REDUCE (Maintain)

CMP: **INR 1,752** Target Price: **INR 1,455** ▼ -17%

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29 August 2024

India | Equity Research | Company Update

HCL Technologies

Technology

Analyst and Investor-day update: Co makes big bets on cloud, infra and AI; increases focus on TMT

HCLT analyst day KTAs: Leveraging an all-weather portfolio, HCLT aims for consistent growth over medium term. Key growth drivers are: Data and AI, SAP cloud platform, ER&D, cloud migration and cybersecurity. Its key focus areas include: 1) Capitalising on gAI wave, 2) ramping up stagnated margins through project Ascend – using gAI as a strategic tool to reduce costs and increase efficiency in SDLC, and 3) delivering industry leading growth in TMT where demand is improving (led by semiconductor). Current demand environment is mostly driven by cost optimisation but it looks better vs three months ago, especially for financial services (refer our note: link). HCLT is taking pro-active approach to take genAI led productivity gains to clients. We maintain **REDUCE** based on muted FY25 growth guidance of 3-5% CC.

Key growth vectors

Data and AI is likely to grow at 19.1% CAGR. **SAP cloud platform** is expanding at 26% CAGR. **ER&D** is likely to reach USD 170bn by 2027. **Cloud migration and cybersecurity (**Cybersecurity (growing at a CAGR of 25%) are also expected to be high growth areas. Full stack AI solutions: HCLT has two offerings key in this domain: **AI Force and AI Foundry**. HCLT is positioning itself as a differentiated challenger in SAP, other enterprise applications, data and AI. It is focusing on consolidating infrastructure leadership via cloud modernisation.

Project Ascend: gAI as a strategic tool for margin optimisation

HCLT is expecting to eke out efficiency by using gAI as a key tool for: 1) Coding productivity, operational/ managed services automation, 2) fresher deployment, 3) AI led reskilling and upskilling to improve utilisation through AI led customized learning programming, 4) reducing costs by delivering away from prime locations; deploying nearshore and offshore locations strategically, 5) G&A optimisation through gAI, 6) expanding non-linear operating models.

Aspirations

1) HCLT's aspirational TCV range is between USD 2.5-3bn, 2) to become a preferred partner for G2000 companies, 3) to increase EBIT margin through fresher hiring and reducing employee cost, to be brought down to pre-pandemic era, 4) to step up growth of its software business from low single digit to high single digit through expansion in India, Africa and the Middle East, 5) capability additions like Zeenea.

Financial Summary

Y/E March (INR mn)	FY24A	FY25E	FY26E	FY27E
Net Revenue	10,99,130	11,54,398	12,57,456	13,83,246
EBITDA	2,45,710	2,53,508	2,82,590	3,11,853
EBITDA %	22.4	22.0	22.5	22.5
Net Profit	1,59,590	1,62,455	1,79,682	1,96,385
EPS (Rs)	58.9	60.0	66.3	72.5
EPS % Chg YoY	7.4	1.8	10.6	9.3
P/E (x)	29.7	29.2	26.4	24.2
EV/EBITDA (x)	16.1	15.1	13.6	12.3
RoCE (%)	21.9	21.5	23.7	25.5
RoE (%)	23.9	23.6	25.5	27.4

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Market Data

Market Cap (INR)	4,754bn
Market Cap (USD)	56,675mn
Bloomberg Code	HCLT IN
Reuters Code	HCLT.BO
52-week Range (INR)	1,757 /1,148
Free Float (%)	39.0
ADTV-3M (mn) (USD)	65.3

Price Performance (%)	3m	6m	12m
Absolute	29.5	5.3	51.3
Relative to Sensex	19.2	(8.0)	25.1

Previous Reports

14-07-2024: Q1FY25 results review

27-04-2024: Q4FY24 results review

AI led efficiency gains

AI is aiding efficiency in SDLC (Software Development Lifecycle): 1) 20-25% efficiency gains in coding, 2) 40-45% in testing, 3) 50-60% in legacy modernisation. The overall efficiency gain for SDLC can range from 10-30%. HCLT has implemented AI solutions in healthcare, financial services and telecom reducing time to market, increasing potential saving and reducing customer churn.

AI and gAI offerings

Data and AI is likely to grow at 19.1% CAGR. HCLT started investing in AI since 2016. The areas of investment are: 1) AI engineering, building AI silicon for training: Edge AI chip, training and inference accelerator, 2) AI led IP solutions, 3) focussed investments in niche areas: Actian, Zeenea. AI Force is increasing efficiency in IT and BPS and accelerating build and modernisation. 3) AI Foundry: Modernised data and AI stack, running cognitive infrastructure, dealing with distributed data, building data-driven applications. 4) AI Labs. AI optimised compute: GPU, TPU.

