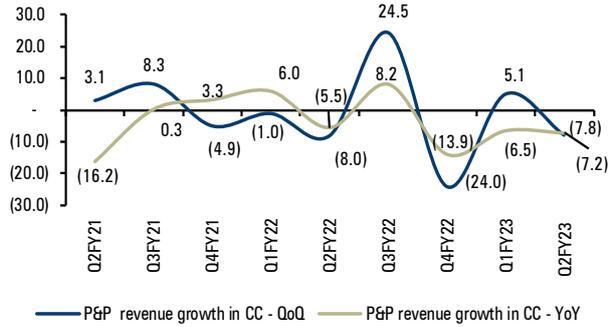
Source: Company, ICICI Direct Research

Exhibit 5: ER&D also grew strong...



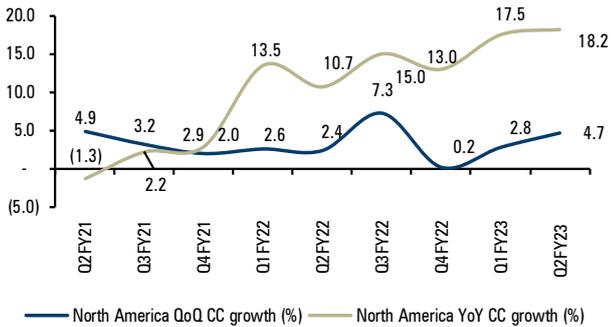
Source: Company, ICICI Direct Research

Exhibit 6: ...while P&P was down on seasonality



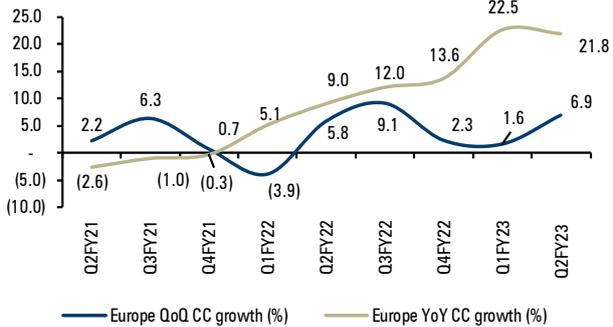
Source: Company, ICICI Direct Research

Exhibit 7: North America continued strongly on YoY



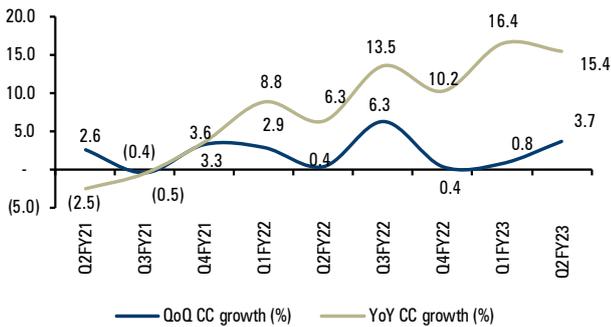
Source: Company, ICICI Direct Research

Exhibit 8: Europe has picked up QoQ



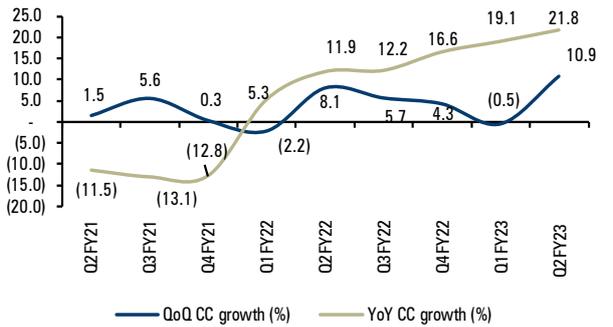
Source: Company, ICICI Direct Research

Exhibit 9: BFSI revenue trend



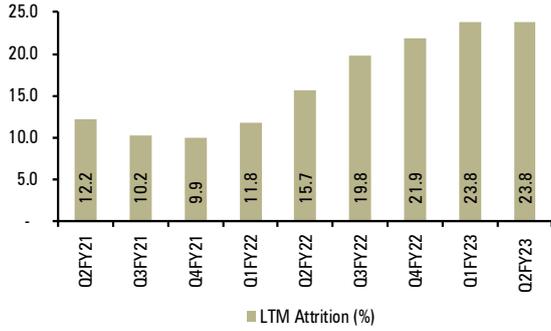
Source: Company, ICICI Direct Research

Exhibit 10: Manufacturing revenue trend



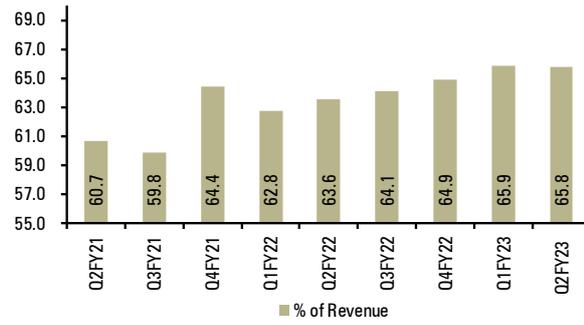
Source: Company, ICICI Direct Research

Exhibit 11: Attrition flattish QoQ



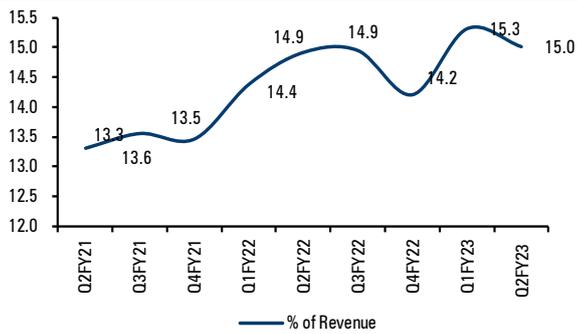
Source: Company, ICICI Direct Research

Exhibit 12: Employee costs flattish despite partial wage hike



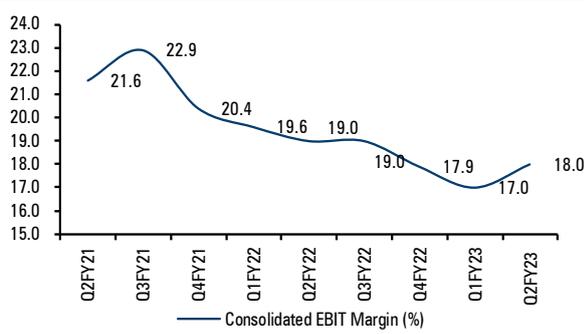
Source: Company, ICICI Direct Research

Exhibit 13: Which along with lower outsourcing costs



