

HOLD**TP: Rs 1,240 | ▲ 12%****HCL TECHNOLOGIES**

Technology & Internet

13 July 2023

Weak Q1 but full-year guidance retained – a tall order

- Q1 revenue missed estimates largely due to a slowdown in ER&D services and the telecom & media vertical
- Full-year guidance remains intact but implied 2.8-4% CQGR ask rate looks optimistic in an uncertain macro environment
- Upside capped post recent stock runup; maintain HOLD and TP of Rs 1,240, set at 18.7x FY25E EPS

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Weak performance: HCLT posted Q1FY24 revenue of US\$ 3.2bn (-1.3% QoQ CC, +6.3% YoY CC) vs. US\$ 3.3bn estimated as IT and business services (ITBS: 75% of revenue) declined 0.1% QoQ CC, engineering and R&D (ER&D) services fell 5.2% and software business was down 3.1%. Services revenue (ITBS + ER&D) dipped 1% QoQ CC owing to a sharp decline in the technology (-7.8%) and telecom (-14.4%) verticals. Among the other verticals, financial services grew 5.1% QoQ CC, manufacturing was up 3.6%, and retail & consumer packaged goods (CPG) was largely flat. Lifesciences and healthcare fell 1.3% QoQ CC.

Dichotomy between net new deal TCV and order pipeline: Net new deal TCV stood at US\$ 1.6bn in Q1FY24 as compared to a quarterly average of US\$ 2.2bn in FY23. In contrast, the deal pipeline continues to grow, rising 18% QoQ and 26% YoY. HCLT signed 18 large deals in Q1, 7 in services (vs. 10 the previous quarter) and 11 in software. Net new deal value has contracted due to a slowdown in the telecom and technology verticals and in the Europe and RoW geographies. Average contract value has also shrunk 21% YoY in Q1 and while management expects to close a few large deals over the next 45 days, this hardly inspires confidence.

Operating margin disappoints but FY24 guidance retained: EBIT margin declined 120bps QoQ to 17% (17.9% est.), impacted by a margin drop in ER&D whereas the software segment was stable. Nevertheless, the company maintained its margin guidance for FY24 at 18-19%, factoring in a sequential drop in revenue and lower utilisation. Revenue growth guidance for the year was maintained at 6-8% CC (including services revenue at 6.5-8.5% CC). This implies a 2.8-4% CQGR which we find rather optimistic against the backdrop of an uncertain macro climate.

Maintain HOLD: HCLT is trading at 18.5x/16.8x FY24E/FY25E EPS. Despite muted first-quarter results, management has stuck to its full-year guidance, which looks difficult to achieve at this stage. Following the recent run-up in stock price, upside potential also looks capped. We maintain HOLD and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Key changes

| Target | Rating |
|--------|--------|
| ◀ ▶ | ◀ ▶ |

| | |
|------------------|------------------|
| Ticker/Price | HCLT IN/Rs 1,109 |
| Market cap | US\$ 36.6bn |
| Free float | 38% |
| 3M ADV | US\$ 33.4mn |
| 52wk high/low | Rs 1,203/Rs 877 |
| Promoter/FPI/DII | 61%/17%/22% |

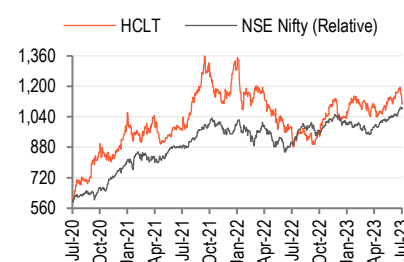
Source: NSE | Price as of 13 Jul 2023

Key financials

| Y/E 31 Mar | FY23P | FY24E | FY25E |
|-------------------------|-----------|-----------|-----------|
| Total revenue (Rs mn) | 10,14,355 | 11,31,246 | 12,36,314 |
| EBITDA (Rs mn) | 2,24,451 | 2,59,888 | 2,82,793 |
| Adj. net profit (Rs mn) | 1,41,181 | 1,62,773 | 1,79,498 |
| Adj. EPS (Rs) | 52.0 | 60.0 | 66.1 |
| Consensus EPS (Rs) | 52.0 | 63.5 | 64.5 |
| Adj. ROAE (%) | 21.7 | 22.3 | 21.9 |
| Adj. P/E (x) | 21.3 | 18.5 | 16.8 |
| EV/EBITDA (x) | 13.3 | 11.4 | 10.4 |
| Adj. EPS growth (%) | 4.6 | 15.3 | 10.3 |