Big techs are leading the big AI bets. HCLT is improving its partnership with big tech. Data centre and semiconductor chip demand is likely to rise because of this.

Other highlights

- Telecom has been doing well for HCLT since last four quarters. TMT is HCLT's highest growing vertical among peers. Telecom industry has a lot of technology debt. Telcom companies are transforming from Netco (network companies) to servco (service companies), on their way to become Digitalco (digital companies). HCLT is focusing on improving time to market by 21 for telcos, reducing billing and fallout by 30%, deploying 3x faster new capabilities.

- HCLT has 25.2% market share in TMT vertical. It aims to deliver industry-leading growth in TMT over the next 2 years. Technology vertical's ~60% revenue is formed by top 10 tech companies. 20 new logos were added in technology vertical in last 2 years. Clients include marquee names like: Broadcom, Cloud Software group. HCLT is a vendor for Intel. Customer chip development is an upcoming sub-segment within hitech.

- HCLT sees white spaces in BFSI in sub-segments of: Insurance brokerage firms, specialised banks, large central banks.

- HCLT's software currently has 15,000+ customers with FY24 EBITDA of 38.8%. 90% of investment made in this business has been recovered.

- Focused on diversifying delivery, localised delivery. HCLT has launched centres in Vietnam, Costa Rica, Lucknow, etc.

- Company aims to train 50,000 people in generative AI.

- CSP TAM is growing at 8% CAGR (industry size at USD 272bn).

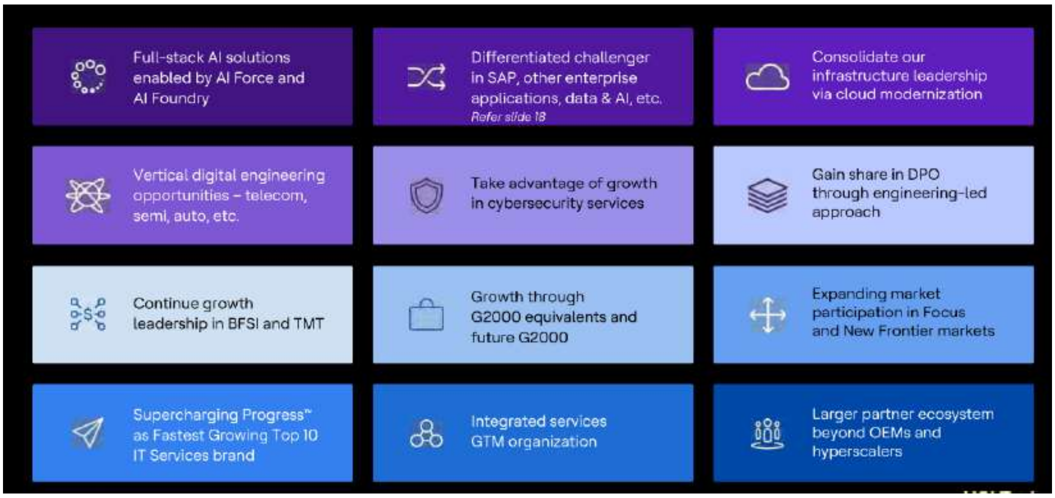
- Client mining has been a key strength. Number of clients has gone up from 208 in FY22 to 254 in USD 10mn+ clients. 951 USD 1mn+ clients from 882 in FY22.

- HCLT aims to return 75% of profit to shareholders from FY22-26.

- Currently, HCLT has 24,797 nearshore employee strength vs 21,497 in FY22.

Key risks: 1) demand turning for telecom vertical 2) Fed rate cuts driving the demand recovery significantly.

