

BUY

TP: Rs 1,240 | ▲ 16%

HCL TECHNOLOGIES

Technology & Internet

12 January 2023

Profit beat in seasonally weak quarter

- Q3 revenue growth at 5% QoQ CC beat consensus as well as our estimates
- EBIT margin held strong at 19.6% backed by improvement in services business and seasonal gains in software business
- Maintain BUY and TP of Rs 1,240, set at 18.7x FY25E EPS

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Stellar Q3 driven by P&P segment: HCLT's Q3FY23 revenue at US\$ 3.2bn (+5% QoQ, +13% YoY CC) was marginally higher than our estimate. The company pared FY23 revenue growth guidance by 50bps to 13.5-14% CC, with services now likely to grow by 16-16.5%. While management pointed to ramp-downs of certain projects by vendors and reprioritisation of spending by clients, it sees robust growth in the areas of cost optimisation, business model transformation and cloud migration. Growth in Q3 was led by engineering and research & development (ERD) and IT & business services that rose 2.5% and 2.1% QoQ CC respectively. The software business (products & platforms or P&P) and Mode-2 services also witnessed tailwinds in Q3.

Strong deal wins to buoy growth across geographies: HCLT booked net-new TCV of US\$ 2.3bn (+10% QoQ, ACV up by 1.9% YoY), which included 17 large deal wins (7 in services and 10 in software). Due to furloughs and delayed decision-making in Europe, the company experienced a hit in the BFSI segment but indicated that the pipeline remains healthy with deal conversion expected in Q4. The majority of deals wins are related to cost takeout/cloud adoption, but the three latest large contracts were mainly spurred by vendor consolidation and product operation.

Margin guidance narrowed to 18-18.5% for FY23: EBIT margin for Q3 was at 17.9%, supported by forex gains (+70bps), pyramid optimisation (+40bps), realisation and other efficiency gains (+30bps), partially offset by furloughs and the holiday season (-60bps). Margins in IT services grew 5bps QoQ, ERD 25bps and P&P 1,230bps. The guidance band for FY23 was revised from 18-19% to 18-18.5%.

Maintain BUY: The stock is trading at 17.8x/16.2x FY24E/FY25E EPS. Given its deep capabilities in the IMS space and strategic partnerships alongside continued investments in cloud/digital capabilities, we expect HCLT to emerge stronger on the back of rising demand from enterprises. Strong sequential growth within IT services, robust headcount addition, healthy deal wins and a solid pipeline indicate an improved outlook. We retain BUY 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 1,072
Market cap	US\$ 35.6bn
Free float	38%
3M ADV	US\$ 37.8mn
52wk high/low	Rs 1,359/Rs 877
Promoter/FPI/DII	61%/17%/22%

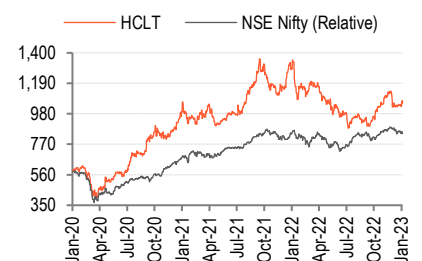
Source: NSE | Price as of 12 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	8,56,510	10,14,355	11,31,246
EBITDA (Rs mn)	2,01,920	2,24,451	2,59,888
Adj. net profit (Rs mn)	1,35,560	1,41,181	1,62,773
Adj. EPS (Rs)	49.8	52.0	60.0
Consensus EPS (Rs)	49.8	56.7	63.5
Adj. ROAE (%)	21.9	21.7	22.3
Adj. P/E (x)	21.5	20.6	17.9
EV/EBITDA (x)	14.3	12.8	11.0
Adj. EPS growth (%)	3.9	4.6	15.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

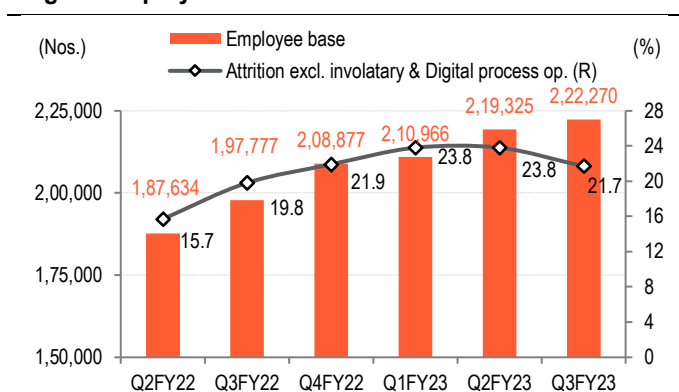


Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q2FY23	Q3FY22	QoQ (%)	YoY (%)	BOBCAPS EST.	Variance (%)
US\$ Revenue (US\$ mn)	3,244	3,082	2,978	5.3	8.9	3,201	1.3
INR Revenue	2,67,000	2,46,860	2,23,310	8.2	19.6	2,63,766	1.2
EBIT	52,280	44,280	42,570	18.1	22.8	49,324	6.0
PAT	40,960	34,890	34,420	17.4	19bps	38,906	5.3
EBIT Margin (%)	19.6	17.9	19.1	164bps	52bps	18.7	88bps
PAT Margin (%)	15.3	14.1	15.4	121bps	(7bps)	14.8	59bps

