Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

HCL Technologies Ltd

Soft Quarter, Strong guidance amidst uncertainty

IT & ITES	Sharekhan code: HCLTECH
Reco/View: Buy ↔	CMP: Rs. 1,038
	Price Target: Rs. 1,175 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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 12.92

Updated Mar 08, 2023

Low Risk

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

Source: Morningstar

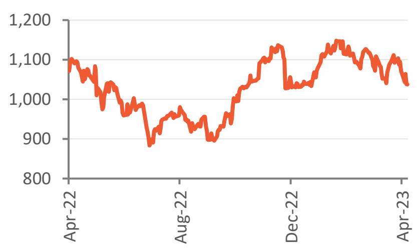
Company details

Market cap:	Rs. 2,81,556 cr
52-week high/low:	Rs. 1,157 / 876
NSE volume: (No of shares)	29.8 lakh
BSE code:	532281
NSE code:	HCLTECH
Free float: (No of shares)	106.6 cr

Shareholding (%)

Promoters	60.7
FII	18.3
DII	15.9
Others	5.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.9	-6.3	2.0	-4.8
Relative to Sensex	-8.4	-4.7	1.3	-9.3

Sharekhan Research, Bloomberg

Summary

- HCL Tech reported constant currency revenue degrowth of 1.2% q-o-q in-line with our estimates, while EBIT margin contracted 140 bps q-o-q to 18.2% chiefly due to software seasonality but was slightly better than our estimates of 18.1%.
- The company reported new deal win TCV of $2,074 million down 8% y-o-y. Company guided for FY24 cc revenue growth of 6%-8% y-o-y with services revenue growth expected to be slightly higher between 6.5-8.5%. The company expects FY24 EBIT margin to be between 18%-19% and aspires to take it to 19%-20% going forward.
- Management stated that booking delays and deal ramp downs are only on the discretionary space while cost optimisation and transformation initiatives in others continue. The Management highlighted that Europe is weaker than US with bookings being stronger in the US than Europe.
- HCL Tech is trading at a discount to its peers and considering reasonable valuation we maintain Buy rating on the stock with a revised PT of Rs.1175. At CMP, the stock trades at the stock trades at 18.7x its FY2024E EPS and 16.9 its FY2025E EPS.

For Q4FY23, HCL Tech reported constant currency revenue degrowth of 1.2% q-o-q in-line with our estimates, while EBIT margin contracted 140 bps q-o-q to 18.2% chiefly due to software seasonality but was slightly better than our estimates of 18.1%. HCL Tech reported Q4FY23 revenue of Rs 26,606 crore, down 0.4% q-o-q and up 17.7 y-o-y in line with our estimates. Net profit of Rs. 3,981 crore (down 2.8% q-o-q) was above our estimates of Rs 3813 crore, led by strong net other income. Management has guided for revenue growth of 6-8% in CC terms, slightly higher than street estimates of 5-7% with 18%-19% EBIT margins for FY24. Deal wins were decent with TCV Bookings at US$2,074 million, down 8% y-o-y .The company won 13 large deals, of which ten were in Services and three in the software sector. The attrition rate declined significantly by 220 bps q-o-q from 21.7% in Q3FY23 to 19.5% in Q4FY23 and the company expects attrition rates to further decline going forward.Net additions stood at 3,674 with 4480 freshers taking total headcount to 225,944. Strong client addition continued across large revenue categories – it added 2, 1 and 1 clients sequentially in $100 million, $50 million and $20 million revenue bucket. The Management highlighted that Europe is weaker than US with bookings being stronger in the US than Europe. The decision making is slower in Europe, and they are anticipating some improvement after another quarter. The management stated that they do not have a lot of near-term confidence on huge bookings in Europe. Management stated that booking delays and ramp down deals are only on the discretionary space while cost optimization and transformation initiatives in others continue. Although the outlook for FY24 is uncertain in the near term owing to challenging macro environment, the resilient model, diverse portfolio mix, strong client additions, strong deal pipeline and decent hiring makes Hcltech well placed to navigate the uncertainty. HCL Tech is trading at a discount to its peers and considering reasonable valuation we maintain a Buy rating on the stock with a revised PT of Rs1175. At CMP, the stock trades at the stock trades at 18.7x its FY2024E EPS and 16.9 its FY2025E EPS.