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



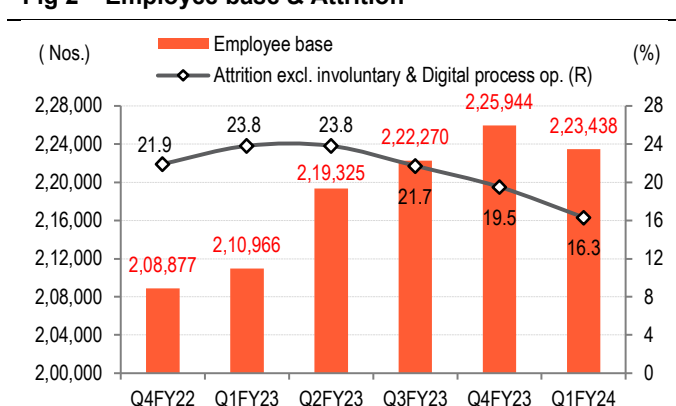
Source: NSE



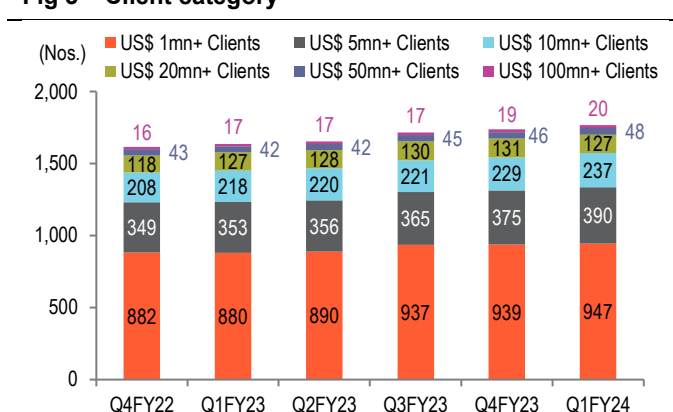
Fig 1 – Quarterly performance

| (Rs mn) | Q1FY24 | Q4FY23 | Q1FY23 | QoQ (%) | YoY (%) | Estimates | Variance (%) |
|-------------------|----------|----------|----------|----------|---------|-----------|--------------|
| Revenue (US\$ mn) | 3,200 | 3,235 | 3,025 | (1.1) | 5.8 | 3,282 | (2.5) |
| Revenue (Rs mn) | 2,62,960 | 2,66,060 | 2,34,640 | (1.2) | 12.1 | 2,69,780 | (2.5) |
| EBIT | 44,600 | 48,053 | 39,956 | (7.2) | 11.6 | 48,217 | (7.5) |
| PAT | 35,340 | 39,507 | 32,866 | (10.5) | 7.5 | 38,767 | (8.8) |
| EBIT Margin (%) | 17.0 | 18.1 | 17.0 | (110bps) | (6.8) | 17.9 | (91bps) |
| PAT Margin (%) | 13.4 | 14.8 | 14.0 | (141bps) | (56.8) | 14.4 | (93bps) |

