

HCL Technologies Limited



HCL Technologies Limited.
Strong all-round performance; Services business drives the revenue guidance upgrade

| | | | | | |
|---------|-----------|------------------|---------------------|----------------|------------------------------|
| CMP | Target | Potential Upside | Market Cap (INR Mn) | Recommendation | Sector |
| INR 952 | INR 1,119 | 17.5% | INR 25,82,460 | BUY | Internet Software & Services |

Synopsis:

HCL Technologies Limited (HCLT) Q2FY23 performance was in marginally higher than our estimate. USD revenue grew by 1.9% QoQ, due to higher cross-currency headwinds. Revenue was up +3.8%QoQ CC, led by 5%+ sequential growth in both IT & BS as well as ER&D segments. Q2 revenue outperformance and H2 visibility syncs with upgrade in revenue guidance to 13.5-14.5% CC for FY23E (vs 12-14% earlier), including Services (ex-P&P) growth guidance of 16-17% CC. A few key drivers for HCLT are (1) confidence on the pricing front from caution shown in 1QFY23 and (2) stronger hiring numbers QoQ (driven by a big fresher hiring number) & a reversal of 1QFY23 numbers. HCLT's margin will see traction in 3QFY23 (due to P&P spike) before it eases off seasonally in 4QFY23. HCLT believes that it is in a unique position for both cost-takeout and growth & transformation projects. Our target price of INR 1,119 is based on 20x Mar-24E EPS with EPS CAGR of 7.3% over FY22-24E.

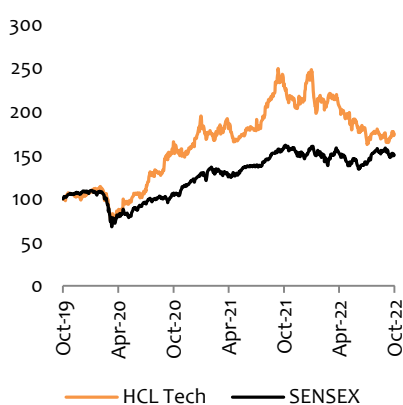
MARKET DATA

| | |
|-------------------|-------------|
| Shares outs (Mn) | 2,707 |
| Mkt Cap (INR Mn) | 25,82,460 |
| 52 Wk H/L (INR) | 1359/875.65 |
| Volume Avg (3m K) | 3667.8 |
| Face Value (INR) | 2 |
| Bloomberg Code | HCLT IN |

KEY FINANCIALS

| (INR Mn) | Q2FY23A | Q1FY23A | Q2FY22A | QoQ | YoY | KRChoksey Est. | Variance (%) |
|-------------|----------|----------|----------|--------|----------|----------------|--------------|
| USD Revenue | 3,082 | 3,025 | 2,791 | 1.9% | 10.4% | 3,070 | 0.4% |
| Revenue | 2,46,860 | 2,34,640 | 2,06,550 | 5.2% | 19.5% | 2,45,017 | 0.8% |
| EBIT | 44,270 | 39,920 | 39,160 | 10.9% | 13.0% | 42,853 | 3.3% |
| PAT | 34,890 | 32,830 | 32,650 | 6.3% | 6.9% | 34,098 | 2.3% |
| OPM (%) | 17.9% | 17.0% | 19.0% | 92 bps | -103 bps | 17.5% | 44 bps |
| NPM(%) | 14.1% | 14.0% | 15.8% | 14 bps | -167 bps | 13.9% | 22 bps |

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE

Strong Service Show; Broad Based Growth

HCLT revenue came in line with our estimate at USD 3,082mn, +3.8/+15.8% QoQ/YoY CC. Overall YoY CC revenue growth guidance was upped from 12-14% to 13.5-14.5%, with services now likely to grow by 16-17% and P&P likely flattish (ex-divestments). While HCLT management stated that there have been ramp-downs of certain projects and re-prioritization of spending by clients, it sees robust growth if the focus is on the right areas – cost optimization, business model transformation and cloud migration. Growth was led by ERD and IT & Business Services that grew 5% and 5.3% in CC sequentially. The overall services portfolio has grown at 18.9% YoY and 5.3% QoQ. The applications portfolio drove growth in the IT business, as reflected in 30.9% YoY CC growth in Mode 2 services. The P&P vertical declined 7.8% QoQ on seasonality and is likely to remain flat for FY23. Within verticals, growth was led by manufacturing (+10.9% QoQ CC) and public services (+6% QoQ CC). Company hired 8,3k+ employees at a net level which included record fresher hiring of 10k+ during the quarter with company sticking to its outlook of adding 30-35k fresher during FY23.