Key positives

- LTM attrition moderated to 19.5% in Q4FY23 from 21.7% in Q3FY23, down 220 points.
- Net additions stood at 3,674 with 4480 freshers taking the total headcount to 225,944.
- Management has guided for constant currency revenue growth of 6-8% with 18%-19% EBIT margin for FY24.
- Strong client addition continued across large revenue categories – company added 2, 1 and 1 clients sequentially in $100 mn, $50 mn and $20 mn revenue bucket.

Key negatives

- EBIT margin contracted 140 bps q-o-q to 18.2% chiefly due to software seasonality.
- Telecom, media & entertainment/ Manufacturing/ and Technology services declined by 5.6%/3.5%/and 1.6% q-o-q in cc respectively.

Management Commentary

- Management has guided for constant currency revenue growth of 6-8% with 18%-19% EBIT margin for FY24.The tight margin guidance factors the tailwinds from supply side while factoring potential headwinds due to macro environment. The management expects growth to be led by volume and has not baked in pricing while determining the guidance. The management also reiterated the aspirations of 19-20% EBIT margin.
- From deal win perspective, the management stated that they are witnessing market share gains in Financial services and Retail CPG which is expected to start reflecting in revenue this year. They also mentioned that they are seeing vendor consolidation opportunities in Telecom and Tech and expect to gain market share from all the above verticals during this year.
- The Management highlighted that Europe is weaker than US with bookings being stronger in the US than Europe. The decision making is slower in Europe and they are anticipating some improvement after another quarter. The management stated that they do not have lot of near-term confidence on huge bookings in Europe. For Hcltech, US continues to remain very strong in contrast to other Industry players.
- The Management believes that Financial services will continue to deliver strong growth. The recovery is focused on Tech vertical which saw ramp downs in last two quarters with significant layoffs. Hcltech is seeing visible vendor consolidation opportunities in big tech which is one of their forte.

Revision in estimates – We have fine-tuned our estimates for FY2024/FY2025 owing to macro-overhang.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 1175: Although the outlook for FY24 is uncertain in the near term owing to challenging macro environment, the resilient model, diverse portfolio mix, strong client additions, a strong deal pipeline and decent hiring makes Hcltech well placed to navigate the uncertainty. HCL Tech is trading at a discount to its peers and considering reasonable valuations, we maintain Buy rating on the stock with a revised PT of Rs1175. At CMP, the stock trades at the stock trades at 18.7x its FY2024E EPS and 16.9 its FY2025E EPS.

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	FY23	FY24E	FY25E
Revenue	85,651.0	1,01,456.0	1,04,897.7	1,13,869.2
OPM (%)	24.0	22.3	23.0	23.4
Adjusted PAT	13,499.0	14,850.0	16,149.5	17,879.2
% y-o-y growth	*4.3*	*10.0*	*8.8*	*10.7*
Adjusted EPS (Rs.)	49.7	52.4	55.6	61.5
P/E (x)	20.9	19.8	18.7	16.9
P/B (x)	4.5	4.3	4.1	3.8
EV/EBITDA (x)	14.4	13.0	11.7	10.2
RoNW (%)	22.1	23.3	24.0	24.9
ROCE (%)	23.7	26.4	27.4	28.7

