Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↓	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 13.33
Updated Oct 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 290,877 cr
52-week high/low:	Rs. 1,359 / 876
NSE volume: (No of shares)	31.0 lakh
BSE code:	532281
NSE code:	HCLTECH
Free float: (No of shares)	106.6 cr

Shareholding (%)

Promoters	60.7
FII	17.2
DII	16.5
Others	5.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	4.2	12.6	15.5	-20.7
Relative to Sensex	7.7	8.6	4.2	-18.7

Sharekhan Research, Bloomberg

HCL Technologies Ltd

Strong Quarter, uncertainties persist

IT & ITES	Sharekhan code: HCLTECH
Reco/View: Buy ↔	CMP: Rs. 1,072
Price Target: Rs. 1,205 ↑	

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result Update

Summary

- For Q3FY2023, HCL Tech reported strong performance across all metrics – revenue growth, margin expansion, booking growth, and people metrics. Revenue in constant currency was up 5% q-o-q and 13.1% y-o-y, beating our estimates of CC growth of 3.6% q-o-q, led by the services business, which grew by 15.4% y-o-y in CC terms. EBIT margin improved by 165 bps to 19.6% in Q3FY23.
- HCL Tech reported new deal wins worth a total contract value (TCV) of $2.35 billion. The company won 17 large deals, of which seven were in Services and 10 in Software verticals. The company also won a major deal of over $500 million for a US-headquartered Fortune 500 financial services company.
- HCL Tech, which recently tempered its FY23 growth guidance to the lower end of 13.5-14.5% band, has narrowed its revenue and margin guidance band due to seasonal challenges in the fourth quarter. FY23 revenue growth is now seen at 13.5-14% in constant currency, with EBIT margin at 18-18.5%.
- Owing to multiple global headwinds, outlook for FY24E looks uncertain, and recovery could be gradual in the coming quarters. However, we believe the structural growth story for the Indian IT sector remains intact. We maintain Buy on HCL Tech with a revised PT of Rs. 1,205, given strong deal pipeline and tailwinds due cloud adoption and vendor consolidation. We advise investors to adopt a staggered approach to invest from a long-term perspective.

For Q3FY2023, HCL Tech's revenue in constant currency was up 5% q-o-q and 13.1% y-o-y, beating our estimates of CC growth of 3.6% q-o-q, led by the services business, which grew by 15.4% y-o-y in CC terms. EBIT margin improved by 165 bps to 19.6% in Q3FY2023, beating our estimates of 18.5%. Management has revised its FY2023 growth guidance to 13.5-14.0% with services growth guidance of 16.0-16.5% as Q4FY23 is expected to be weak due to seasonality in HCL Software, while IT Services should see better growth. HCL Tech has narrowed its EBIT margin guidance to the lower side at 18-18.5% from 18-19%. Deal wins were healthy with TCV Bookings at US$2,347 million, up 10% y-o-y; ACV was up 1.9% q-o-q. The company won 17 large deals, of which seven were in Services and 10 in Software verticals. The company has also won a major deal of over $500 million for a US-headquartered Fortune 500 financial services company. With respect to geographies, Europe registered 7.2% sequential growth on CC basis, while North America grew 0.5% q-o-q on CC basis. In terms of industry verticals, on a CC basis, manufacturing grew 4.9 q-o-q and 21.8 % y-o-y, while Financial Services and Retail & CPG witnessed a degrowth of 1.7% and 0.6% q-o-q respectively. HCL Tech's attrition rate eased to 21.7% in Q3 from 23.8% in Q2. Management cited decision delay in Europe, but it stated that the deal pipeline in Europe is good. Increased vendor consolidation deals, strong pipeline of cost takeout deals, and favourable pricing should assist the company in facing macro challenges. Owing to multiple global headwinds, FY24E looks uncertain, and recovery could be gradual in the coming quarters. However, we believe the structural growth story for Indian IT sector remains intact. We maintain a our Buy rating on HCL Tech with a revised PT of Rs. 1,205, given the strong deal pipeline and tailwinds due to cloud adoption and vendor consolidation. We advise investors to adopt a staggered approach from a long-term perspective.