Strong deal wins to drive growth across geographies

HCLT booked a net-new TCV of USD 2.38bn (+16.1% QoQ), which included eight large services deals and three product deals in the quarter. HCLT has won a mega deal of USD 625mn (for 5 years) in 2QFY23. Moreover, the continued strong deal TCV (book to bill of 0.8x), pipeline commentary and revenue growth guidance of 16-17% YoY in CC terms for the vertical should reassure investor concerns on the company's growth. Management attributed the decline to seasonal headwinds and the impact of DXC divestiture (~5% QoQ impact). Due to recent macro events globally, HCLT software carries mid & end-of-the-life products with little growth prospects (products revenue declined 10.3%QoQ to USD 288mn). IMS business faces pressure from client demand for higher productivity and deflation during renewals.

Revised margin guidance band to 18-20%

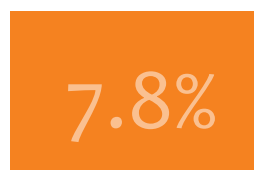
EBIT margin during the quarter was 17.9%, +90bps. Services margin expansion of 1.3% sequentially was supported by realization and utilization +1.1%, SG&A leverage of 0.4%, FX benefit of 0.6%, offset by a wage hike impact of -0.9%. IT services was up 100bp QoQ, ER&D up 270bp QoQ, while P&P down 220bp QoQ.

MARKET INFO

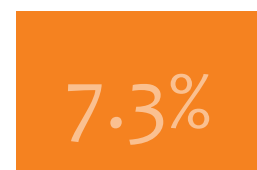
| | |
|--------|----------|
| SENSEX | 57,625.9 |
| NIFTY | 17,123.6 |

SHARE HOLDING PATTERN (%)

| Particulars | Jun-22 | Mar-22 | Dec-21 |
|-------------|--------|--------|--------|
| Promoters | 60.7 | 60.7 | 60.3 |
| FIIs | 18.1 | 19 | 20.3 |
| DIIIs | 15.6 | 14.7 | 13.7 |
| Others | 5.6 | 5.6 | 5.7 |
| Total | 100 | 100 | 100 |



Revenue CAGR between FY22 and FY24E



PAT CAGR between FY22 and FY24E

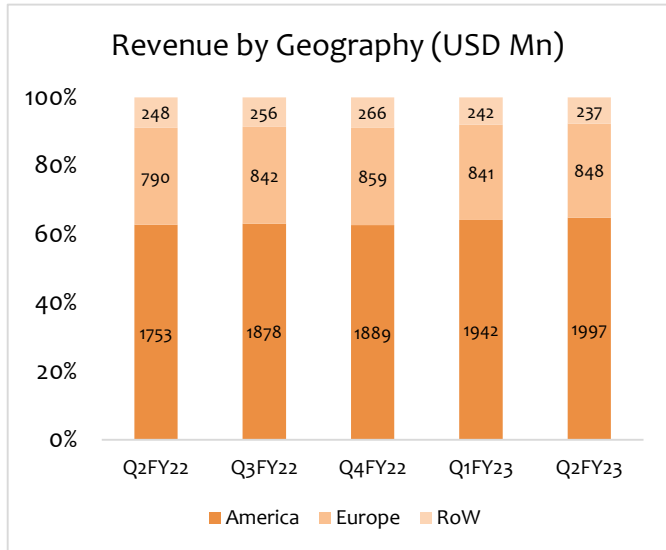
HCL Technologies Limited.

Key Concall Highlights:

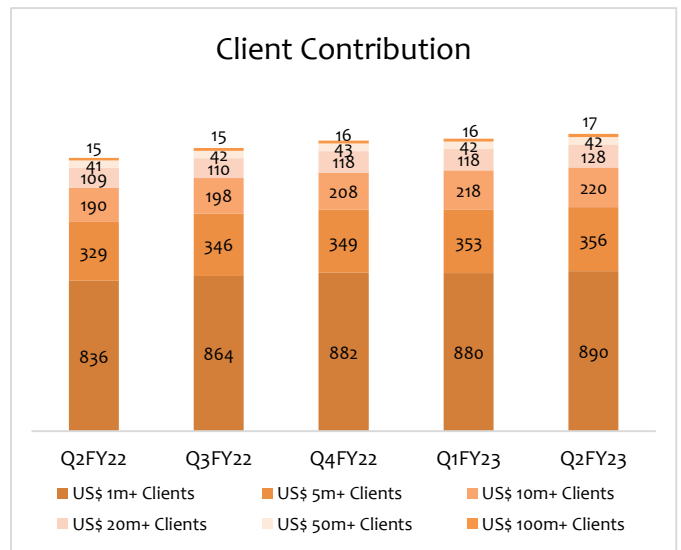
(i) Deal wins remained strong with 11 large deals; 8 in services and 3 in products. TCV Bookings (New Deal wins) at USD 2,384mn, up 16.0%/6% QoQ/YoY. ACV is up 10.3%/23.5% QoQ/YoY. These included a mega deal with average ACV of USD 125mn/yr from FY24E (ii) HCLT expects deal win target of USD 2-2.5bn/ qtr and Americas is expected to lead momentum in these wins (iii) Manufacturing and Public services verticals largely contributed to growth in services registering double digit QoQ growth of 10.9% and 6% respectively (iv) Attrition rate was stable at 23.8% in Q2FY23, same as Q1FY23. Company has targeted hiring 30-35k fresher in FY23 (lower end) (v) Net addition of +8k during the quarter & employee base increased by ~4%QoQ to ~220k (vi) A lot of clients are lagging behind in consuming Cloud capacity and need to accelerate spends to consume the same (vii) HCLT is seeing some stabilization in the P&P vertical and is expected to remain flat in FY23, though the management is seeing very strong recognition and adoption for some products.