Exhibit 1: Key vectors for growth leadership

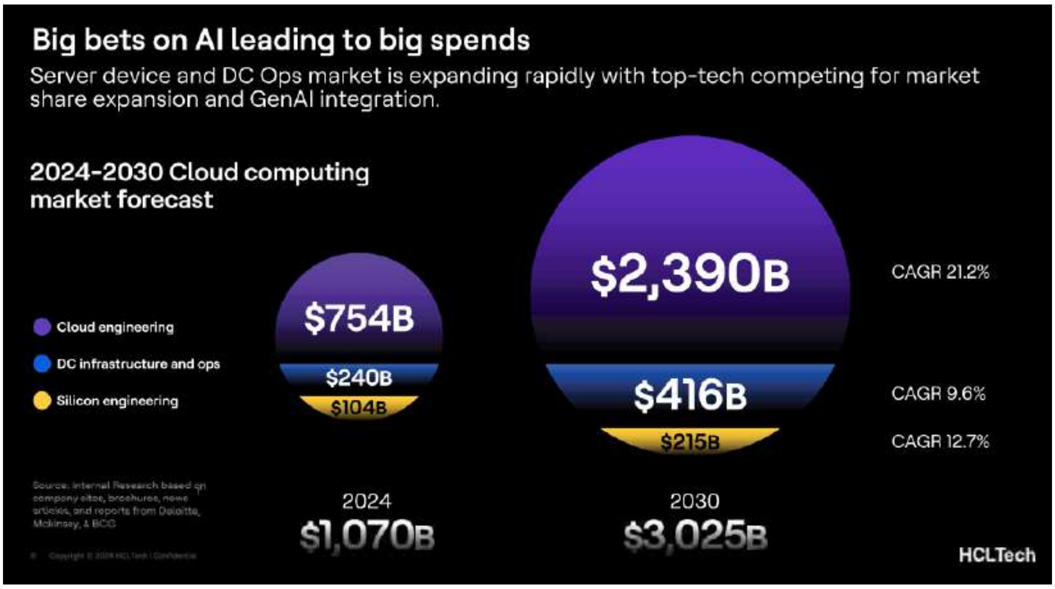


Source: Company data

Exhibit 2: Project Ascend

Source: Company data

Exhibit 3: Big bets on AI



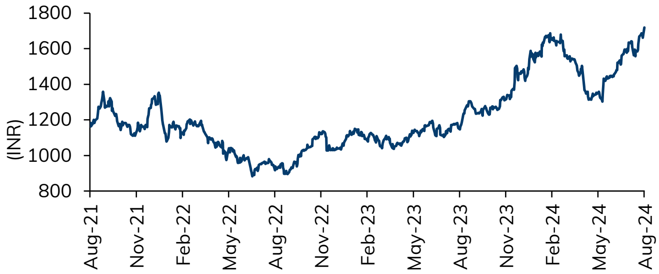
Source: Company data

Exhibit 4: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	60.8	60.8	60.8
Institutional investors	34.7	34.7	34.2
MFs and other	9.1	8.8	9.3
Banks/ FIs	0.0	0.1	0.0
Insurance Cos.	6.0	6.0	6.3
FIIs	19.6	19.8	18.6
Others	4.5	4.5	5.0

Source: Bloomberg

Exhibit 5: Price chart



Source: Bloomberg

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Financial Summary

Exhibit 6: Profit & Loss

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Net Sales (US$ mn)	**13,270**	**13,839**	**14,970**	**16,467**
Net Sales (INR mn)	**10,99,130**	**11,54,398**	**12,57,456**	**13,83,246**
Operating Expense	8,53,420	9,00,890	9,74,866	10,71,393
EBITDA	**2,45,710**	**2,53,508**	**2,82,590**	**3,11,853**
EBITDA Margin (%)	22.4	22.0	22.5	22.5
Depreciation & Amortization	41,730	45,855	49,976	56,825
EBIT	2,03,980	2,07,654	2,32,613	2,55,028
Interest expenditure	1,470	2,601	921	921
Other Non-operating Income	9,650	15,339	11,122	11,278
Recurring PBT	**2,12,160**	**2,20,392**	**2,42,814**	**2,65,385**
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	52,570	57,937	63,132	69,000
PAT	1,59,590	1,62,455	1,79,682	1,96,385
Less: Minority Interest	-	(80)	(80)	(80)
Net Income (Reported)	**1,59,590**	**1,62,455**	**1,79,682**	**1,96,385**
Extraordinaries (Net)	-	-	-	-
Recurring Net Income	**1,59,590**	**1,62,375**	**1,79,602**	**1,96,305**