Key positives

- LTM attrition moderated to 21.7% in Q3FY2023 from 23.8% for Q2FY2023. HCL Tech added 5,892 freshers in Q3FY2023.
- The company also won a major deal of over $500 million for a US-headquartered Fortune 500 financial services company.

Key negatives

- HCL Tech has narrowed its revenue and margin guidance band due to seasonal challenges in the fourth quarter.
- Financial services witnessed a decline in CC q-o-q growth at 1.7%.

Management Commentary

- Management narrowed its FY2023 growth guidance to 13.5-14.0% with services growth guidance of 16.0-16.5%. EBIT margin guidance to 18.0-18.5% from 18-19% earlier as Q4FY23 is expected to be weak due to seasonality in HCL Software, while IT Services should see better growth.
- Management cited decision delay in Europe but stated that deal pipeline in Europe is good. Increased vendor consolidation deals, strong pipeline of cost-take out deals, and favorable pricing should help tide macro challenges.

Revision in estimates – We have fine-tuned our estimates for FY2023/FY2024/FY2025 owing to macro-overhang and INR-USD reset.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 1,205: Owing to multiple global headwinds, FY2024E outlook looks uncertain and recovery could be gradual in the coming quarters. However, we believe the structural growth story for the Indian IT sector remains intact. We maintain a Buy on HCL Tech with a revised PT of Rs. 1,205, given strong deal pipeline and tailwinds due to cloud adoption and vendor consolidation. We advise investors to adopt a staggered approach to invest from a long-term perspective.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures, and/or constraints in local talent supply in the US would affect earnings.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	85,651.0	1,01,394.5	1,06,950.7	1,17,059.5
OPM (%)	24.0	22.2	23.5	23.0
Adjusted PAT	13,499.0	14,255.7	16,566.9	17,594.2
% y-o-y growth	4.3	5.6	16.2	6.2
Adjusted EPS (Rs.)	49.7	54.3	63.2	67.1
P/E (x)	19.1	17.5	15.1	14.2
P/B (x)	4.2	3.9	3.7	3.5
EV/EBITDA (x)	11.8	11.1	9.9	9.2
RoNW (%)	22.1	22.2	24.2	24.2
ROCE (%)	23.7	25.3	27.7	27.9

Source: Company; Sharekhan estimates

Q3FY2023 Key Earnings Call Highlights

- **Revenue growth across business verticals and geographies:** In terms of geographies, revenue stood at 0.5%/7.2%/-1.2% q-o-q in CC terms from Americas/Europe/RoW. Among verticals, manufacturing led the pack with 4.9% q-o-q CC revenue growth, while Financial services/Technology/Retail & CPG/Telecom, media & entertainment/life sciences/public services posted -1.7%/0.1%/-0.6%/4.5%/5.5%/3% q-o-q CC revenue growth in Q3FY23.
- **Strong deal TCVs:** Deal wins were healthy with TCV bookings at US$2,347 mn, up 10% y-o-y. The company won 17 large deals, of which seven were in Services and 10 in Software verticals. The company also won a major deal of over $500 million for a US-headquartered Fortune 500 financial services company. ACV increased 1.9% yoy, indicating higher tenure of deals signed.
- **Strong Product revenue:** Products business grew by 30.5% q-o-q but declined by 1.5% y-o-y. Strong q-o-q growth was driven by 10 large deal wins.
- **Attrition rate and headcount additions:** HCL Tech's attrition rate eased to 21.7% in Q3 from 23.8% in Q2. The company added a net of 2,945 people with 5892 fresher hirings, increasing the headcount to 2,22,270.
- **Demand environment:** Management cited decision delay in Europe but stated that the deal pipeline in Europe is good. Increased vendor consolidation deals, strong pipeline of cost takeout deals, and favourable pricing should help tide challenging macro environment. Management expects $150 million worth of vendor consolidation deals up for grabs over the next three years, and that the company is well positioned to benefit from that. Cloud adoption and vendor consolidation are some of the tailwinds expected to drive demand.
- **Guidance Revision:** HCL Tech has revised its FY2023 growth guidance to 13.5-14.0% with services growth guidance of 16.0-16.5%. EBIT margin guidance has been revised to 18.0-18.5% from 18-19% earlier, as 4QFY23 is expected to be weak due to seasonality in HCL Software, while IT Services should see better growth.

