

HCL Tech

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Software business drives performance beat

HCLT posted operating performance beat in Q3 due to better-than-expected strength in the software business. Revenue grew by 5% CC QoQ because of strong performance in the software business (30.5% CC QoQ), while the services business (2.2% CC) delivered broadly in-line performance. Growth in the services business was steady despite higher-than-usual furloughs in financial services (-1.7% CC QoQ), ramp-down by clients under stress in retail (-0.6%), and impact from furloughs and spending optimization by clients in technology and services (0.1%). Deal intake remained healthy at USD2.35bn in Q3, led by IT operating model transformation, cloud adoption, and large vendor consolidation deals. Management expects revenue growth in Q4 to be weak QoQ due to seasonality in the software business. However, management remains confident about the medium-term growth outlook due to market share gain, strong deal intake, and deal pipeline. HCLT has narrowed its overall revenue growth guidance to 13.5-14.0% CC (earlier 13.5-14.5%) and EBITM guidance to 18.0-18.5% for FY23 (earlier 18-19%). HCLT has also narrowed down its services revenue growth guidance to 16.0-16.5% CC for FY23 (earlier 16-17%), implying 1.0-2.5% QoQ growth in Q4. We raise our earnings estimates by 1.4-1.8% for FY23E-25E, factoring in Q3 performance. We maintain BUY with a TP of Rs1,125/share at 17x Dec-24E EPS (earlier Rs1,100).

Results summary: Revenue grew by 5.3% QoQ to USD3.24bn (5% QoQ/13.1% YoY CC), above our estimates, due to strong performance in the software business (30.5% CC QoQ). EBITM expanded by ~160bps QoQ to 19.6%, 70bps above our expectations, due to increased contribution from the software business. The services business's EBITM grew by ~10bps QoQ to 17.7% due to pyramid and cost optimization (+40bps), better realization (+30bps), currency movement (+70bps) negated by salary hike for middle management (-70bps), and impact of furloughs (-60bps). Net profit stood at Rs40.97bn, higher than our estimate, due to better-than-expected operating performance. HCLT signed seven large services deals and 10 software deals with total new deal TCV of USD2.35bn in Q3. **What we liked:** Revenue and margin beat, healthy deal intake, and strong performance in the software segment. **What we did not like:** Weakness in financial services, retail and CPG, and technology.

Earnings call KTAs: 1) HCLT signed three large deals in Q3 in which the bulk of work is in the nature of transformation and attributable to vendor consolidation, transition from struggling service provider, and realignment of the product operating model. The share of cost takeout deals is growing in the unqualified deal pipeline, which may lead to a higher share in booking in future. 2) Growth in Europe was led by large deal ramp-up in a telecom client in the past two quarters. Growth was partly offset in the reported communication vertical due to the decline in another large telecom client. 3) BFSI growth is expected to improve in Q4, while weakness in retail and CPG is expected to persist. Technology is likely to remain stable, as the impact from spend optimization would be negated by vendor-consolidation opportunities. 4) Management aspires to return to the 19-20% EBITM trajectory. Lower backfilling costs with moderating attrition, flattening employee pyramid, better utilization, improved realization, and higher offshoring/nearshoring remain key margin levers. 5) IT services LTM attrition moderated to 21.7% in Q3FY23 vs. 23.8% in Q2FY23. 6) New deal intake TCV grew by 10% YoY to USD2.35bn (ACV up 1.9% YoY; 13% YoY in 9MFY23). HCLT hopes to sustain 10%+ ACV growth on a TTM rolling forward basis. 7) The company announced an interim dividend of Rs10 per share.

Financial Snapshot (Consolidated)

(Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	753,790	856,510	1,009,712	1,094,263	1,218,942
EBITDA	207,750	205,300	225,649	245,091	269,346
EBITDA Margin (%)	27.6	24.0	22.3	22.4	22.1
APAT	111,440	134,990	146,790	164,922	183,946
EPS (Rs)	41.1	49.7	54.1	60.8	67.8
EPS (% chg)	0.7	21.1	8.7	12.4	11.5
ROE (%)	19.9	22.2	23.0	24.3	25.4
P/E (x)	26.1	21.5	19.8	17.6	15.8
EV/EBITDA (x)	13.3	13.4	12.0	10.8	9.6
P/BV (x)	4.9	4.7	4.4	4.1	3.9

Source: Company, Emkay Research

CMP	Target Price
Rs 1,072 as of (January 13, 2023)	Rs 1,125 (▲) 12 months
Rating	Upside
BUY (■)	5.0 %