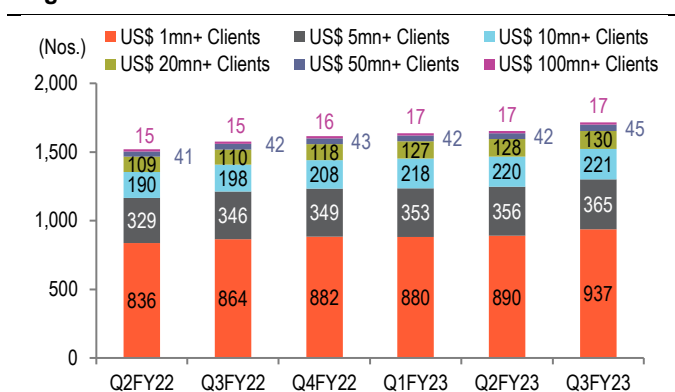
Source: Company, BOBCAPS Research

Fig 2 – Employee base & Attrition



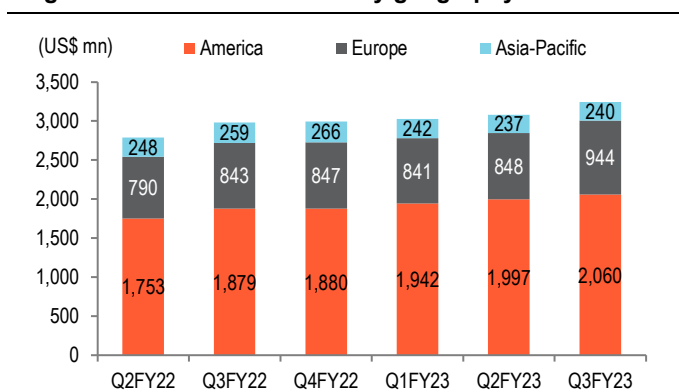
Source: Company, BOBCAPS Research

Fig 3 – Client contribution



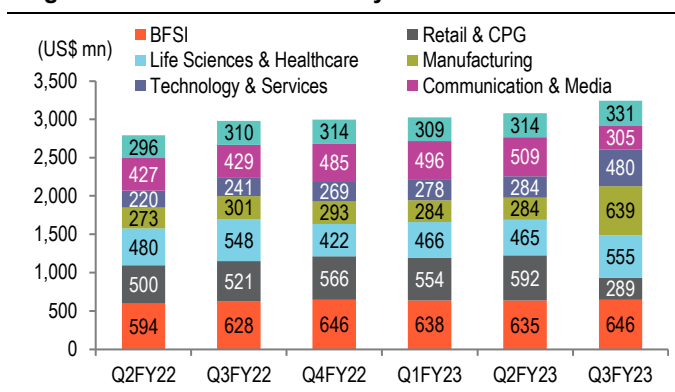
Source: Company, BOBCAPS Research

Fig 4 – Revenue contribution by geography



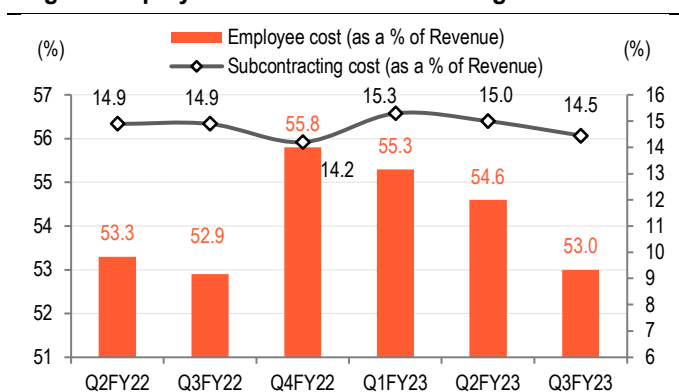
Source: Company, BOBCAPS Research

Fig 5 – Revenue contribution by vertical



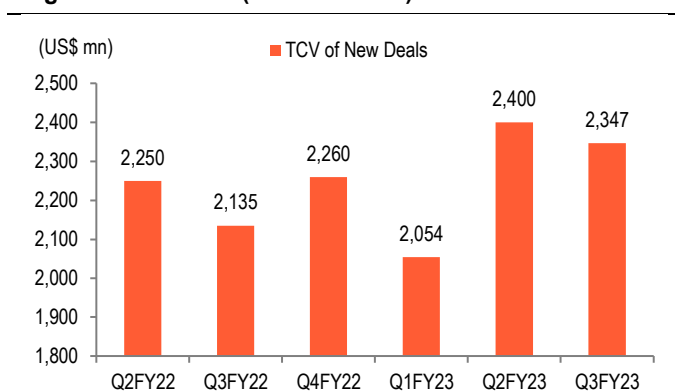
Source: Company, BOBCAPS Research

Fig 6 – Employee cost and Subcontracting cost



Source: Company, BOBCAPS Research

Fig 7 – Order book (new deal TCV)