Source: Company; Sharekhan estimates

Q4FY2023 Key Earnings Call Highlights

- **FY24 guidance:** Hcltech has guided FY24 cc revenue growth of 6%-8% y-o-y with services revenue growth expected to be slightly higher between 6.5%-8.5%. The company expects FY24 EBIT margin to be between 18%-19% but aspires to take it to 19%-20% going forward. The tax rate for FY24 will be between 25.5-26.5% more than the FY23 tax rate of 23.9% as some units will be exiting the SEZ benefits.
- **Weak ERS growth was partially offset by strong BFSI performance:** Financial services, Lifesciences and Healthcare verticals grew by 6.9% and 3.6% q-o-q in cc. BFSI grew strongly despite the turmoil in the global financial market. HCL Tech's exposure to regional banks is only 0.2% of total revenue, which is the lowest in the industry. BFSI growth was led by the capital markets and insurance segments. In Q4 company won deals from a top 50 BFSI company in Europe, a top Australian financial institution and a global top 100 BFSI. ERS services declined by 3.8% q-o-q in cc led by lower discretionary spending in technology and telecom. Telecom, media & entertainment/ Manufacturing/ and Technology services declined by 5.6%/3.5%/1.6% q-o-q in cc respectively while Public services and Retail & CPG stayed flat sequentially.
- **Tepid Europe performance partially offset by growth in Americas:** Europe and RoW declined by 1.4% and 1.9% q-o-q in cc respectively and was partially offset by 1.8% q-o-q cc growth in Americas. Decision making and bookings in Americas is faster than Europe. Europe might also see a tepid Q1FY24.
- **Strong employee metrics; low attrition:** The attrition rate significantly declined by 220 bps q-o-q from 21.7% in Q3 to 19.5% in Q4 and the company expects attrition rates to further decline going forward. The company's attrition rate is also lower than the industry levels. Employee headcount increased by 1.7% q-o-q to 2,25,944. Employee addition in FY24 will moderate due to the significant hiring done in FY23. Though the company expects to add fewer freshers than FY24, the proportion of freshers in the total hiring will be more. Management also guided lower lateral hiring in FY24 which will help support the EBIT margins.
- **Strong client metric performance:** The number of clients in the $100 million, $50 million, $20 million, $10 million, and $5 million categories increased by 2, 1, 1, 8, & 10 to 19, 46, 131, 229, & 375 respectively. DSO declined to 66 from 70 in Q3FY23.
- **Booking performance:** Q4 TCV at $2,074 Mn declined by 8% y-o-y. In Q4, the company closed 13 large deals, 10 of which were in the services sector and 3 in the software sector. ACV increased by 4.3% in FY23. The management also highlighted that the deal pipeline is near record highs and is evenly distributed across geographies and service lines.
- **Robust cash flows:** Q4 OCF and FC at $924/$886 million came at 121%/110% of net income respectively. Net cash balance at $2,536 million was up by 6.2% y-o-y.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	Q3FY23	Y-o-Y %	Q-o-Q %
Revenues ($ mn)	**3,234.6**	**2,993.1**	**3,244.0**	**8.1**	**-0.3**
Net sales	**26,606.0**	**22,597.0**	**26,700.0**	**17.7**	**-0.4**
Direct Costs	16,889.0	14,292.0	16,720.0	18.2	1.0
Gross Profit	**9,717.0**	**8,305.0**	**9,980.0**	**17.0**	**-2.6**
Research & development	438.0	380.0	415.0	15.3	5.5
SG&A	3,416.0	2,872.0	3,200.0	18.9	6.7
EBITDA	**5,863.0**	**5,053.0**	**6,365.0**	**16.0**	**-7.9**
Depreciation & amortization	1,027.0	984.0	1,136.0	4.4	-9.6
EBIT	**4,836.0**	**4,069.0**	**5,229.0**	**18.8**	**-7.5**
Forex gain/(loss)	-40.0	135.0	3.0	-129.6	-1,433.3
Other Income	397.0	117.0	141.0	239.3	181.6
PBT	**5,193.0**	**4,321.0**	**5,373.0**	**20.2**	**-3.4**
Tax Provision	1,214.0	721.0	1,276.0	68.4	-4.9
Net profit	**3,981.0**	**3,594.0**	**4,097.0**	**10.8**	**-2.8**
EO	0.0	0.0	0.0		
Reported net profit	**3,981.0**	**3,594.0**	**4,097.0**	**10.8**	**-2.8**
EPS (Rs)	13.7	12.4	13.3	10.1	2.7
Margin (%)					
EBITDA	22.0	22.4	23.8	-32	-180
EBIT	18.2	18.0	19.6	17	-141
NPM	15.0	15.9	15.3	-94	-38
Tax rate	23.4	16.7	23.7	669	-37