Results Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	Y-o-Y %	Q-o-Q %
Revenues ($ mn)	**3,244.0**	**2,977.5**	**3,082.1**	**9.0**	**5.3**
Net sales	**26,700.0**	**22,331.0**	**24,686.0**	**19.6**	**8.2**
Direct Costs	16,720.0	13,798.0	15,849.0	21.2	5.5
Gross Profit	**9,980.0**	**8,533.0**	**8,837.0**	**17.0**	**12.9**
Research & development	415.0	381.0	388.0	8.9	7.0
SG&A	3,200.0	2,759.0	3,024.0	16.0	5.8
EBITDA	**6,365.0**	**5,393.0**	**5,425.0**	**18.0**	**17.3**
Depreciation & amortization	1,136.0	1,136.0	998.0	0.0	13.8
EBIT	**5,229.0**	**4,257.0**	**4,427.0**	**22.8**	**18.1**
Forex gain/(loss)	3.0	73.0	46.0	-95.9	-93.5
Other Income	141.0	100.0	111.0	41.0	27.0
PBT	**5,373.0**	**4,430.0**	**4,584.0**	**21.3**	**17.2**
Tax Provision	1,276.0	982.0	1,096.0	29.9	16.4
Net profit	**4,097.0**	**3,442.0**	**3,489.0**	**19.0**	**17.4**
EO	0.0	0.0	0.0		
Reported net profit	**4,097.0**	**3,442.0**	**3,489.0**	**19.0**	**17.4**
EPS (Rs)	15.6	11.8	12.7	32.4	22.6
Margin (%)					
EBITDA	23.8	24.2	22.0	-31	186
EBIT	19.6	19.1	17.9	52	165
NPM	15.3	15.4	14.1	-7	121
Tax rate	23.7	22.2	23.9	158	-16

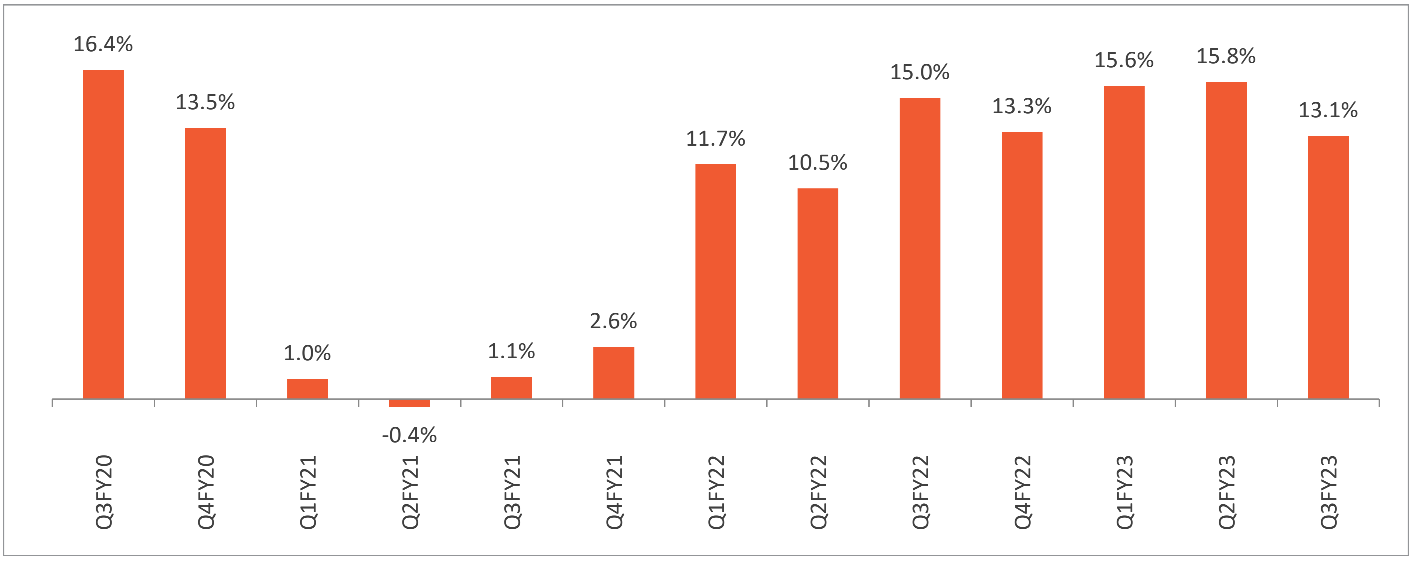
Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals, and other operating metrics