Change in Estimates

EPS Chg FY23E/FY24E (%)	1.5/1.4
Target Price change (%)	2.3
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates		
	FY23E	FY24E
Emkay	54.1	60.8
Consensus	53.4	60.1
Mean Consensus TP (12M)	Rs 1,135	

Stock Details

Bloomberg Code	HCLT IN
Face Value (Rs)	2
Shares outstanding (mn)	2,714
52 Week H/L	1,359 / 876
M Cap (Rs bn/USD bn)	2,908 / 35.66
Daily Avg Volume (nos.)	3,011,371
Daily Avg Turnover (US\$ mn)	38.8

Shareholding Pattern Sep '22

Promoters	60.7%
FIIIs	17.2%
DIIIs	16.5%
Public and Others	5.6%

Price Performance

(%)	1M	3M	6M	12M
Absolute	4	13	16	(21)
Rel. to Nifty	8	8	4	(19)

Relative price chart



Source: Bloomberg

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Exhibit 1: Quarterly snapshot (Q3FY23)

Rs mn	Q3 FY23	Q2 FY23	QoQ (%)	Q3 FY22	YoY (%)
Net sales (US\$ mn)	3,244	3,082	5.3	2,978	9.0
Net sales (Rs mn)	267,000	246,860	8.2	223,310	19.6
Operating expenses	203,350	192,600	5.6	169,380	
EBITDA	63,650	54,260	17.3	53,930	18.0
Margins (%)	23.8	22.0	190	24.2	-30.0
Depreciation	11,360	9,980		11,360	
EBIT	52,290	44,280	18.1	42,570	22.8
Margins (%)	19.6	17.9	160	19.1	50.0
Other income	1,440	1,570		1,730	
Pre-tax profit	53,730	45,850	17.2	44,300	
Tax provided	12760	10960		9820	
Profit after tax	40,970	34,890	17.4	34,480	18.8
Emkay Net profit*	40,970	34,900	17.4	34,420	19.0
EPS, Rs	15.1	12.9	17.4	12.7	19.0

Source: Company, Emkay Research

Exhibit 2: Actuals vs. estimates (Q3FY23)

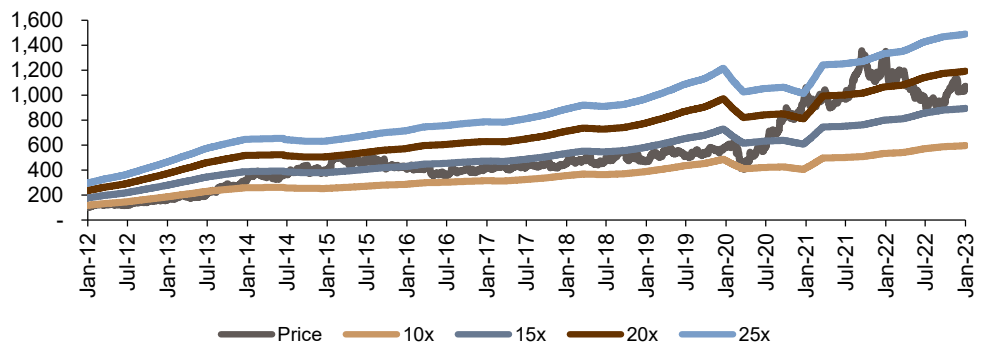
(Rs mn)	Actual	Estimate		% variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenue (USD mn)	3,244	3,189	3,186	1.7%	1.8%	Revenue came ahead of our/consensus estimates due to better-than-expected growth in the software business
Sales	267,000	262,460	261,813	1.7%	2.0%	
EBIT	52,290	49,684	48,959	5.2%	6.8%	Margin came 70bps ahead of our estimates
EBIT, margin	19.6%	18.9%	18.7%	70 bps	90 bps	
PAT	40,970	39,276	38,748	4.3%	5.7%	Profit came higher than our estimates on account of operating performance beat

Source: Company, Bloomberg, Emkay Research

Exhibit 3: Changes in estimates

(All fig. in Rs mn, except EPS)	FY23E			FY24E			FY25E		
	Old	New	% change	Old	New	% change	Old	New	% change
Revenue (USD mn)	12,524	12,576	0.4	13,445	13,509	0.5	14,782	14,865	0.6
YoY growth, %	9.1%	9.5%		7.4%	7.4%		9.9%	10.0%	
Revenue	1,005,440	1,009,712	0.4	1,089,060	1,094,263	0.5	1,212,163	1,218,942	0.6
EBIT	181,194	184,254	1.7	200,758	202,757	1.0	222,733	225,784	1.4
EBIT margin %	18.0	18.2		18.4	18.5		18.4	18.5	
Net profit	144,577	146,790	1.5	162,599	164,922	1.4	180,713	183,946	1.8
EPS (Rs)	53.3	54.1	1.5	59.9	60.8	1.4	66.6	67.8	1.8