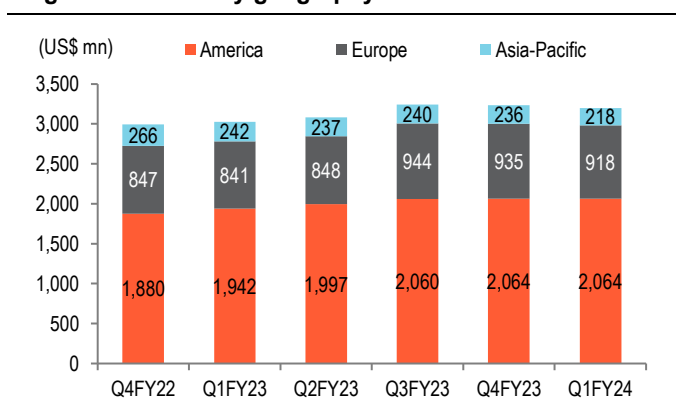
Source: Company, BOBCAPS Research

Fig 2 – Employee base & Attrition

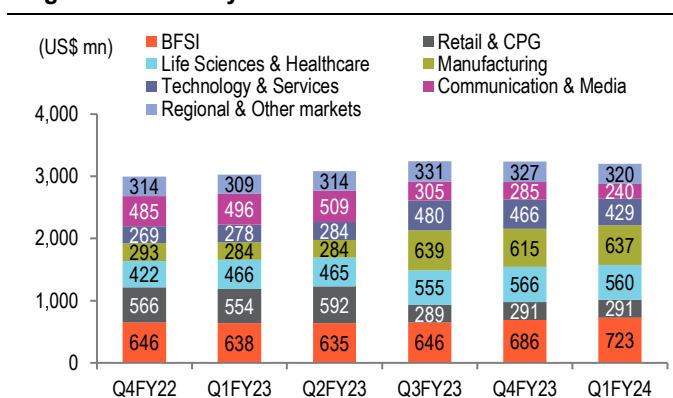
Source: Company, BOBCAPS Research

Fig 3 – Client category

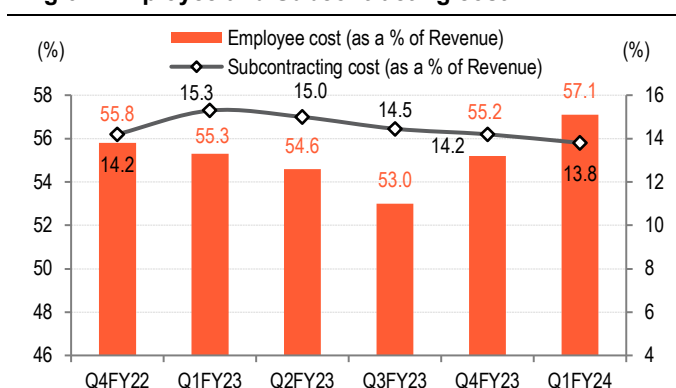
Source: Company, BOBCAPS Research

Fig 4 – Revenue by geography

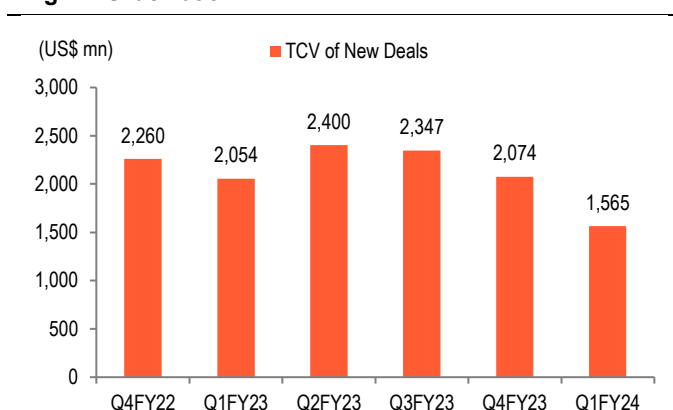
Source: Company, BOBCAPS Research

Fig 5 – Revenue by vertical

Source: Company, BOBCAPS Research

Fig 6 – Employee and Subcontracting cost

Source: Company, BOBCAPS Research

Fig 7 – Order book

Source: Company, BOBCAPS Research

Earnings call highlights

- Cuts in discretionary spending and delays in telecom and technology projects continued to impact ER&D revenue in Q1FY24.
- HCLT indicated that it has witnessed momentum in efficiency-led deals over the last two quarters.
- Per management, more consolidation deals in engineering services are helping to augment the pipeline. The pipeline remains well diversified and is at an all-time high, which HCLT expects will translate to strong conversions in Q2FY24 as several deals are already in the advanced stage.
- To maintain margins, HCLT has decided to skip management-level increments (E4 and above which form a large part of the wage bill) and defer increments for others.

