

August 29, 2024

Analyst Meet Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY25E	FY26E	FY25E	FY26E
Rating	BUY		BUY	
Target Price	1,960		1,790	
Sales (Rs.m)	1,161	1,277	1,160	1,276
% Chng.	0.1	0.1		
EBITDA (Rs.m)	268	305	267	304
% Chng.	0.2	0.2		
EPS (Rs.)	62.8	70.5	62.7	70.3
% Chng.	0.3	0.3		

Key Financials - Consolidated

Y/e Mar	FY24	FY25E	FY26E	FY27E
Sales (Rs. bn)	1,099	1,161	1,277	1,426
EBITDA (Rs. bn)	259	268	305	343
Margin (%)	23.5	23.1	23.8	24.0
PAT (Rs. bn)	157	170	191	217
EPS (Rs.)	58.0	62.8	70.5	80.1
Gr. (%)	5.7	8.4	12.2	13.6
DPS (Rs.)	52.0	56.5	63.4	72.0
Yield (%)	3.0	3.3	3.7	4.2
RoE (%)	23.5	24.7	27.0	29.7
RoCE (%)	21.7	22.1	24.9	27.6
EV/Sales (x)	4.0	3.8	3.4	3.1
EV/EBITDA (x)	17.0	16.4	14.4	12.8
PE (x)	29.7	27.4	24.4	21.5
P/BV (x)	6.8	6.7	6.5	6.3

Key Data

HCLT.BO | HCLT IN

52-W High / Low	Rs.1,757 / Rs.1,148
Sensex / Nifty	81,786 / 25,052
Market Cap	Rs.4,666bn/ \$ 55,574m
Shares Outstanding	2,714m
3M Avg. Daily Value	Rs.5477.7m

Shareholding Pattern (%)

Promoter's	61.02
Foreign	19.65
Domestic Institution	14.99
Public & Others	4.34
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	5.3	3.3	48.5
Relative	4.8	(8.4)	18.2

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HCL Technologies (HCLT IN)

Rating: BUY | CMP: Rs1,719 | TP: Rs1,960

Chasing for robust and sustainable execution

Quick Pointers:

- Gaining higher wallet share on the digital engineering service, while confident to outgrow its peers on BFS and TMT verticals
- Confident of delivering margins within a guided band of 18-19%

We attended investor day of HCLT, the management was confident of continued executions of strong operating performance while having offered service lines within a scope of both discretionary and non-discretionary front. It is aspiring to grow its topline by double-digit for the next five years, while improving its TCV run-rate and going beyond the current offerings where the participation is currently suboptimal. While leveraging GenAI solutions, the company is gaining higher mind-share and wallet-share on the back of passing on efficiency and productivity benefits to clients and in return deriving higher scope of work. With its strong capabilities on the key verticals BFS and TMT, which have delivered CQGR of 1.4% and 1.8% over 1QFY23-4QFY24, are expected to further outgrow its peers in the future course. However, the verticals that are sensitive to the interest rates and consumer spends, are expected to grow below consolidated business growth in the near-term. On the margins front, pyramid rationalization, G&A optimization through GenAI, and growing nearshore/offshore deliveries would help flex better margins and deliver within the guided band of 18-19%. We rollover our estimates and introduce FY27 with USD revenue and INR PAT CAGR of 10.9% and 12.9% over FY25E-FY27E. Maintain BUY with a revised target price of Rs1,960, implies target PE multiple of 24x FY27E EPS.

Aspiration of sustained double digit growth: HCLT dollar revenue grew at a CAGR of 9% & IT Services revenue grew at a CAGR of 8.7% between FY2019-2024 despite the adverse macro environment in last 2 fiscal years. With the improving macro sentiment, the company believes it can continue its growth momentum and aspires for double digit USD growth for the next 5 years. The growth will be sustained by rising demand in the areas of Data & AI (TAM of US\$ 200 bn, growth at CAGR of 19.1% by 2029), Enterprise Business Application (TAM of US\$ 325 bn, growth at CAGR of 14.3% by 2029), Cloud & Cyber security, ER&D (TAM of US\$ 170 bn by 2027, growth at CAGR of 8-9%), BPM (TAM of US\$ 300 bn by 2028) & faster growth compared to industry across BFSI & TMT verticals.