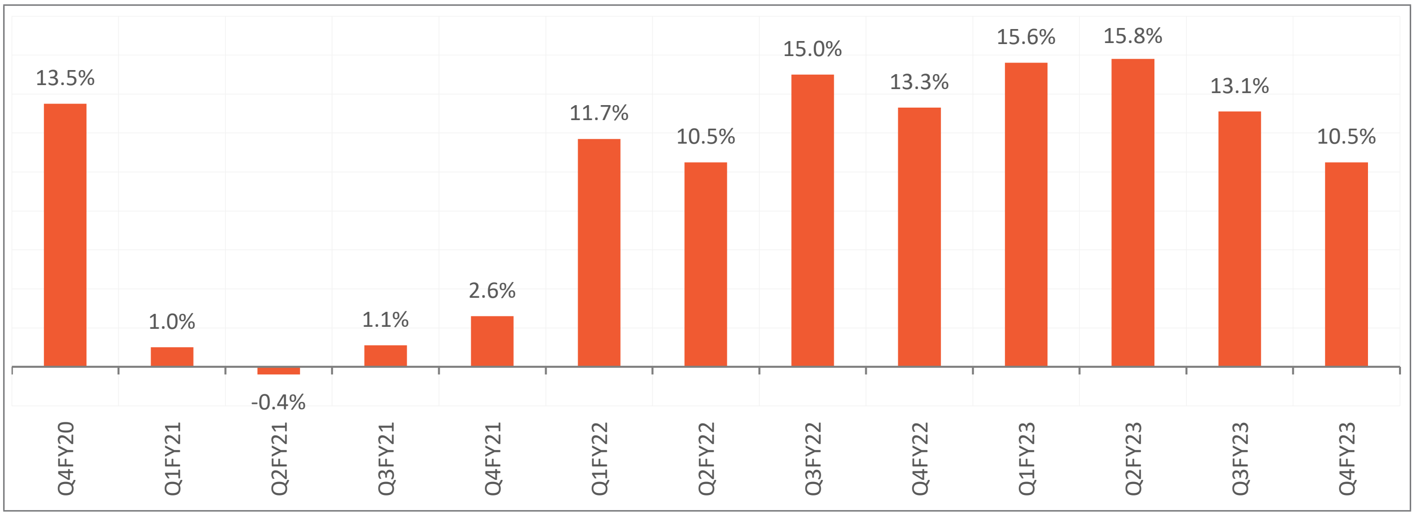
Source: Company; Sharekhan Research

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 %
Revenues ($ mn)	3,235	100	-0.3	8.1	-1.2	10.5
Geographic mix						
Americas	2,064	63.8	0.2	9.8	1.8	10.0
Europe	935	28.9	-1.0	10.4	-1.4	14.6
RoW	236	7.3	-1.6	-11.4	-1.9	1.4
Industry verticals						
Financial services	686	21.2	6.2	9.6	6.9	9.6
Manufacturing	615	19.0	-3.8	14.1	-3.5	11.8
Technology & services	466	14.4	-3.0	-11.1	-1.6	11.8
Retail & CPG	291	9.0	0.8	3.5	0.6	1.6
Telecommunications, media,	5,193.0	5,193.0	4,321.0	5,373.0	20.2	-3.4
publishing & entertainment	285	8.8	-6.7	10.6	-5.6	7.6
Lifesciences & healthcare	566	17.5	2.0	26.9	3.6	17.9
Public services	330	10.2	-0.3	3.0	0.6	1.6
Service line						
IT and business services	2,387	73.8	2.6	8.6	1.6	11.4
Engineering and R&D Services	521	16.1	-3.3	6.3	-3.8	7.3
Products & platforms	343	10.6	-14.1	12.8	-14.6	8.2
Clients Contribution						
Top 5	327	10.1	-2.2	-5.9	0.0	0.0
Top 10	573	17.7	-3.0	-3.4	0.0	0.0
Top 20	899	27.8	-1.7	3.2	0.0	0.0