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%)		CC growth (%)	
			Q-o-Q %	Y-o-Y %	Q-o-Q %	Y-o-Y %
Revenue ($ mn)	3,244	100	5.3	9.0	5.0	13.1
Geographic mix						
Americas	2,060	63.5	3.1	9.6	0.5	12.3
Europe	944	29.1	11.4	12.0	7.2	23.3
RoW	240	7.4	1.2	-7.3	-1.2	11.6
Industry verticals						
Financial services	646	19.9	1.7	2.8	-1.7	8.8
Manufacturing	639	19.7	8.0	22.6	4.9	21.2
Technology & services	480	14.8	3.2	-12.4	0.1	19.3
Retail & CPG	289	8.9	1.8	-4.0	-0.6	-3.8
Telecommunications, media, publishing & entertainment	305	9.4	7.5	26.4	4.5	27.9
Lifesciences & healthcare	555	17.1	9.1	29.4	5.5	19.5
Public services	331	10.2	5.3	6.9	3.0	16.7
Service line						
IT and business services	2,326	71.7	2.5	10.6	2.1	15.3
Engineering and R&D Services	539	16.6	2.8	13.8	2.5	16.0
Products & platforms	399	12.3	32.1	-0.7	30.5	-1.5
Clients Contribution						
Top 5	334	10.3	1.3	-8.0	0.0	0.0
Top 10	590	18.2	1.9	-2.3	0.0	0.0
Top 20	915	28.2	3.8	4.5	0.0	0.0