Project Ascend for Margin improvement: HCLT operating margins remained in the range of 18-19% in the last 3 fiscal years. The company aims to improve its operating margin with the following key levers for margin improvement: a) pyramid optimization by freshers deployment, b) utilizing Gen AI for reskilling & upskilling employees to improve productivity & utilization, c) transferring work to newly inaugurated centers from prime centers, d) Optimizing G&A expenses & e) increase offshoring to offshore & near shore locations.

Gen AI to lead the next phase of Tech Transformation: HCLT had started investments in Gen AI since 2016 and now it has the foundation to drive the company's growth from it. It has till now worked on 350+ Gen AI projects and through its learnings it created AI Force & AI Foundry. AI Force is the company's module to improve efficiencies in IT & Business processes. It has witnessed 10-50% improved efficiencies across the functions of coding, testing, legacy modernization, app development & maintenance, BPO and Infra operations. AI Foundry is the company's module for modernizing the unstructured data.

TMT growth momentum to sustain: BFSI & TMT are HCLT's anchor verticals & together they contribute ~34% of company's revenue mix. Both the verticals relatively outpaced its peers in the last 2 fiscal years and this growth is expected to continue going forward. In the BFSI sector, growth is expected to be sustained on the back of an anticipated rate cut by the Fed in September. In TMT sector, the addressable opportunity is meaningful to increase the wallet share on account of legacy modernization and tech transformation within the teleco clients. Gen AI will also aid to increase the TAM of CSP's to US\$ 200 bn as it will help to reduce the time to launch new products and also to innovate existing products. The acquisition of HPE's Communication Tech Group (CTG) will not only strengthened the company's offerings but also gave HCLT access to 25 out of 30 large CSP and near shore centers in the regions of Europe, APAC & South America.

HCL Software: The software business contributes ~10% of the company's revenue mix and has grown at a CAGR of 13.7% between FY2019-2024. However, in FY2024 the software business reported USD revenue growth of 2.7%. HCLT aims to grow the software business revenue to mid-single digit going forward, for which it has made investments in the sales team and restructured the GTM strategy. The growth is expected due to the traction in geographies of Africa, Middle East & India. The recent acquisition of Zeenea will also enhance the company's software offering which has high market potential.

Valuations and outlook: Given its defensive business mix and resilient vertical portfolio, HCLT is well positioned to capture the boarder market theme and participate in the critical aspects of enterprise operations. Even if it delivers within the mid-range of the revenue guidance, it would end up achieving growth above the peer average. We are baking in USD revenue and INR PAT CAGR of 10.9% and 12.9% over FY25E-FY27E. Maintain BUY with a revised target price of Rs1,960, implies target PE multiple of 24x FY27E EPS. The stock is currently trading at 21.4x FY27E.

Other KTA's

- The management indicated that the demand environment has improved compared to Q4FY24. They further indicated that they have witnessed traction within the TMT sector. They also indicated that it is witnessing some momentum in banking segment but mentioned that it is too early to call it an industry wide pattern.
- In manufacturing segment, the management indicated that the growth will be driven by demand in SAP integration. They further mentioned that SAP cloud platform service market is expected to grow at CAGR of 26%.
- The management mentioned that it aspires to double its revenue to US\$26 bn and the factors to scale the revenue will be: a) Increase presence among the G2000 clients, b) expand market share in developing markets, c) proactively win large deals, d) expand strategic partnerships & e) increase market in public services segment.
- The management mentioned that the initial demand for Gen AI was similar to cloud demand, but the high euphoria has now toned down. Most of the enterprises have shortlisted a few Gen AI use cases and working on adopting those wherein the ROI is acceptable for the enterprises.
- The management mentioned that, despite the slower pace of scaling of Gen AI, they are optimistic that Gen AI will drive demand in the future as Gen AI will accelerate enterprise spending on tech modernization & transformation. They also mentioned that the adoption of Gen AI had led to loss of revenue of ~15% from some clients due to the pass back of efficiency gains in its earlier contracts. However, due to its proactive approach it was able to win new contracts which offset the revenue loss. The management believes the same can be replicated with other clients also.
- The management mentioned that it has 5 Gen AI labs globally and it will open a new lab in Munich, Germany soon. They also mentioned that it has integrated its AI Force module with GitHub Copilot as an extension which can be used for legacy modernization, product & app development, devops, infra & app support., etc.
- The management mentioned that it has strengthened its partnership with SAP & it will set up a migration factory with SAP for faster SAP integration for end users
- The management mentioned that it had added 20 new logos in TMT segment in the last 2 years. They also mentioned the company is providing a broad portfolio of services to its clients in the areas of product engineering, app modernization, semiconductor engineering, cloud engineering & cyber security. The management further mentioned that semiconductor segment is well positioned to continue its growth momentum as the demand is still high in the segment
- The management mentioned that the rise of GCC could be headwind for the IT services industry but remained optimistic that the industry is well positioned for double digit growth going ahead.