Valuation methodology

HCLT is trading at 18.5x/16.8x FY24E/FY25E EPS. Despite muted first-quarter results, management has stuck to its full-year revenue growth guidance of 6-8% CC, which looks rather optimistic in our view. Following the recent run-up in stock price, upside potential also looks capped. We maintain HOLD and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Key risks

- Better-than-expected improvement in the BFSI, retail and hi-tech verticals in developed economies represents an upside risk to our estimates.
- Further reduction in IT-related spends by target clients is a key downside risk.

Sector recommendation snapshot

| Company | Ticker | Market Cap (US\$ bn) | Price (Rs) | Target (Rs) | Rating |
|---------------------------|------------|----------------------|------------|-------------|--------|
| Affle (India) | AFFLE IN | 0.3 | 1,066 | 1,110 | HOLD |
| Coforge | COFORGE IN | 3.6 | 4,756 | 4,830 | HOLD |
| HCL Technologies | HCLT IN | 36.6 | 1,109 | 1,240 | HOLD |
| Infosys | INFO IN | 69.9 | 1,365 | 1,760 | BUY |
| Mphasis | MPHL IN | 4.4 | 1,922 | 2,541 | BUY |
| Persistent Systems | PSYS IN | 4.6 | 4,760 | 5,330 | HOLD |
| Tata Consultancy Services | TCS IN | 148.8 | 3,341 | 3,580 | HOLD |
| Tech Mahindra | TECHM IN | 12.5 | 1,175 | 1,130 | HOLD |
| Wipro | WPRO IN | 26.3 | 394 | 420 | HOLD |

Source: BOBCAPS Research, NSE | Price as of 13 Jul 2023

Financials

Income Statement

| Y/E 31 Mar (Rs mn) | FY21A | FY22A | FY23P | FY24E | FY25E |
|----------------------------|-----------------|-----------------|------------------|------------------|------------------|
| Total revenue | 7,53,780 | 8,56,510 | 10,14,355 | 11,31,246 | 12,36,314 |
| EBITDA | 2,02,350 | 2,01,920 | 2,24,451 | 2,59,888 | 2,82,793 |
| Depreciation | 41,360 | 40,190 | 45,515 | 50,511 | 51,098 |
| EBIT | 1,60,990 | 1,61,730 | 1,78,936 | 2,09,378 | 2,31,695 |
| Net interest inc./(exp.) | 0 | 0 | 0 | 0 | 0 |
| Other inc./(exp.) | 5,540 | 8,260 | 6,969 | 4,797 | 4,485 |
| Exceptional items | 0 | 0 | 0 | 0 | 1 |
| EBT | 1,66,530 | 1,69,990 | 1,85,906 | 2,14,175 | 2,36,180 |
| Income taxes | 36,580 | 34,430 | 44,725 | 51,402 | 56,683 |
| Extraordinary items | 0 | 0 | 0 | 0 | 1 |
| Min. int./Inc. from assoc. | 0 | 0 | 0 | 0 | 0 |
| Reported net profit | 1,29,950 | 1,35,560 | 1,41,181 | 1,62,773 | 1,79,497 |
| Adjustments | 0 | 0 | 0 | 0 | 1 |
| Adjusted net profit | 1,29,950 | 1,35,560 | 1,41,181 | 1,62,773 | 1,79,498 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY21A | FY22A | FY23P | FY24E | FY25E |
|---------------------------------|-----------------|-----------------|-----------------|------------------|------------------|
| Accounts payables | 0 | 0 | 0 | 0 | 1 |
| Other current liabilities | 2,17,050 | 2,30,420 | 2,33,302 | 2,60,187 | 2,84,352 |
| Provisions | 0 | 0 | 0 | 0 | 0 |
| Debt funds | 39,070 | 39,850 | 39,850 | 39,850 | 39,850 |
| Other liabilities | 0 | 0 | 0 | 0 | 0 |
| Equity capital | 5,430 | 5,430 | 5,430 | 5,430 | 5,430 |
| Reserves & surplus | 6,15,480 | 6,09,200 | 6,82,445 | 7,66,891 | 8,60,014 |
| Shareholders' fund | 6,20,910 | 6,14,630 | 6,87,875 | 7,72,321 | 8,65,444 |
| Total liab. and equities | 8,77,030 | 8,84,900 | 9,61,026 | 10,72,358 | 11,89,646 |
| Cash and cash eq. | 65,150 | 79,090 | 92,168 | 1,22,470 | 1,68,381 |
| Accounts receivables | 1,75,250 | 2,06,710 | 2,22,324 | 2,47,944 | 2,70,973 |
| Inventories | 0 | 0 | 0 | 0 | 0 |
| Other current assets | 74,290 | 77,920 | 91,292 | 1,24,437 | 1,35,995 |
| Investments | 1,40,220 | 1,14,850 | 1,39,850 | 1,69,850 | 1,99,850 |
| Net fixed assets | 62,450 | 59,540 | 38,242 | 20,570 | 18,431 |
| CWIP | 0 | 0 | 0 | 0 | 0 |
| Intangible assets | 2,91,500 | 2,90,930 | 2,90,930 | 2,90,930 | 2,90,930 |
| Deferred tax assets, net | 0 | 0 | 0 | 0 | 1 |
| Other assets | 68,170 | 55,860 | 86,220 | 96,156 | 1,05,087 |
| Total assets | 8,77,030 | 8,84,900 | 9,61,026 | 10,72,358 | 11,89,646 |