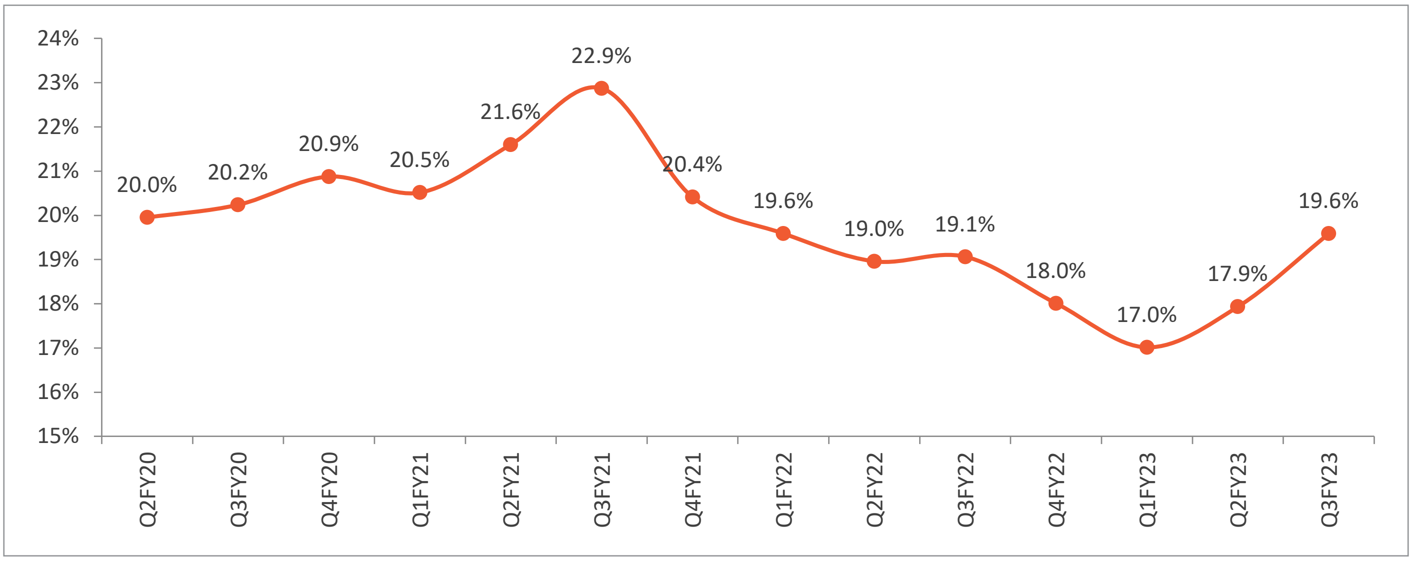
Source: Company; Sharekhan Research

HCL Tech's constant-currency revenue growth trend (y-o-y)