Exhibit 1: Key levers for margin improvement



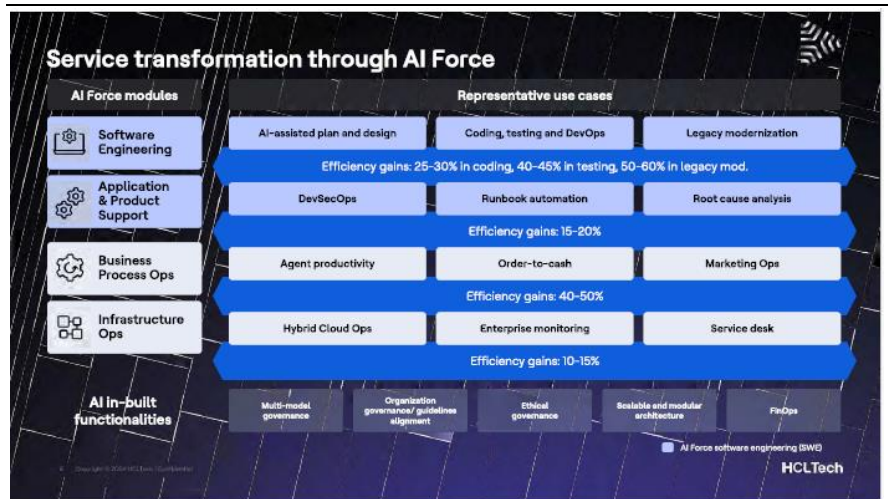
Source: Company, PL

Exhibit 2: HCLT's Gen AI offerings for enterprise clients



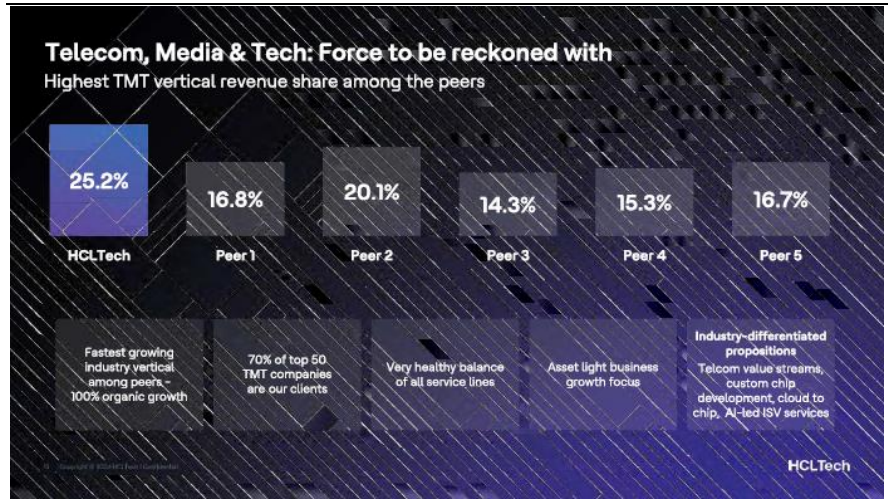
Source: Company, PL

Exhibit 3: Efficiency gains across services from Gen AI



Source: Company, PL

Exhibit 4: HCLT aspires to maintain its lead in TMT segment



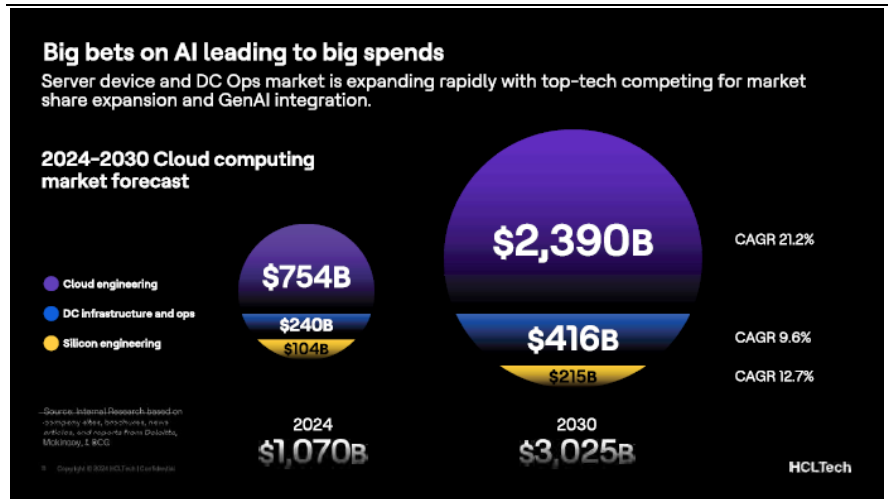
Source: Company, PL

Exhibit 5: Semiconductor market poised to grow at mid-single digit CAGR



Source: Company, PL

Exhibit 6: Gen AI provides boost in Tech Modernization



Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY24	FY25E	FY26E	FY27E
Net Revenues	1,099	1,161	1,277	1,426
YoY gr. (%)	8.3	5.6	10.0	11.7
Employee Cost	705	750	815	908
Gross Profit	394	410	462	518
Margin (%)	35.9	35.3	36.1	36.3
Employee Cost	-	-	-	-
Other Expenses	-	-	-	-
EBITDA	259	268	305	343
YoY gr. (%)	6.6	3.7	13.6	12.6
Margin (%)	23.5	23.1	23.8	24.0
Depreciation and Amortization	42	42	46	51
EBIT	200	209	242	275
Margin (%)	18.2	18.0	18.9	19.3
Net Interest	-	-	-	-
Other Income	9	17	11	13
Profit Before Tax	210	226	253	288
Margin (%)	19.1	19.5	19.8	20.2
Total Tax	53	56	62	70
Effective tax rate (%)	25.1	24.7	24.5	24.5
Profit after tax	157	170	191	217
Minority interest	0	0	0	0
Share Profit from Associate	-	-	-	-
Adjusted PAT	157	170	191	217
YoY gr. (%)	5.7	8.5	12.2	13.6
Margin (%)	14.3	14.7	15.0	15.2
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	157	170	191	217
YoY gr. (%)	5.7	8.5	12.2	13.6
Margin (%)	14.3	14.7	15.0	15.2
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	157	170	191	217
Equity Shares O/s (bn)	3	3	3	3
EPS (Rs)	58.0	62.8	70.5	80.1

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY24	FY25E	FY26E	FY27E
Non-Current Assets				