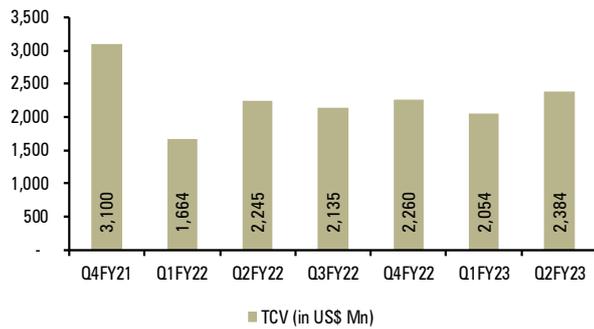
Source: Company, ICICI Direct Research

Exhibit 14: Helped in margin improvement



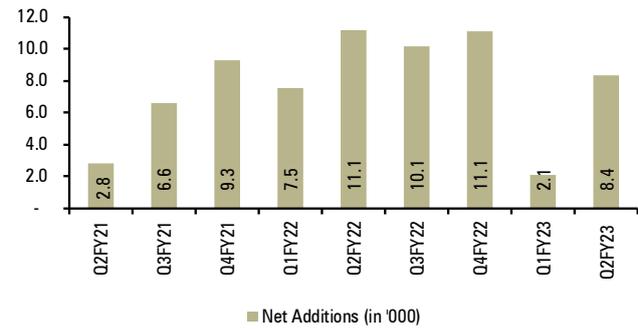
Source: Company, ICICI Direct Research

Exhibit 15: TCV up 16.1% QoQ



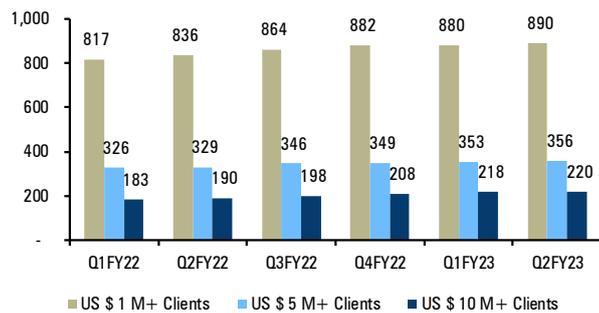
Source: Company, ICICI Direct Research

Exhibit 16: Employee net add picked up



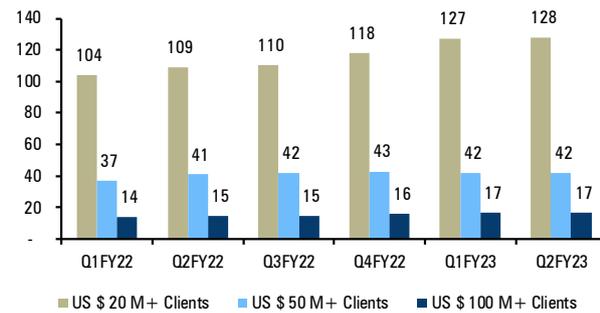
Source: Company, ICICI Direct Research

Exhibit 17: Customer bucket trend



Source: Company, ICICI Direct Research

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



Source: Company, ICICI Direct Research

Financial Summary

Exhibit 19: Profit and loss statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Total operating Income	85,651	1,01,552	1,11,707	1,19,638
Growth (%)	13.6	18.6	10.0	7.1
Direct costs	54,701	65,704	72,163	77,167
S,G&A expenses	10,909	13,811	15,136	16,390
Total Operating Expenditure	65,610	79,515	87,299	93,557
EBITDA	20,041	22,037	24,408	26,081
Growth (%)	2.9	10.0	10.8	6.9
Depreciation	3,874	4,079	4,184	4,389
Amortisation	-	-	-	-
Net Other Income	856	1,076	724	704
PBT	17,023	19,034	20,948	22,396
Forex adjustments	-	-	-	-
Total Tax	3,458	4,663	5,132	5,599