Source: Company, Emkay Research

Exhibit 4: HCLT one-year forward P/E chart

Source: Company, Emkay Research

Key Financials (Consolidated)**Income Statement**

Y/E March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	753,790	856,510	1,009,712	1,094,263	1,218,942
Expenditure	546,040	651,210	784,063	849,172	949,596
EBITDA	207,750	205,300	225,649	245,091	269,346
Depreciation	46,110	43,260	41,395	42,334	43,562
EBIT	161,640	162,040	184,254	202,757	225,784
Other Income	4,160	7,470	8,815	14,246	16,250
Interest expenses	0	0	0	0	0
PBT	165,800	169,510	193,069	217,003	242,034
Tax	54,120	34,280	46,309	52,081	58,088
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	240	240	(30)	0	0
Reported Net Income	111,440	134,990	146,790	164,922	183,946
Adjusted PAT	111,440	134,990	146,790	164,922	183,946

Balance Sheet

Y/E March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity share capital	5,427	5,427	5,427	5,427	5,427
Reserves & surplus	593,703	613,713	651,956	695,849	744,112
Net worth	599,130	619,140	657,384	701,277	749,539
Minority Interest	1,690	920	920	920	920
Loan Funds	65,010	65,790	65,950	65,950	65,950
Net deferred tax liability	(10,328)	(10,641)	(10,260)	(10,260)	(10,260)
Total Liabilities	655,502	675,209	713,994	757,887	806,149
Net block	374,570	371,390	350,568	323,275	304,611
Investment	140,700	114,850	173,120	173,120	173,120
Current Assets	334,860	392,330	446,743	538,314	635,300
Cash & bank balance	65,210	105,100	99,341	161,956	216,245
Other Current Assets	93,460	78,910	116,186	125,915	140,262
Current liabilities & Provision	194,628	203,361	256,437	276,822	306,882
Net current assets	140,232	188,969	190,306	261,492	328,418
Misc. exp	0	0	0	0	0
Total Assets	655,502	675,209	713,994	757,887	806,149

Cash Flow

Y/E March (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
PBT (Ex-Other income) (NI+Dep)	161,640	162,040	184,254	202,757	225,784
Other Non-Cash items	3,874	(4,371)	(3,730)	0	0
Chg. in working cap	(4,149)	(39,913)	(6,714)	(8,571)	(12,639)
Operating Cashflow	203,390	169,127	181,471	198,686	214,869
Capital expenditure	(29,856)	(15,219)	(20,573)	(15,041)	(24,898)
Free Cash Flow	173,534	153,908	160,898	183,644	189,971
Investments	(27,559)	29,916	(58,270)	0	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(57,415)	14,697	(78,843)	(15,041)	(24,898)
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	(76,751)	(14,995)	160	0	0
Dividend paid (incl tax)	(32,595)	(122,051)	(108,547)	(121,029)	(135,683)
Other Financing Cash Flow	(8,238)	(6,888)	0	0	0
Financing Cashflow	(117,585)	(143,934)	(108,387)	(121,029)	(135,683)
Net chg. in cash	28,390	39,890	(5,759)	62,615	54,288
Opening cash position	48,430	65,210	105,100	99,341	161,956
Closing cash position	76,820	105,100	99,341	161,956	216,245

Source: Company, Emkay Research

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Key Ratios

Profitability (%)	FY21	FY22	FY23E	FY24E	FY25E
EBITDA Margin	27.6	24.0	22.3	22.4	22.1
EBIT Margin	21.4	18.9	18.2	18.5	18.5
Effective Tax Rate	32.6	20.2	24.0	24.0	24.0
Net Margin	14.8	15.8	14.5	15.1	15.1
ROCE	26.8	25.5	27.8	29.5	30.9
ROE	19.9	22.2	23.0	24.3	25.4
RoIC	24.9	28.6	31.2	35.7	40.9

Per Share Data (Rs)	FY21	FY22	FY23E	FY24E	FY25E
EPS	41.1	49.7	54.1	60.8	67.8
CEPS	58.1	65.7	69.3	76.4	83.8
BVPS	220.8	228.2	242.2	258.4	276.2
DPS	26.0	44.0	40.0	44.6	50.0

