Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

HCL Technologies Ltd

Weak Quarter, Strong Order pipeline amidst uncertainty

IT & ITES	Sharekhan code: HCLTECH
Reco/View: Buy ↔	CMP: Rs. 1,110
	Price Target: Rs. 1,265 ↑

↑ 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 Jul 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. 3,01,230 cr
52-week high/low:	Rs. 1,203 / 876
NSE volume: (No of shares)	27.1 lakh
BSE code:	532281
NSE code:	HCLTECH
Free float: (No of shares)	106.6 cr

Shareholding (%)

Promoters	60.8
FII	18.9
DII	15.3
Others	5.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-2.6	1.4	3.6	19.6
Relative to Sensex	-6.8	-6.9	-5.5	-1.7

Sharekhan Research, Bloomberg

Summary

- HCL Tech reported a CC revenue decline of 1.3% q-o-q, missing our estimates of 1.1% revenue growth. Revenue stood at $3,200 million, down 1.1 % q-o-q/up 5.8% y-o-y, led by the decline in ERS business, down 5.2% q-o-q in CC terms, and HCL Software, down 3.1% q-o-q in CC terms.
- EBIT margin contracted 120 bps q-o-q to 17%, below our estimates of 18.1% in a seasonally soft quarter due to higher direct costs, increased SG&A expenses, and weak revenue.
- New deal wins TCVs declined 24% q-o-q to $1,565 million. Order pipeline was at all-time high, which grew by 17.7% q-o-q/26.2% y-o-y. The telecom, media and entertainment segment fell 14.4%, while the technology services segment declined 7.8% q-o-q in CC terms.
- Management expects a revival in the coming quarters after two consecutive quarters of softness due to seasonal weakness, given the all-time high order pipeline. Hence, it is optimistic about achieving guidance on revenue and EBIT for FY24. We believe the stock continues to trade at reasonable valuations. At the CMP, the stock trades at 19.7x/17.6x its FY24/25E EPS. Hence, we maintain Buy on HCL Tech with a revised PT of Rs. 1,265.

HCL Tech reported constant currency (CC) revenue decline of 1.3% q-o-q, missing our estimates of 1.1% revenue growth. Revenue stood at $3,200 million, down 1.1 % q-o-q/up 5.8% y-o-y, led by the decline in ERS business, down 5.2% q-o-q in CC terms and HCLSoftware down 3.1% q-o-q in CC terms. Revenue in rupee terms stood at Rs. 26,296 crore, down 1.2% q-o-q/up 12.1% y-o-y. EBIT margin contracted by 120 bps q-o-q to 17%, well below our estimates of 18.1% in a seasonally soft quarter due to higher direct costs, increased SG&A expenses, and weak revenue. Net profit stood at Rs. 3,534 crore, up 11.3% q-o-q/7.6% y-o-y. New deal wins TCV stood at $1,565 million, down 24% q-o-q/25% y-o-y. The company won 18 large deals, seven of which were in the services sector and three in the software sector. Order pipeline, at all-time high, grew 17.7% q-o-q/26.2% y-o-y. Financial services and Manufacturing grew 5.1% and 3.6% q-o-q, respectively. Telecom, media & entertainment/Technology services/ Lifesciences/Public services declined by 14.4%/7.8%/1.3%/2.2% q-o-q in CC terms, while Retail & CPG was flat sequentially. Net headcount additions declined by 2,506, taking the total headcount to 223,438 as the company did not backfill some of the attrition. LTM attrition rate significantly declined by 320 bps q-o-q to 16.3% from 19.5% in Q4. Management commented that the booking pipeline is strong, leading to expected strong bookings in the coming quarters. Going ahead, management expects revival after two consecutive quarters of softness due to seasonal weakness, given the all-time high order pipeline. Hence, it is optimistic about achieving guidance on revenue and EBIT for FY24. We believe the stock continues to trade at reasonable valuations. At the CMP, the stock trades at 19.7x/17.6x its FY24/25E EPS. Hence, we maintain Buy on HCL Tech with a revised price target (PT) of Rs. 1,265.