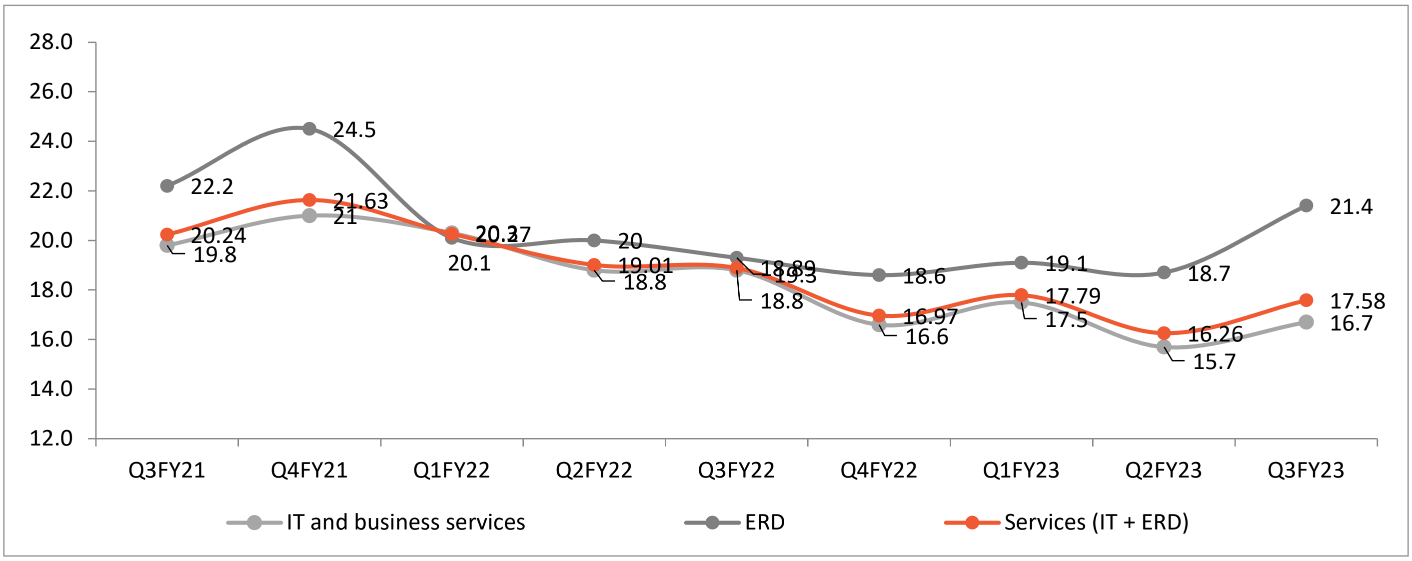
Source: Company, Sharekhan Research

EBIT margin improved sequentially beating estimates



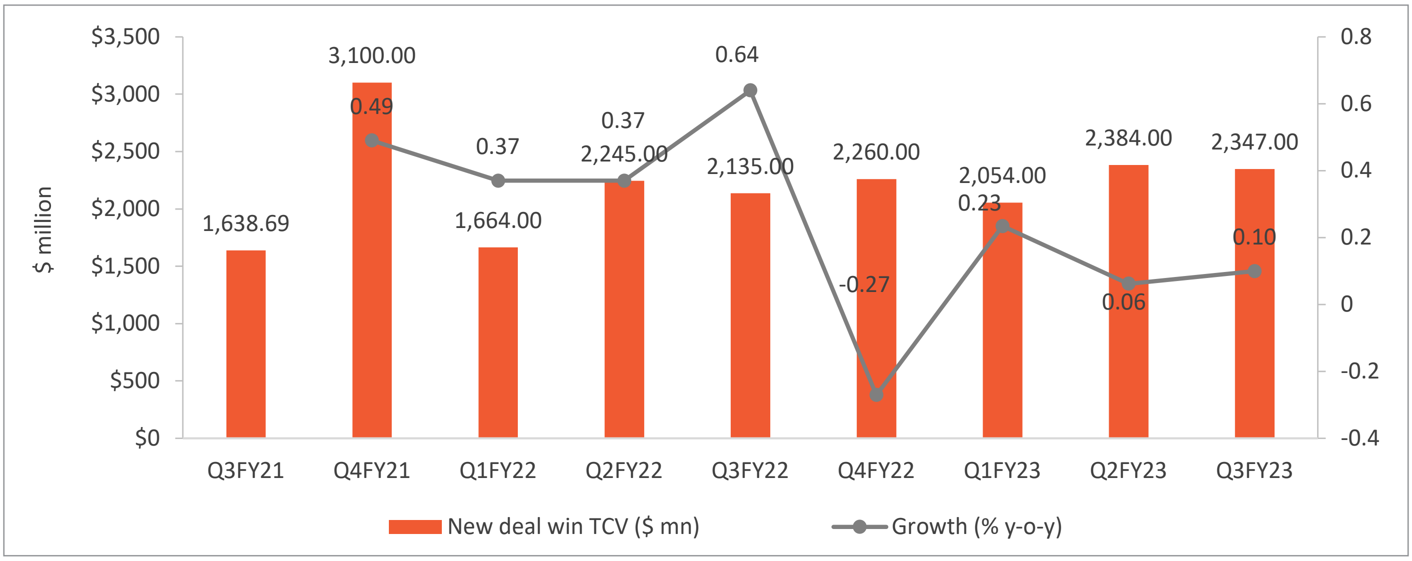
Source: Company, Sharekhan Research

Trend in services (IT+ ERD) EBIT margin



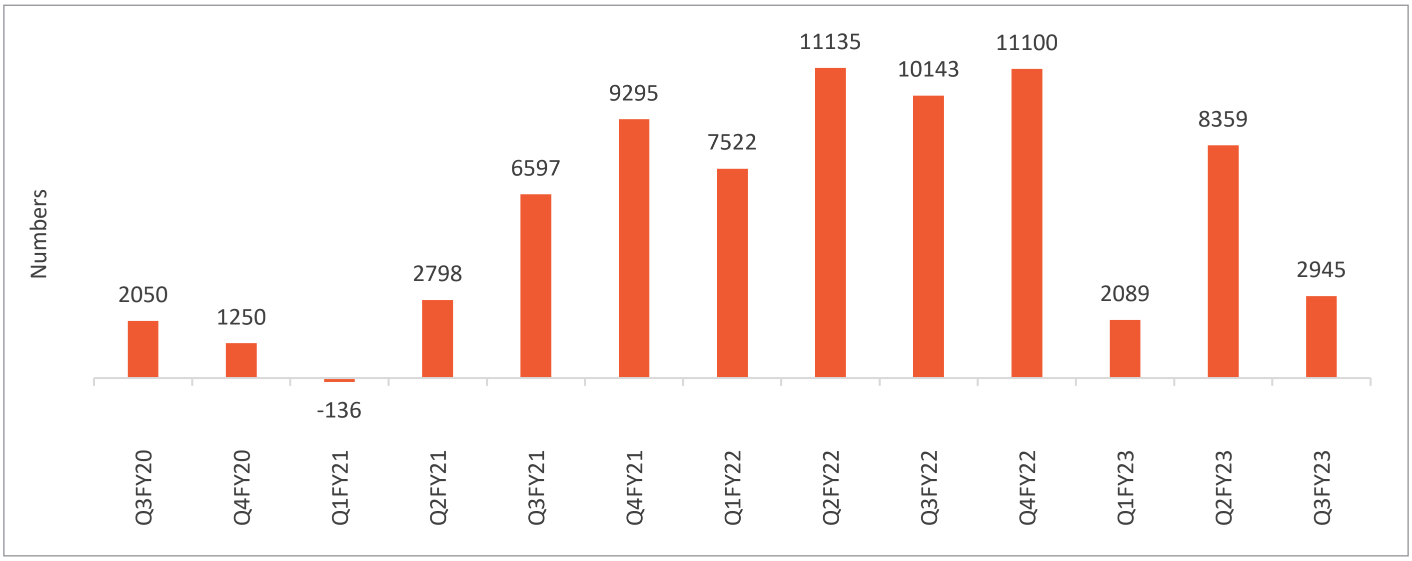
Source: Company, Sharekhan Research

New deal wins TCVs trend



Source: Company, Sharekhan Research

Net headcount addition trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