Valuations (x)	FY21	FY22	FY23E	FY24E	FY25E
PER	26.1	21.5	19.8	17.6	15.8
P/CEPS	18.5	16.3	15.5	14.0	12.8
P/BV	4.9	4.7	4.4	4.1	3.9
EV / Sales	3.7	3.2	2.7	2.4	2.1
EV / EBITDA	13.3	13.4	12.0	10.8	9.6
Dividend Yield (%)	2.4	4.1	3.7	4.2	4.7

Gearing Ratio (x)	FY21	FY22	FY23E	FY24E	FY25E
Net Debt/ Equity	(0.2)	(0.2)	(0.3)	(0.4)	(0.4)
Net Debt/EBIDTA	(0.7)	(0.8)	(0.9)	(1.1)	(1.2)
Working Cap Cycle (days)	36.3	35.7	32.9	33.2	33.6

Growth (%)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	6.7	13.6	17.9	8.4	11.4
EBITDA	24.5	(1.2)	9.9	8.6	9.9
EBIT	16.7	0.2	13.7	10.0	11.4
PAT	0.7	21.1	8.7	12.4	11.5

Quarterly (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Revenue	223,310	225,970	234,640	246,860	267,000
EBITDA	53,930	50,530	49,750	54,260	63,650
EBITDA Margin (%)	24.2	22.4	21.2	22.0	23.8
PAT	34,420	35,940	32,830	34,900	40,970
EPS (Rs)	12.7	13.2	12.1	12.9	15.1

Source: Company, Emkay Research

Shareholding Pattern (%)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	60.3	60.3	60.7	60.7	60.7
FII	22.3	20.4	19.0	17.9	17.2
DII	12.5	13.7	14.7	15.5	16.5
Public and Others	4.9	5.5	5.6	5.8	5.6

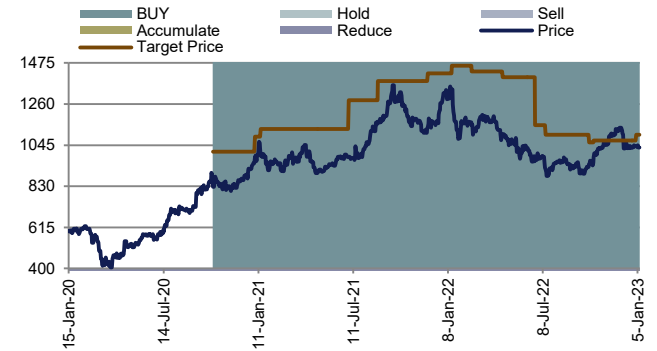
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
2-Jan-23	1,039	1,100	12m	Buy	Dipeshkumar Mehta
13-Oct-22	982	1,070	12m	Buy	Dipeshkumar Mehta
4-Oct-22	946	1,060	12m	Buy	Dipeshkumar Mehta
13-Jul-22	918	1,100	12m	Buy	Dipeshkumar Mehta
23-Jun-22	971	1,150	12m	Buy	Dipeshkumar Mehta
12-May-22	1,059	1,400	12m	Buy	Dipeshkumar Mehta
22-Apr-22	1,102	1,400	12m	Buy	Dipeshkumar Mehta
1-Apr-22	1,170	1,430	12m	Buy	Dipeshkumar Mehta
22-Feb-22	1,150	1,430	12m	Buy	Dipeshkumar Mehta
15-Jan-22	1,337	1,460	12m	Buy	Dipeshkumar Mehta
1-Jan-22	1,319	1,420	12m	Buy	Dipeshkumar Mehta
30-Nov-21	1,139	1,420	12m	Buy	Dipeshkumar Mehta
15-Oct-21	1,251	1,380	12m	Buy	Dipeshkumar Mehta
2-Oct-21	1,274	1,380	12m	Buy	Dipeshkumar Mehta
27-Aug-21	1,163	1,380	12m	Buy	Dipeshkumar Mehta
20-Jul-21	977	1,280	12m	Buy	Dipeshkumar Mehta
2-Jul-21	985	1,280	12m	Buy	Dipeshkumar Mehta
24-Apr-21	956	1,130	12m	Buy	Dipeshkumar Mehta
5-Apr-21	1,034	1,130	12m	Buy	Dipeshkumar Mehta
18-Mar-21	948	1,130	12m	Buy	Dipeshkumar Mehta
15-Jan-21	990	1,130	12m	Buy	Dipeshkumar Mehta
4-Jan-21	980	1,090	12m	Buy	Dipeshkumar Mehta
18-Dec-20	891	1,010	12m	Buy	Dipeshkumar Mehta
16-Oct-20	827	1,010	12m	Buy	Dipeshkumar Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

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Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 13 Jan 2023 04:40:42 (SGT)

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