Key positives

- LTM attrition moderated to 16.3% in Q1FY24 from 19.5% in Q4FY23, down 320 bps.
- The number of clients in the $100 million+, $50 million+, $10 million+ categories increased by 1, 2, and 8 q-o-q, respectively.
- Order pipeline at an all-time high grew 17.7% q-o-q/26.2% y-o-y.

Key negatives

- EBIT margin contracted by 120 bps q-o-q to 17% due to a seasonally soft quarter and lower revenue.
- ERS business declined by 5.2% q-o-q in CC terms, while products and platform declined by 3.1% q-o-q in CC terms.
- Telecom, media & entertainment and Technology services declined by 14.4% and 7.8% q-o-q, respectively, in CC terms.
- Net addition declined by 2506, taking the total headcount to 223,438.

Management Commentary

- Management highlighted that BFSI, Manufacturing, and Life Science have shown higher y-o-y growth, led by large deal execution, which offset the impact of lower discretionary spends. Efficiency-led deals and new projects are contributing to growth.
- Management commented that the booking pipeline is strong, leading to expected strong bookings in the coming quarters. Pipeline of large deals has significantly increased, which includes cost transformation and automation projects.

Revision in estimates – We have revised our estimates for FY24/25E to factor the company's weak Q1FY24 performance and persisting macro-overhang.

Our Call

Valuation – Maintain Buy with revised PT of Rs. 1,265: The management expects revival in the coming quarters after two consecutive soft quarters due to seasonal weakness given the all-time high order pipeline. Hence, it is optimistic about achieving guidance on revenue and EBIT for FY24. We expect 5.3%/7.3% Sales and PAT CAGR over FY23-25E. We believe the stock continues to trade at reasonable valuations. At the CMP, the stock trades at 19.7x/17.6x its FY24/25E EPS. Hence, we maintain Buy on Hcltech with a revised price target (PT) of Rs. 1,265.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and a possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	85,651.0	1,01,456.0	1,04,218.6	1,12,471.5
OPM (%)	24.0	22.3	22.1	22.8
Adjusted PAT	13,499.0	14,850.0	15,287.3	17,088.6
% y-o-y growth	4.3	10.0	2.9	11.8
Adjusted EPS (Rs.)	49.7	54.7	56.3	63.0
P/E (x)	22.3	20.3	19.7	17.6
P/B (x)	4.9	4.6	4.4	4.1
EV/EBITDA (x)	14.3	13.0	12.3	10.6
RoNW (%)	22.1	23.3	22.7	23.9
ROCE (%)	23.7	26.4	26.0	27.5