We believe that the need for business continuity, operational resilience, and the switch to digital transactions have led to strong demand for IT services post the pandemic. Industry analysts such as Gartner estimate that IT services spending would grow by 8-8.5% in the next four years as compared to the average of 4.2% achieved over the past 10 years. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients and increased online adoption across verticals.

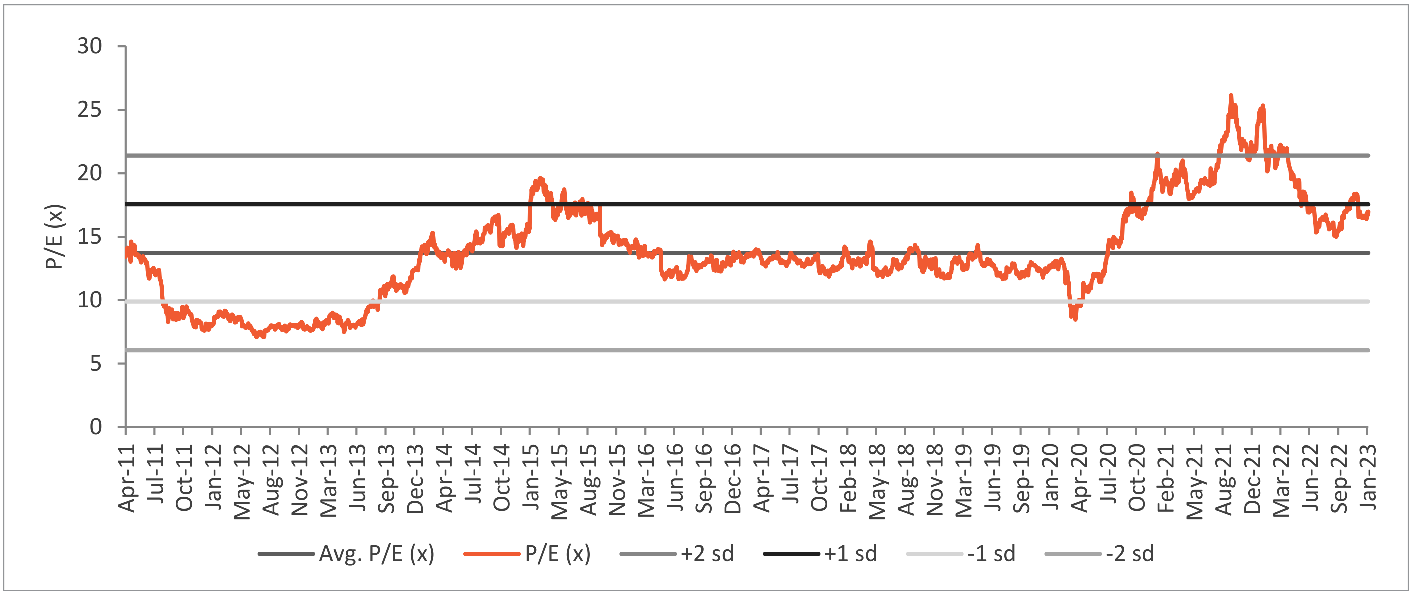
■ Company outlook - Leveraging on core strengths