Valuation and view

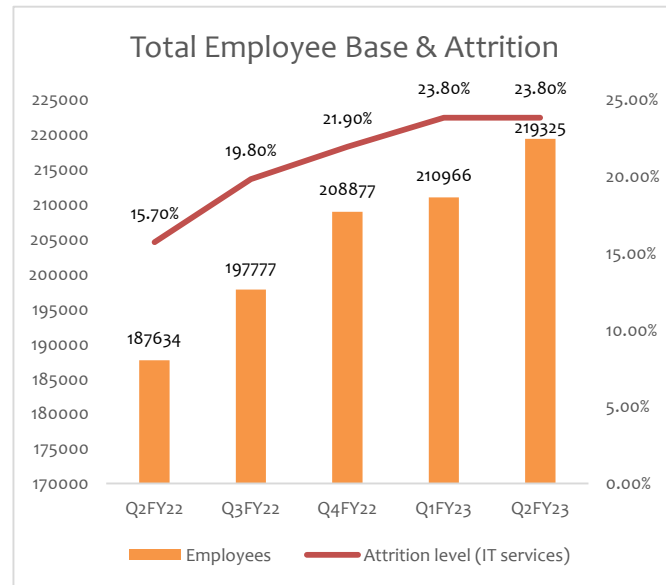
HCLT is currently trading at a valuation with a P/E multiple of 18x/17x on FY23E/FY24E earnings. Given its deep capabilities in the IMS space and strategic partnerships, continued investments in the cloud/digital capabilities, we expect HCLT to emerge stronger on the back of rising demand for the services from the enterprises. Strong sequential growth within Services, robust headcount addition, healthy deal wins, and a solid pipeline indicate an improved outlook. So we continue with the target price of INR 1,119 with a P/E multiple of 20x to the FY24 estimated EPS of INR 56, an upside of ~17.5% over the CMP. Accordingly, we maintain our rating to “BUY” rating to the stock.



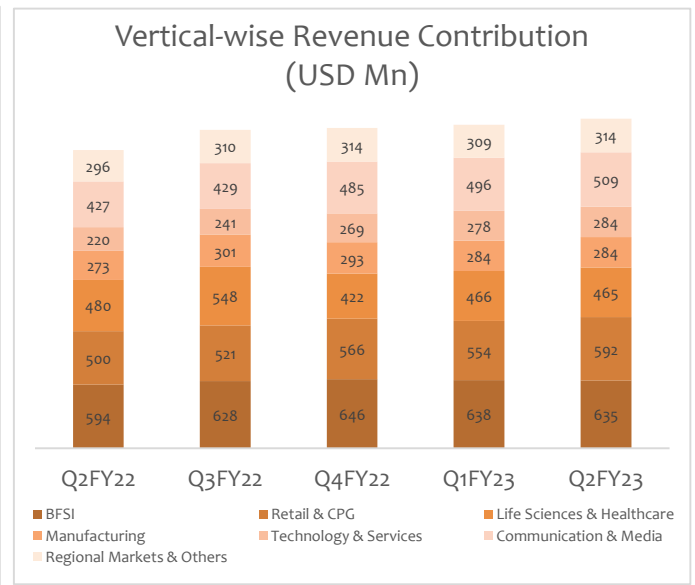
Source: Company, KRChoksey Research



Source: Company, KRChoksey Research



Source: Company, KRChoksey Research



Source: Company, KRChoksey Research

HCL Technologies Limited.

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

HCL Technologies Limited.

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

HCL Technologies Limited.

| HCL Technologies Limited | | | | Rating Legend (Expected over a 12-month period) | |
|--------------------------|-----------|---------|----------------|---|----------------|
| Date | CMP (INR) | TP(INR) | Recommendation | Our Rating | Upside |
| 13-Oct-22 | 952 | 1119 | BUY | Buy | More than 15% |
| 13-Jul-22 | 918 | 1119 | BUY | Accumulate | 5% – 15% |
| 22-Jan-22 | 1102 | 1391 | BUY | Hold | 0 – 5% |
| | | | | Reduce | -5% – 0 |
| | | | | Sell | Less than – 5% |

ANALYST CERTIFICATION:

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