Source: Company, BOBCAPS Research

Earnings call highlights

- Deal wins remained strong with HCLT bagging 17 large contracts in Q3FY23: 7 in services and 10 in products. New deal wins totalled ~US\$ 2.3bn with average contract value (ACV) up 1.9% YoY.
- Growth in services came primarily from the life science & healthcare (+5.5% QoQ CC), manufacturing (+4.9%) and telecom & media services (+4.5%) verticals.
- HCLT is seeing traction in the P&P business with strong recognition and adoption of some of its products.
- Per management, clients are lagging behind in consuming cloud capacity and need to accelerate spends to utilise the same.
- Attrition went down materially by ~210bps to 21.7% in Q3FY23, similar to Q4FY22. As the supply side eases, management expects utilisation to pick up.
- HCLT added over 3k staff during the quarter, raising its employee base by 1% QoQ to ~222k.

Valuation methodology

The stock is trading at 17.8x/16.2x FY24E/FY25E EPS. Given its deep capabilities in the IMS space and strategic partnerships alongside continued investments in cloud/digital capabilities, we expect HCLT to emerge stronger on the back of rising demand from enterprises. Strong sequential growth within IT services, robust headcount addition, healthy deal wins and a solid pipeline indicate an improved outlook. We retain BUY and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Fig 8 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY23E-25E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
TCS	TCS IN	HOLD	3,580	10.7	131.4	143.3	41.3	38.7	25.0
Infosys	INFO IN	BUY	1,760	14.9	58.7	73.0	30.6	33.5	20.5
HCL Tech	HCLT IN	BUY	1,240	10.4	52.0	59.8	21.7	22.3	18.7
Wipro	WPRO IN	HOLD	440	9.9	20.1	23.9	16.7	19.5	16.0
Tech Mahindra	TECHM In	HOLD	1,160	12.4	60.5	77.9	18.4	21.4	12.5

Source: Company, BOBCAPS Research

Key risks

- A further decline in interest rates would be a key downside risk to our estimates as it would induce extended weakness in deal wins in the areas of BFSI, retail, tech and manufacturing.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	35.6	1,072	1,240	BUY
Infosys	INFO IN	76.3	1,481	1,760	BUY
Tata Consultancy Services	TCS IN	149.5	3,334	3,580	HOLD
Tech Mahindra	TECHM IN	10.7	1,002	1,160	HOLD
Wipro	WPRO IN	26.5	395	440	HOLD

Source: BOBCAPS Research, NSE | Price as of 12 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	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	FY23E	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	FY23E	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	FY23E	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	FY23E	FY24E	FY25E
EV/Sales	3.8	3.4	2.8	2.5	2.3
EV/EBITDA	14.3	14.3	12.8	11.0	10.0
Adjusted P/E	22.4	21.5	20.6	17.9	16.2
P/BV	4.7	4.7	4.2	3.8	3.4

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	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	FY23E	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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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

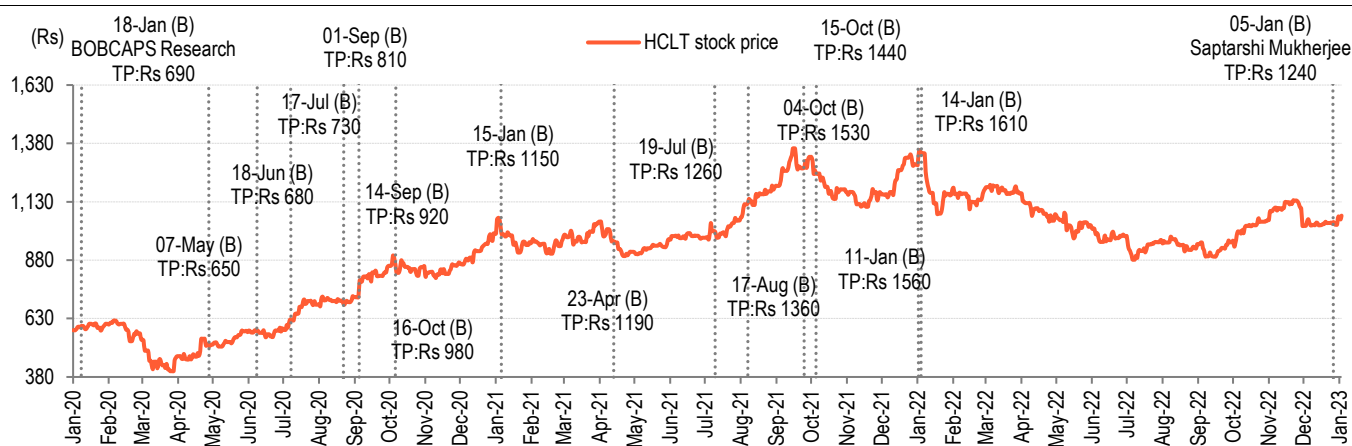
HOLD – Expected return from -6% to +15%

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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