Source Company data, I-Sec research

Exhibit 7: Balance sheet

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Total Current Assets	5,22,880	4,25,240	4,66,070	4,69,915
of which cash & cash eqv.	94,560	1,01,208	1,07,137	1,10,636
Total Current Liabilities & Provisions	2,27,260	2,07,282	2,29,607	2,33,297
Net Current Assets	**2,95,620**	**2,17,959**	**2,36,463**	**2,36,618**
Investments	79,830	1,79,560	1,79,560	1,79,560
Net Fixed Assets	49,670	50,810	54,810	55,810
ROU Assets	39,900	26,200	26,200	26,200
Capital Work-in-Progress	-	-	-	-
Goodwill	-	-	-	-
Other assets	22,560	39,780	39,780	39,780
Deferred Tax assests	10,310	9,510	9,510	9,510
Total Assets	**7,70,510**	**7,92,189**	**8,14,693**	**8,15,848**
Liabilities				
Borrowings	**22,230**	**23,020**	**23,020**	**23,020**
Deferred Tax Liability	**7,710**	**-**	**-**	**-**
provisions	16,120	-	-	-
other Liabilities	41,740	75,940	75,940	75,940
Minority Interest	80	-	-	-
Equity Share Capital	-	-	-	-
Reserves & Surplus*	-	-	-	-
Total Net Worth	**6,82,630**	**6,93,229**	**7,15,733**	**7,16,888**
Total Liabilities	**7,70,510**	**7,92,189**	**8,14,693**	**8,15,848**

Source Company data, I-Sec research

Exhibit 8: Quarterly trend

(INR mn, year ending March)

	Sep-23	Dec-23	Mar-24	Jun-24
Net Sales	2,66,720	2,84,460	2,84,990	2,80,570
% growth (YOY)	1.4	6.7	0.2	(1.6)
EBITDA	49,340	56,150	50,240	47,950
Margin %	18.5	19.7	17.6	17.1
Other Income	1,940	2,590	2,510	9,120
Adjusted Net Profit	38,320	43,500	40,000	42,570

Source Company data, I-Sec research

Exhibit 9: Cashflow statement

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
CFO before WC changes	2,42,040	2,54,238	2,82,510	3,11,773
CFO after WC changes	**2,01,360**	**2,31,507**	**2,69,935**	**3,15,118**
Capital Commitments	(57,330)	(29,045)	(53,976)	(57,825)
Free Cashflow	**2,06,120**	**2,02,615**	**2,60,780**	**3,03,943**
Other investing cashflow	18,900	6,639	10,201	10,357
Cashflow from Investing Activities	**(38,430)**	**(22,406)**	**(43,776)**	**(47,468)**
Issue of Share Capital	12,392	(20,247)	-	(21,800)
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	1,120	790	-	-
Cash flow from Financing Activities	**(1,06,450)**	**(1,44,517)**	**(1,57,098)**	**(1,95,150)**
Dividend paid	(1,40,822)	(1,35,430)	(1,57,098)	(1,73,350)
Others	20,860	10,370	-	-
Chg. in Cash & Bank balance	**3,910**	**6,648**	**5,929**	**3,499**
Closing cash & balance	94,560	1,01,208	1,07,137	1,10,636

Source Company data, I-Sec research

Exhibit 10: Key ratios

(Year ending March)

	FY24A	FY25E	FY26E	FY27E
Per Share Data (INR)				
Reported EPS	58.9	60.0	66.3	72.5
Diluted EPS	58.9	60.0	66.3	72.5
Cash EPS	74.3	76.9	84.8	93.5
Dividend per share (DPS)	52.0	50.0	58.0	64.0
Book Value per share (BV)	252.1	255.9	264.2	264.7
Dividend Payout (%)	88.2	83.4	87.4	88.3
Growth (%)				
Net Sales	8.3	5.0	8.9	10.0
EBITDA	8.6	3.2	11.5	10.4
EPS	7.4	1.8	10.6	9.3
Valuation Ratios (x)				
P/E	29.7	29.2	26.4	24.2
P/CEPS	23.6	22.8	20.7	18.7
P/BV	6.9	6.8	6.6	6.6
EV / EBITDA	16.1	15.1	13.6	12.3
P/S	3.7	3.5	3.3	3.0
Dividend Yield (%)	3.0	2.9	3.3	3.7
Operating Ratios				
EBITDA Margins (%)	22.4	22.0	22.5	22.5
EBIT Margins (%)	18.6	18.0	18.5	18.4
Effective Tax Rate (%)	24.8	26.3	26.0	26.0
Net Profit Margins (%)	14.5	14.1	14.3	14.2
Inventory Turnover Days	-	-	-	-
Fixed Asset Turnover (x)	21.2	23.0	23.8	25.0
Receivables Days	64.8	62.5	61.4	58.6
Payables Days		-	-	-
Working Capital Days				
Net Debt / EBITDA (x)	(3.4)	(5.6)	(5.2)	(4.7)
Profitability Ratios				
RoCE (%)	21.9	21.5	23.7	25.5
RoIC (%)	29.3	35.1	38.0	41.9
RoNW (%)	23.9	23.6	25.5	27.4

Source Company data, I-Sec research

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