Gross Block	643	687	736	790
Tangibles	370	414	463	517
Intangibles	273	273	273	273
Acc: Dep / Amortization	291	333	379	430
Tangibles	291	333	379	430
Intangibles	-	-	-	-
Net fixed assets	352	354	356	359
Tangibles	79	81	84	87
Intangibles	273	273	273	273
Capital Work In Progress	-	-	-	-
Goodwill	-	-	-	-
Non-Current Investments	1	1	1	1
Net Deferred tax assets	-	-	-	-
Other Non-Current Assets	52	51	53	54
Current Assets				
Investments	177	177	177	177
Inventories	-	-	-	-
Trade receivables	255	267	291	323
Cash & Bank Balance	95	103	112	124
Other Current Assets	66	70	77	86
Total Assets	998	1,023	1,067	1,124
Equity				
Equity Share Capital	5	5	5	5
Other Equity	677	694	714	735
Total Network	683	700	719	741
Non-Current Liabilities				
Long Term borrowings	22	22	22	22
Provisions	-	-	-	-
Other non current liabilities	66	67	71	77
Current Liabilities				
ST Debt / Current of LT Debt	1	1	1	1
Trade payables	59	58	61	68
Other current liabilities	168	175	193	215
Total Equity & Liabilities	998	1,023	1,067	1,124

Source: Company Data, PL Research



Cash Flow (Rs m)

Y/e Mar	FY24	FY25E	FY26E	FY27E
PBT	210	170	191	217
Add. Depreciation	42	42	46	51
Add. Interest	-	-	-	-
Less Financial Other Income	9	17	11	13
Add. Other	(50)	-	-	-
Op. profit before WC changes	201	212	237	268
Net Changes-WC	23	(7)	(8)	(7)
Direct tax	-	-	-	-
Net cash from Op. activities	224	206	230	262
Capital expenditures	(31)	(44)	(49)	(54)
Interest / Dividend Income	-	-	-	-
Others	(37)	-	-	-
Net Cash from Invt. activities	(67)	(44)	(49)	(54)
Issue of share cap. / premium	-	-	-	-
Debt changes	(2)	-	-	-
Dividend paid	(141)	(153)	(172)	(195)
Interest paid	-	-	-	-
Others	(12)	-	-	-
Net cash from Fin. activities	(155)	(153)	(172)	(195)
Net change in cash	3	8	9	12
Free Cash Flow	214	162	181	207