PAT	13,516	14,321	15,816	16,797
Growth (%)	8.7	6.0	10.4	6.2
EPS (₹)	49.8	52.8	58.3	61.9
Growth (%)	8.8	6.0	10.4	6.2

Source: Company, ICICI Direct Research

Exhibit 20: Cash flow statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
PBT	17,023	19,034	20,948	22,396
Depreciation & Amortisation	4,326	4,079	4,184	4,079
(Inc)/dec in Current Assets	(2,383)	(7,734)	(3,690)	3,038
Inc/(dec) in CL and Provisions	1,834	5,024	2,521	(2,521)
Taxes paid	(3,443)	(4,663)	(5,132)	(4,663)
CF from operating activities	16,900	14,615	18,107	17,841
(Inc)/dec in Investments	2,994	1,076	724	1,076
(Inc)/dec in Fixed Assets	(1,555)	(1,713)	(1,713)	(452)
CF from investing activities	1,477	(637)	(989)	624
Issue/(Buy back) of Equity	-	-	-	-
Inc/(dec) in loan funds	(60)	(500)	(500)	(500)
Dividend paid & dividend tax	(12,135)	(10,741)	(12,653)	(10,741)
Inc/(dec) in debentures	-	-	-	-
Others	(1,942)	-	-	-
CF from financing activities	(14,508)	(11,241)	(13,153)	(11,241)
Net Cash flow	3,869	2,737	3,966	7,224
Exchange difference	120	-	-	-
Opening Cash	8,888	12,636	15,373	19,338
Bank bal + unclaimed dvd.	-	-	-	-
Cash & bank c/f to balance sheet	12,636	15,373	19,338	26,562