HCL Tech has invested aggressively in the fast-growing Mode-2 (a good proxy for digital offering) capabilities, which would help HCL Tech deliver strong revenue growth in the coming years. Given its differentiated position in infrastructure management services (IMS) and strong capabilities in engineering services, HCL Tech is well positioned to maintain its growth momentum in the IT services business (89% of total revenue) going ahead. HCL Tech's strength in digital foundation and application modernisation make it a strong contender for building out digital transformation initiatives for clients.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,205

Owing to multiple global headwinds outlook for FY24E looks uncertain, and recovery could be gradual in the coming quarters. However, we believe the structural growth story for Indian IT sector remains intact. We maintain a Buy on HCL Technologies with a revised PT of Rs. 1,205, given strong deal pipeline and tailwinds due cloud adoption and vendor consolidation. We advise investors to adopt a staggered approach to invest from long term perspective.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

HCL Tech is a leading global technology company providing software-led IT solutions, remote infrastructure management, BPO services, and engineering-related services. Further, the company helps global enterprises re-imagine and transform their businesses through digital technology transformation. HCL Tech leverages its global network of integrated co-innovation labs and global delivery capabilities to provide holistic multi-service delivery in key industry verticals.

Investment theme

HCL Tech's revenue growth momentum is expected to accelerate, led by several large deal wins in the past few quarters and gradual recovery in infrastructure management services. The company focuses on chasing large deals to capture market share from incumbents in consolidation deals. Being the leader in IMS practices and the third-largest engineering services player globally in revenue, the company is well positioned to win large deal wins. Strong deal wins along with acquisition of select IP products will help the company drive growth going ahead.

Key Risks

1) Continued slowdown in organic revenue growth, 2) integration issues in ongoing M&A activities, especially IP-related transactions, 3) Rupee appreciation and/or adverse cross-currency movements, 4) pressure in renewal of IMS deals, 5) any hostile regulatory visa norms could have an impact on employee expenses, and 6) any major macro issues in developed markets, especially in the US and Europe.

Additional Data

Key management personnel

Shiv Nadar	Founder and Chairman
C Vijay Kumar	Managing Director and CEO
Prateek Aggarwal	Chief Financial Officer
Apparao V V	Chief Human Resources Officer
Kalyan Kumar	Chief Technology Officer and Head, Ecosystems

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	VAMA SUNDARI INVESTMENTS DELHI PVT LTD	44.07
2	HCL HOLDINGS PVT LTD	16.46
3	LIFE INSURANCE CORP OF INIA	3.91
4	ARTISAN PARTNERS LTD	2.04
5	ICICI PRUDENTIAL ASSET MANAGEMENT CO LTD	2.04
6	SBI FUNDS MANAGEMENT LTD	1.93
7	BLACKROCK INC	1.60
8	VANGUARD GROUP INC	1.35
9	HDFC ASSET MANAGEMENT CO LTD	0.96
10	ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO LTD	0.65

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.