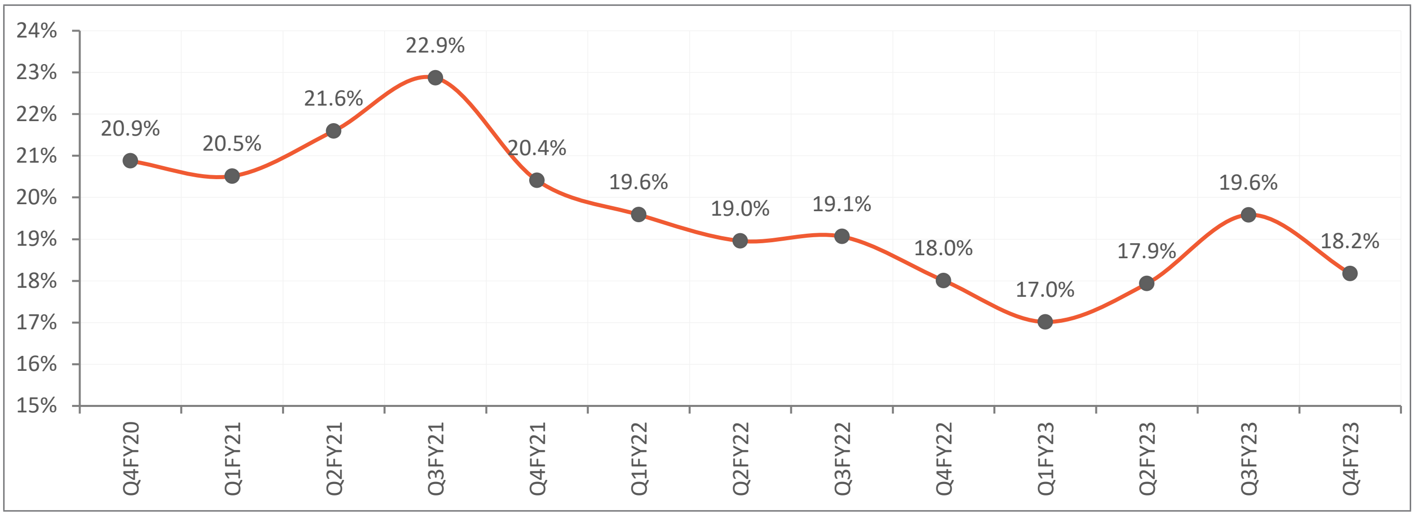
Source: Company; Sharekhan Research

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



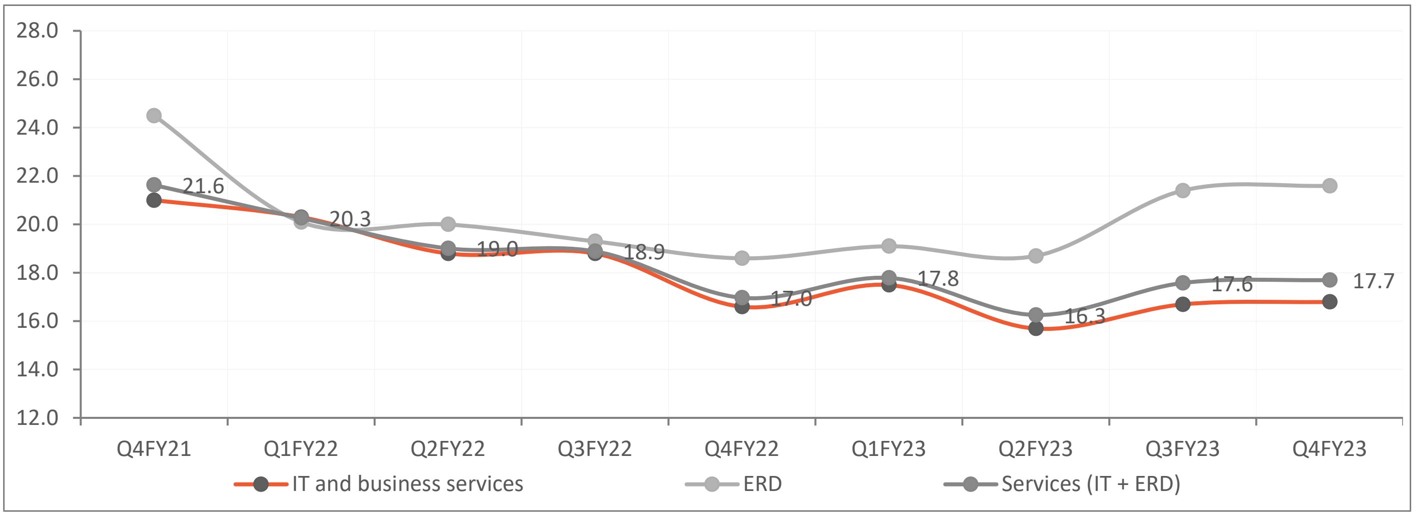
Source: Company; Sharekhan Research

EBIT margin trend