Source: Company; Sharekhan estimates

Key Earnings Call Highlights

- **Revenue and EBIT guidance maintained:** Despite softness in the macro environment, HCL Tech has maintained its revenue growth guidance of 6-8% y-o-y in CC and expects EBIT margin to be at 18-19% for FY24. However, owing to the weak Q1FY24 performance the quarterly ask rate has risen. The company expects incremental growth in revenues over each quarter.
- **Weak ERS growth:** ERS business declined by 5.2% q-o-q in cc terms while HCLSoftware declined 3.1% q-o-q in CC terms. Financial services and Manufacturing grew 5.1% and 3.6% q-o-q respectively, while Telecom and Technology lagged due to dynamic changes and client-specific situations. Telecom, media & entertainment, Technology services, Lifesciences, and Public services declined by 14.4%/7.8%/1.3%/2.2% q-o-q in CC terms, while Retail and CPG were flat sequentially.
- **Geography-wise performance:** Europe and America grew 10.5% and 7.3% y-o-y in CC terms, respectively, and was partially offset by the decline of 6% y-o-y CC in ROW.
- **Net additions disappointed:** LTM attrition rate significantly declined by 320 bps q-o-q from 19.5% in Q4 to 16.3%. Net addition declined by 2506, taking the total headcount to 223,438 as the company did not backfill some of the attrition.
- **Client metric performance:** The number of clients in the $100 million, $50 million, $10 million categories increased by 1, 2, and 8 q-o-q, respectively. DSO improved to 64 from 66 in Q4FY2023. Revenue from the top-five clients declined by 4% q-o-q and 7.4% y-o-y.
- **Booking performance:** New deal wins TCV stood at $1,565 million, down 24%/25% on a q-o-q and y-o-y basis, respectively. The company won 18 large deals, seven of which were in the services sector and three in the software sector. The deal pipeline at all-time high grew 17.7 q-o-q/26.2 y-o-y.
- **Robust cash flows:** For Q1FY24 OCF and FCF stood at $484/$450 million. OCF/NI and FCF/NI were at 135%/126%. Net cash balance at $2,394 million was up by 17% q-o-q.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	Q4FY23	YoY (%)	QoQ (%)
Revenues ($ mn)	**3,200.0**	**3,024.9**	**3,234.6**	**5.8**	**-1.1**
Net sales	26,296.0	23,464.0	26,606.0	12.1	-1.2
Direct Costs	16,936.0	15,066.0	16,889.0	12.4	0.3
Gross Profit	**9,360.0**	**8,398.0**	**9,717.0**	**11.5**	**-3.7**
Research & development	394.0	391.0	438.0	0.8	-10.0
SG&A	3,579.0	3,032.0	3,416.0	18.0	4.8
EBITDA	**5,387.0**	**4,975.0**	**5,863.0**	**8.3**	**-8.1**
Depreciation & amortization	927.0	983.0	1,027.0	-5.7	-9.7
EBIT	**4,460.0**	**3,992.0**	**4,836.0**	**11.7**	**-7.8**
Forex gain/(loss)	-22.0	82.0	-40.0	-126.8	-45.0
Other Income	258.0	263.0	397.0	-1.9	-35.0
PBT	**4,696.0**	**4,337.0**	**5,193.0**	**8.3**	**-9.6**
Tax Provision	1,165.0	1,056.0	1,214.0	10.3	-4.0
Net profit	**3,534.0**	**3,283.0**	**3,981.0**	**7.6**	**-11.2**
EO	0.0	0.0	0.0		
Reported net profit	**3,534.0**	**3,283.0**	**3,981.0**	**7.6**	**-11.2**
EPS (Rs)	13.0	12.5	13.7	4.1	-4.9
Margin (%)					
EBITDA	20.5	21.2	22.0	-72	-155
EBIT	17.0	17.0	18.2	-5	-122
NPM	13.4	14.0	15.0	-55	-152
Tax rate	24.8	24.3	23.4	46	143