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY24	FY25E	FY26E	FY27E
Per Share(Rs)				
EPS	58.0	62.8	70.5	80.1
CEPS	73.4	78.3	87.4	99.0
BVPS	252.1	258.0	265.1	273.1
FCF	79.1	59.6	66.8	76.5
DPS	52.0	56.5	63.4	72.0
Return Ratio(%)				
RoCE	21.7	22.1	24.9	27.6
ROIC	22.3	22.6	24.6	26.1
RoE	23.5	24.7	27.0	29.7
Balance Sheet				
Net Debt : Equity (x)	(0.4)	(0.4)	(0.4)	(0.4)
Net Working Capital (Days)	65	66	66	65
Valuation(x)				
PER	29.7	27.4	24.4	21.5
P/B	6.8	6.7	6.5	6.3
P/CEPS	23.4	22.0	19.7	17.4
EV/EBITDA	17.0	16.4	14.4	12.8
EV/Sales	4.0	3.8	3.4	3.1
Dividend Yield (%)	3.0	3.3	3.7	4.2

Source: Company Data, PL Research

Quarterly Financials (Rs m)

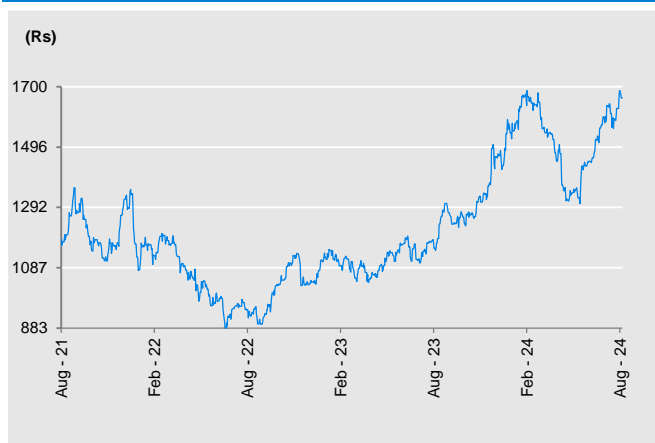
Y/e Mar	Q2FY24	Q3FY24	Q4FY24	Q1FY25
Net Revenue	267	284	285	281
YoY gr. (%)	1.4	6.7	0.2	(1.6)
Raw Material Expenses	170	180	185	184
Gross Profit	97	104	100	97
Margin (%)	36.2	36.7	35.0	34.5
EBITDA	63	72	65	62
YoY gr. (%)	-	-	-	-
Margin (%)	23.8	25.2	23.0	22.1
Depreciation / Depletion	10	11	11	10
EBIT	49	56	50	48
Margin (%)	18.5	19.7	17.6	17.1
Net Interest	-	-	-	-
Other Income	2	3	3	9
Profit before Tax	51	59	53	57
Margin (%)	19.2	20.6	18.5	20.3
Total Tax	13	15	13	14
Effective tax rate (%)	25.3	25.9	24.2	25.4
Profit after Tax	38	44	40	43
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	38	44	40	43
YoY gr. (%)	8.4	13.5	(8.4)	6.8
Margin (%)	14.4	15.3	14.0	15.2
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	38	44	40	43
YoY gr. (%)	8.4	13.5	(8.4)	6.8
Margin (%)	14.4	15.3	14.0	15.2
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	38	44	40	43
Avg. Shares O/s (m)	3	3	3	3
EPS (Rs)	14.2	16.1	14.7	15.7

Source: Company Data, PL Research



Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	14-Jul-24	BUY	1,790	1,560
2	02-Jul-24	BUY	1,680	1,469
3	28-Apr-24	Accumulate	1,550	1,474

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	Accumulate	2,130	2,001
2	HCL Technologies	BUY	1,790	1,560
3	Infosys	Hold	1,680	1,758
4	LTIMindtree	Accumulate	6,040	5,574
5	Mphasis	Hold	2,920	3,041
6	Persistent Systems	Accumulate	5,320	4,910
7	Tata Consultancy Services	Accumulate	4,370	3,924
8	Tech Mahindra	Reduce	1,340	1,530
9	Wipro	Hold	530	558

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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