Cash Flows

| Y/E 31 Mar (Rs mn) | FY21A | FY22A | FY23P | FY24E | FY25E |
|------------------------------------|-------------------|-----------------|-----------------|-----------------|-----------------|
| Cash flow from operations | 1,26,470 | 1,56,990 | 1,23,262 | 1,66,671 | 2,06,760 |
| Capital expenditures | (41,370) | (37,280) | (24,217) | (32,839) | (48,958) |
| Change in investments | 34,540 | (25,370) | 25,000 | 30,000 | 30,000 |
| Other investing cash flows | 13,367 | 521 | (43,031) | (55,203) | (55,515) |
| Cash flow from investing | 6,537 | (62,129) | (42,248) | (58,042) | (74,474) |
| Equities issued/Others | 0 | 0 | 0 | 0 | 0 |
| Debt raised/repaid | (2,510) | (600) | 0 | 0 | 0 |
| Interest expenses | (76,730) | (15,090) | 0 | 0 | 0 |
| Dividends paid | (62,532) | (65,231) | (67,936) | (78,326) | (86,374) |
| Other financing cash flows | 0 | 0 | 0 | 0 | 1 |
| Cash flow from financing | (1,41,772) | (80,921) | (67,936) | (78,326) | (86,373) |
| Chg in cash & cash eq. | (8,765) | 13,940 | 13,078 | 30,302 | 45,913 |
| Closing cash & cash eq. | 65,150 | 79,090 | 92,168 | 1,22,470 | 1,68,381 |

Per Share

| Y/E 31 Mar (Rs) | FY21A | FY22A | FY23P | FY24E | FY25E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 47.9 | 49.8 | 52.0 | 60.0 | 66.1 |
| Adjusted EPS | 47.9 | 49.8 | 52.0 | 60.0 | 66.1 |
| Dividend per share | 19.2 | 20.0 | 20.8 | 24.0 | 26.5 |
| Book value per share | 228.8 | 226.5 | 253.5 | 284.6 | 318.9 |

Valuations Ratios

| Y/E 31 Mar (x) | FY21A | FY22A | FY23P | FY24E | FY25E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 4.0 | 3.5 | 2.9 | 2.6 | 2.4 |
| EV/EBITDA | 14.8 | 14.8 | 13.3 | 11.4 | 10.4 |
| Adjusted P/E | 23.2 | 22.3 | 21.3 | 18.5 | 16.8 |
| P/BV | 4.8 | 4.9 | 4.4 | 3.9 | 3.5 |

DuPont Analysis

| Y/E 31 Mar (%) | FY21A | FY22A | FY23P | FY24E | FY25E |
|------------------------------|-------|-------|-------|-------|-------|
| Tax burden (Net profit/PBT) | 78.0 | 79.7 | 75.9 | 76.0 | 76.0 |
| Interest burden (PBT/EBIT) | 103.4 | 105.1 | 103.9 | 102.3 | 101.9 |
| EBIT margin (EBIT/Revenue) | 21.4 | 18.9 | 17.6 | 18.5 | 18.7 |
| Asset turnover (Rev./Avg TA) | 88.2 | 97.2 | 109.9 | 111.3 | 109.3 |
| Leverage (Avg TA/Avg Equity) | 1.5 | 1.4 | 1.4 | 1.4 | 1.4 |
| Adjusted ROAE | 22.7 | 21.9 | 21.7 | 22.3 | 21.9 |