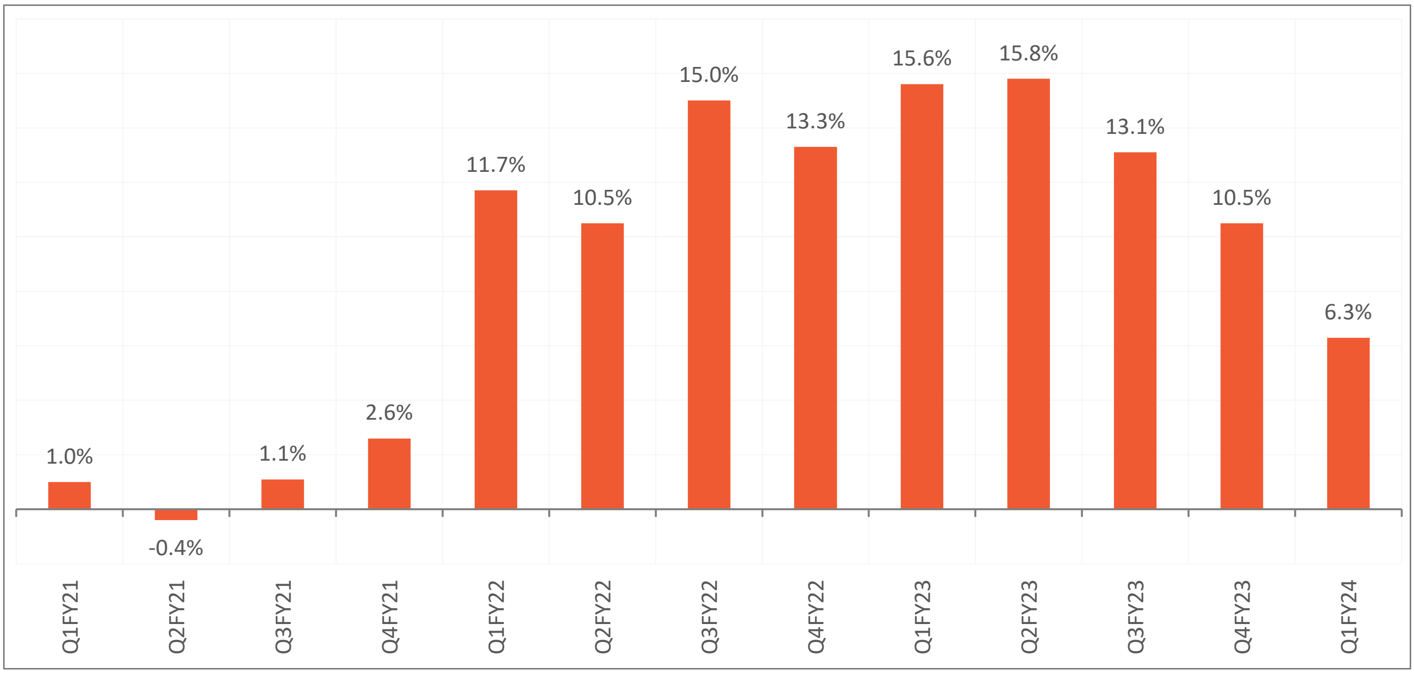
Source: Company; Sharekhan Research

Results (Consolidated) Rs cr

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%)		CC growth (%)	
			QoQ (%)	YoY (%)	QoQ (%)	YoY (%)
Revenues ($ mn)	3,200	100	-1.1	5.8	-1.3	6.3
Geographic mix						
Americas	2,064	64.5	0.0	6.3	0.2	7.3
Europe	918	28.7	-1.8	9.2	-2.4	10.5
RoW	218	6.8	-7.8	-10.1	-6.2	-6.0
Industry verticals						
Financial services	723	22.6	5.5	13.3	5.1	14.4
Manufacturing	637	19.9	3.6	15.0	3.6	16.5
Technology & services	429	13.4	-7.9	-8.0	-7.8	-7.0
Retail & CPG	291	9.1	0.0	2.4	0.3	3.2
Telecommunications, media,	4,696.0	4,696.0	4,337.0	5,193.0	8.3	-9.6
publishing & entertainment	243	7.6	-14.6	-12.6	-14.4	-11.7
Lifesciences & healthcare	560	17.5	-1.1	12.9	-1.3	13.4
Public services	320	10.0	-3.0	3.7	-2.2	6.8
Service line						
IT and business services	2,390	74.7	0.1	8.5	-0.1	9.1
Engineering and R&D Services	493	15.4	-5.4	-1.9	-5.2	-1.8
Products & platforms	333	10.4	-2.9	0.0	-3.1	-0.1
Clients Contribution						
Top 5	314	9.8	-4.0	-7.4	0.0	0.0
Top 10	550	17.2	-3.9	-6.2	0.0	0.0
Top 20	870	27.2	-3.2	-0.4	0.0	0.0