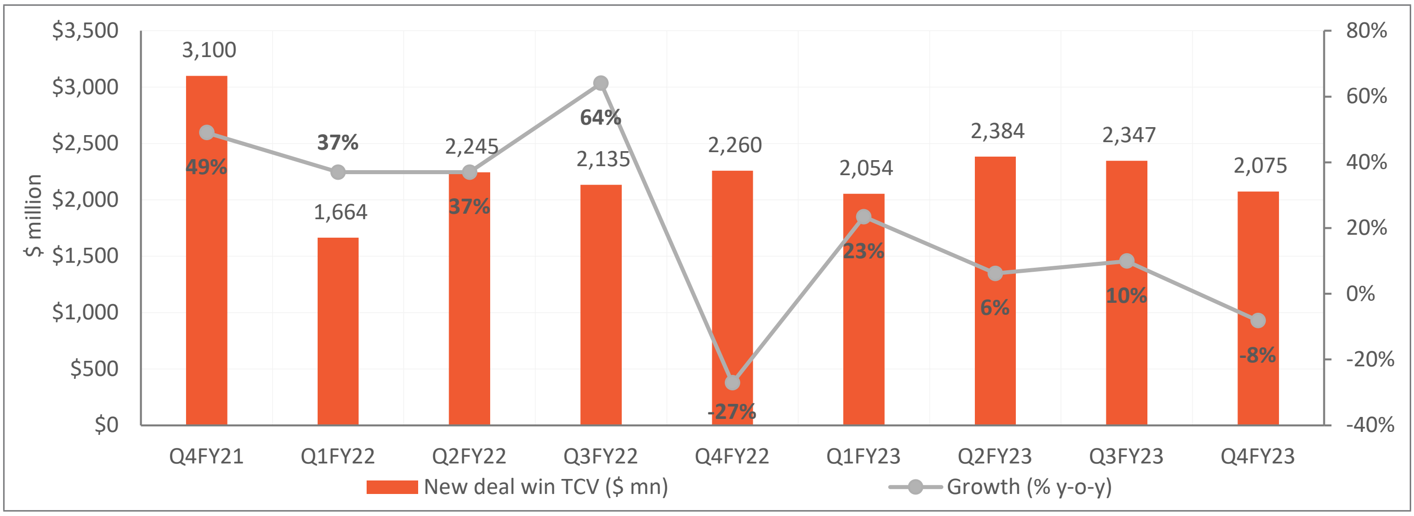
Source: Company; Sharekhan Research

Trend in services (IT+ ERD) EBIT margin



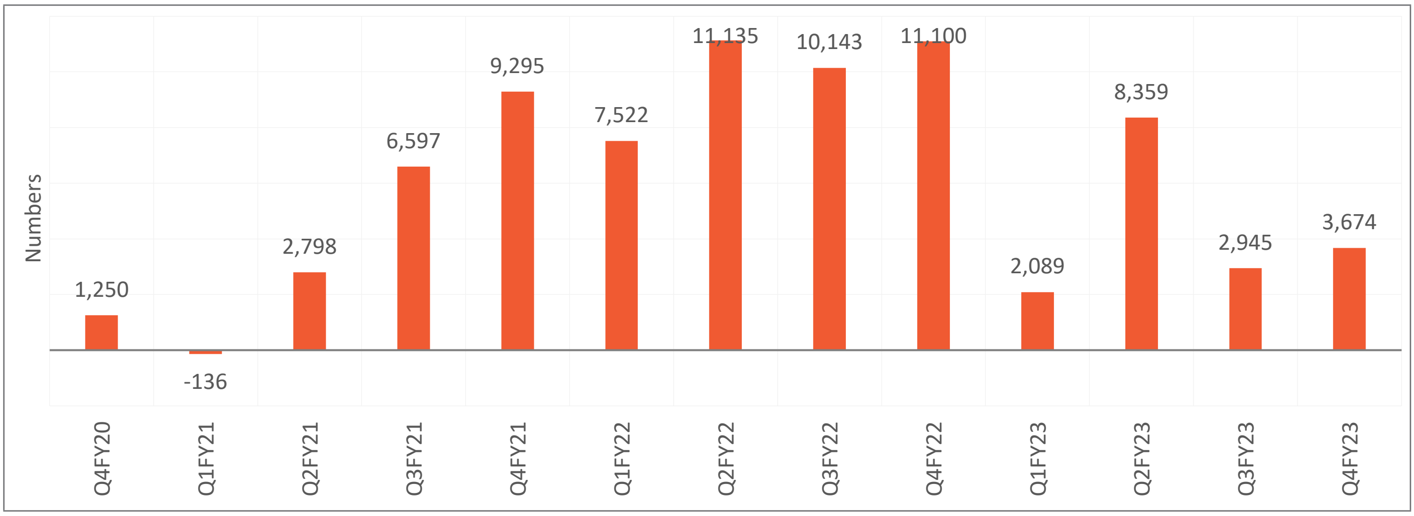
Source: Company; Sharekhan Research

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.