Ratio Analysis

| Y/E 31 Mar | FY21A | FY22A | FY23P | FY24E | FY25E |
|--|-------|-------|-------|-------|-------|
| YoY growth (%) | | | | | |
| Revenue | 6.6 | 13.6 | 18.4 | 11.5 | 9.3 |
| EBITDA | 21.2 | (0.2) | 11.2 | 15.8 | 8.8 |
| Adjusted EPS | 17.1 | 3.9 | 4.6 | 15.3 | 10.3 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 26.8 | 23.6 | 22.1 | 23.0 | 22.9 |
| EBIT margin | 21.4 | 18.9 | 17.6 | 18.5 | 18.7 |
| Adjusted profit margin | 17.2 | 15.8 | 13.9 | 14.4 | 14.5 |
| Adjusted ROAE | 22.7 | 21.9 | 21.7 | 22.3 | 21.9 |
| ROCE | 22.4 | 22.0 | 22.4 | 24.0 | 24.7 |

Working capital days (days)

| | | | | | |
|-------------|-----|-----|-----|-----|-----|
| Receivables | 85 | 81 | 77 | 76 | 77 |
| Inventory | 0 | 0 | 0 | 0 | 0 |
| Payables | 158 | 125 | 107 | 103 | 104 |

Ratios (x)

| | | | | | |
|-----------------------------|------|-------|-------|-------|-------|
| Gross asset turnover | 12.1 | 14.0 | 20.7 | 38.5 | 63.4 |
| Current ratio | 1.8 | 1.8 | 2.1 | 2.3 | 2.4 |
| Net interest coverage ratio | NA | NA | NA | NA | NA |
| Adjusted debt/equity | 0.0 | (0.1) | (0.1) | (0.1) | (0.1) |

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

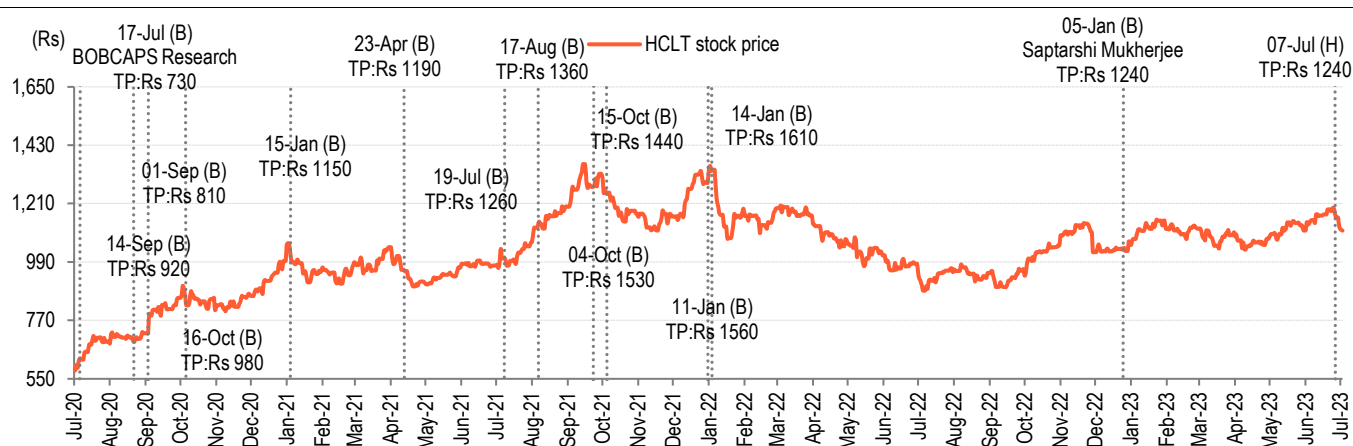
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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Ratings and Target Price (3-year history): HCL TECHNOLOGIES (HCLT IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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