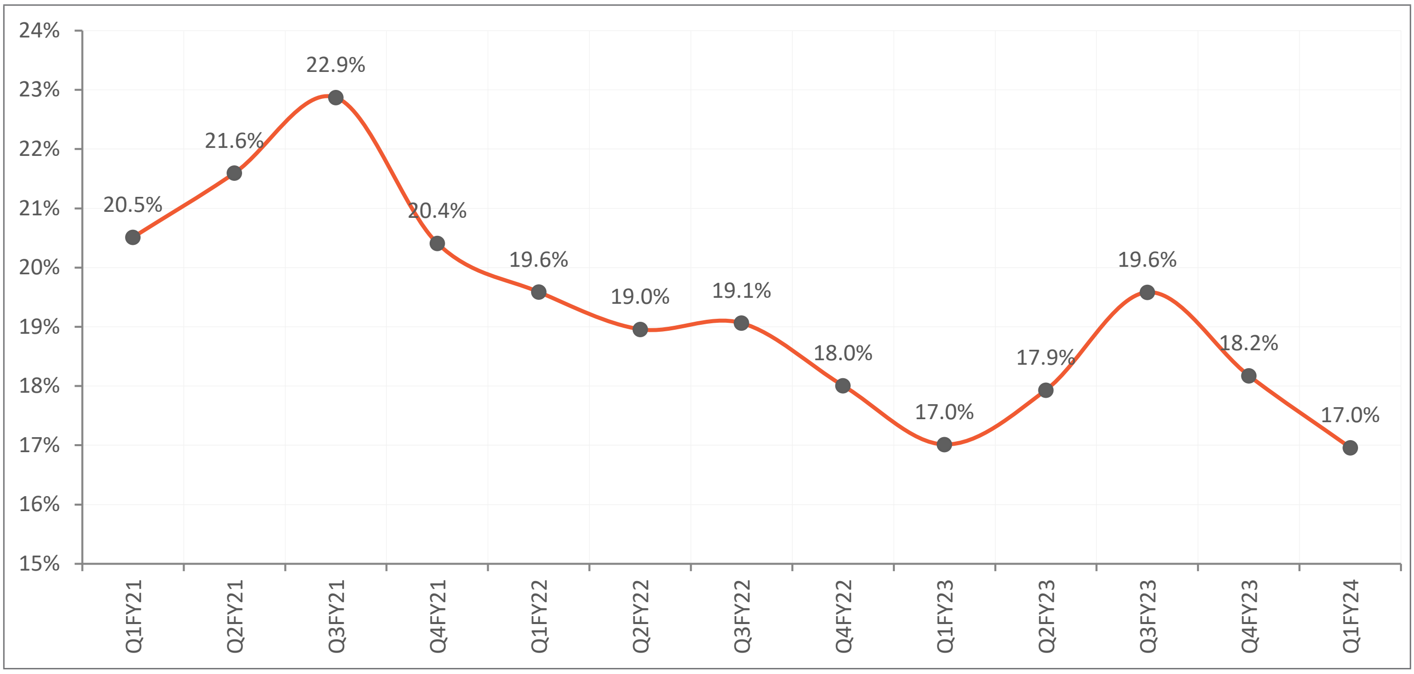
Source: Company; Sharekhan Research

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



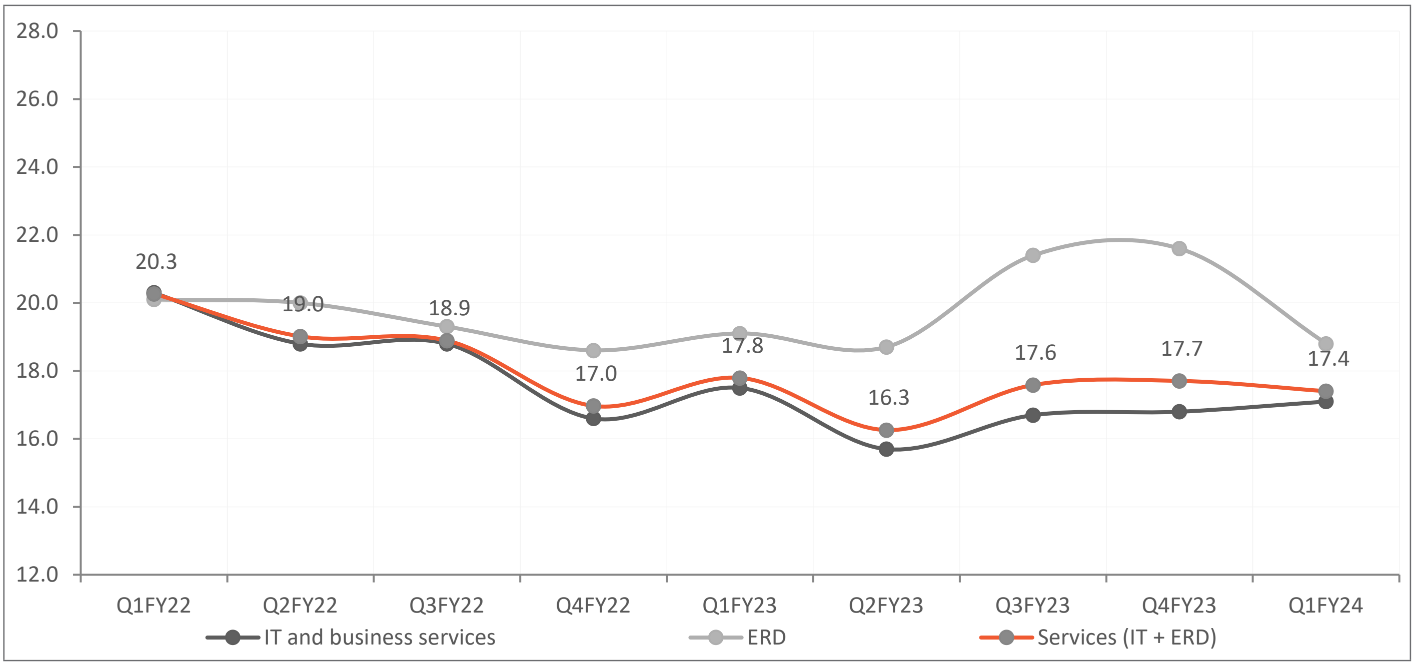
Source: Company; Sharekhan Research

EBIT margin trend



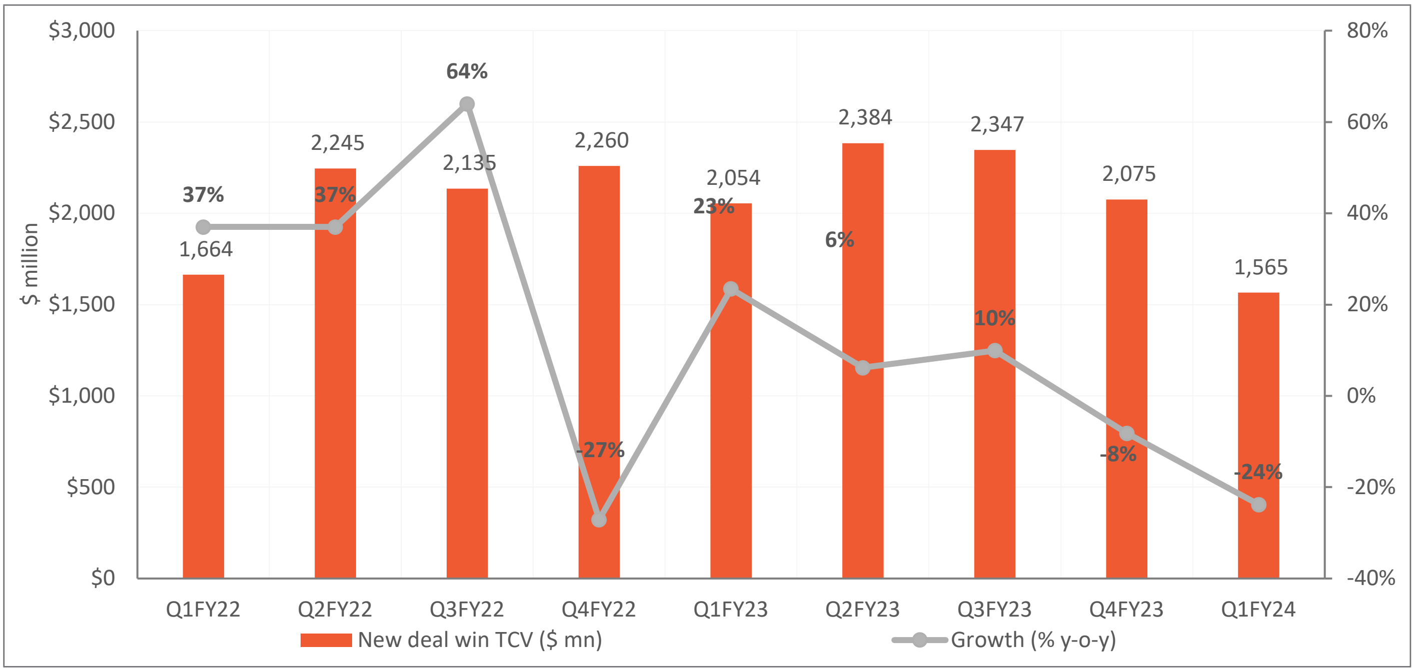
Source: Company; Sharekhan Research

Trend in services (IT+ ERD) EBIT margin



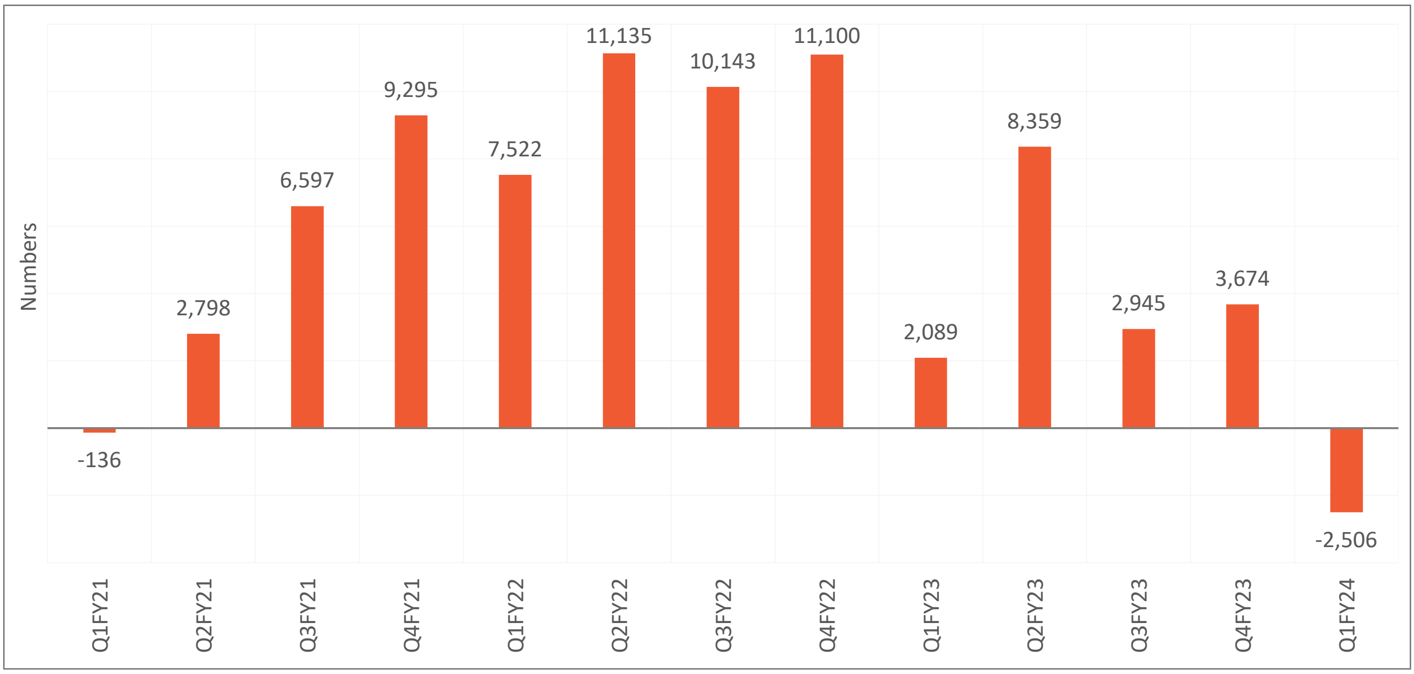
Source: Company; Sharekhan Research

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 the outlook for FY2024E uncertain

Owing to multiple global headwinds, the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence concerns relating to macroeconomic headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

■ 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 revised PT of Rs. 1265

The management expects revival in the coming quarters after two consecutive soft quarters due to seasonal weakness given the all-time high order pipeline and hence is optimistic about achieving guidance on revenue and EBIT for FY24. We expect 5.3%/7.3% Sales and PAT CAGR over FY23-25E. We believe the stock continues to trade at reasonable valuation. At CMP, the stock trades at the stock trades at 19.7/17.6x its FY24/25E EPS. Hence, we maintain Buy on Hcltech with revised price target (PT) of Rs 1265.

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) Rupee appreciation and/or adverse cross-currency movements, 2) Contagion effect of banking crisis and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

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	4.2
2	Artisan Partners Ltd	2.1
3	ICICI Prudential Asset Management	1.5
4	BlackRock Inc	1.5
5	SBI Funds Management Ltd	1.4
6	Vanguard Group Inc	1.4
7	HDFC Asset Management Co Ltd	1.0
8	FMR LLC	1.0
9	FIL Ltd	0.8
10	Mirae Asset Global Investments Co	0.7

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

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/ investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

---

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Other registrations of 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.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600