Source: Company, ICICI Direct Research

Exhibit 21: Balance sheet				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity Capital	543	543	543	543
Reserve and Surplus	61,371	64,951	68,114	71,695
Total Shareholders funds	61,914	65,494	68,657	72,238
Total Debt	3,923	3,423	2,923	2,423
Other liabilities + Provisions	4,329	4,710	4,889	4,710
Minority Interest / Others	92	92	92	92
Total Liabilities	70,258	73,719	76,562	79,463
Assets				
Net Block + CWIP	8,055	7,932	7,763	6,379
Intangible assets + Goodwill	27,160	24,917	22,615	20,372
Investments	103	103	103	103
Liquid investments	6,239	6,239	6,239	6,239
Inventory	161	127	139	127
Debtors	15,476	18,407	20,248	18,407
Loans and Advances	3,008	6,522	7,174	7,174
Other Current Assets	10,521	11,845	13,029	11,845
Cash	12,636	15,373	19,338	26,562
Total Current Assets	48,041	58,512	66,167	70,353
Total Current Liabilities	18,775	23,419	25,761	23,419
Net Current Assets	29,266	35,093	40,407	46,935
Other non current assets	5,674	5,674	5,674	5,674
Application of Funds	70,258	73,719	76,562	79,463

Source: Company, ICICI Direct Research

Exhibit 22: Key ratios				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
EPS	49.8	52.8	58.3	61.9
Cash EPS	64.1	67.8	73.7	78.1
BV	228.3	241.5	253.2	266.4
DPS	23.6	39.6	46.7	49.5
Cash Per Share	46.6	56.7	71.3	97.9
Operating Ratios (%)				
EBIT Margin	18.9	17.7	18.1	18.1
PBT Margin	19.9	18.7	18.8	18.7
PAT Margin	15.8	14.1	14.2	14.0
Debtor days	66	66	66	56
Return Ratios (%)				
RoE	21.8	21.9	23.0	23.3
RoCE	24.2	25.8	27.4	28.2
RoIC	31.5	34.5	39.7	46.5
Valuation Ratios (x)				
P/E	19.1	18.0	16.3	15.4
EV / EBITDA	12.1	10.9	9.6	8.7
EV / Net Sales	2.8	2.4	2.1	1.9
Market Cap / Sales	3.0	2.5	2.3	2.2
Price to Book Value	4.2	3.9	3.8	3.6
Solvency Ratios				
Debt/EBITDA	0.2	0.2	0.1	0.1
Debt/EBITDA	0.2	0.2	0.1	0.1
Current Ratio	1.6	1.6	1.6	1.6
Quick Ratio	1.5	1.6	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)	952	1,115	BUY	2,58,341	49.8	52.8	58.3	19.1	18.0	16.3	24.2	25.8	27.4	21.8	21.9	23.0
Infosys (INFTEC)	1,429	1,760	BUY	6,01,269	52.1	58.1	67.5	27.4	24.6	21.2	36.0	35.0	37.7	29.2	29.1	31.1
TCS (TCS)	3,101	3,630	BUY	11,34,672	104.7	115.7	130.3	29.6	26.8	23.8	51.4	49.3	48.7	43.0	42.0	41.0
Tech M (TECMAH)	1,016	1,170	BUY	98,838	63.1	66.2	77.9	16.1	15.3	13.0	22.5	21.8	22.7	20.7	19.4	20.3
Wipro (WIPRO)	408	450	HOLD	2,23,636	22.3	23.3	27.1	18.3	17.5	15.1	18.8	18.9	21.0	19.6	18.7	20.8
LTI (LTINFC)	4,642	4,480	HOLD	81,338	130.8	140.3	165.9	35.5	33.1	28.0	32.3	29.0	29.6	26.1	24.1	24.4
Mindtree (MINCON)	3,346	3,320	BUY	55,144	100.3	109.8	127.9	33.4	30.5	26.2	38.0	35.4	34.5	30.2	27.4	26.6
Coforge (NIITEC)	3,615	4,375	BUY	22,017	106.5	147.8	175.0	33.9	24.5	20.7	25.6	31.5	31.8	24.2	28.4	28.3
TeamLease (TEASER)	3,040	4,240	BUY	5,197	22.5	85.6	124.6	135.2	35.5	24.4	15.4	17.6	20.8	(4.7)	17.4	20.4
Infoedge (INFEDG)	3,780	5,230	BUY	47,504	35.8	47.8	54.2	105.6	79.1	69.7	4.2	5.7	6.3	3.2	4.3	4.7

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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