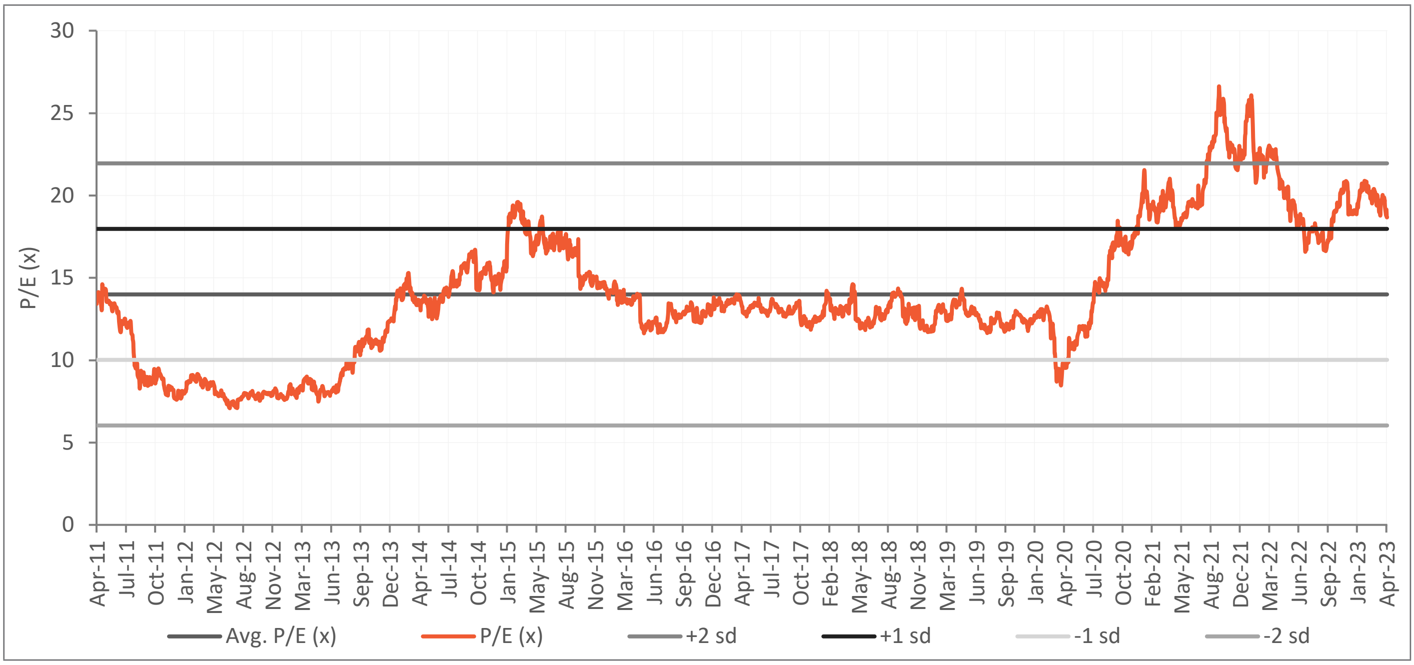
■ Company Outlook – Leveraging on core strengths

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. 1175:

Although the outlook for FY24 is uncertain in the near term owing to challenging macro environment, the resilient model, diverse portfolio mix, strong client additions, a strong deal pipeline and decent hiring makes Hcltech well placed to navigate the uncertainty. HCL Tech is trading at a discount to its peers and considering reasonable valuations, we maintain Buy rating on the stock with a revised PT of Rs. 1175. At CMP, the stock trades at the stock trades at 18.7x its FY2024E EPS and 16.9 its FY2025E EPS.

One-year forward P/E (x) band



Source: Company; 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

Roshni Nadar Malhotra	Chairperson
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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.17
2	Artisan Partners Ltd	2.03
3	Vanguard Group Inc	1.57
4	ICICI Prudential Asset Management	1.44
5	BlackRock Inc	1.41
6	SBI Funds Management Ltd	1.38
7	HDFC Asset Management Co Ltd	1.00
8	FMR LLC	0.98
9	Aditya Birla Sun Life Asset Manage	0.63
10	Mirae Asset Global Investments Co	0.60

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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