

HCL Technologies

BSE SENSEX 62,182
S&P CNX 18,497

HCLTech

Stock Info

| | |
|-----------------------|---------------|
| Bloomberg | HCLT IN |
| Equity Shares (m) | 2,714 |
| M.Cap.(INRb)/(USDb) | 2787.7 / 33.9 |
| 52-Week Range (INR) | 1359 / 876 |
| 1, 6, 12 Rel. Per (%) | -4/-13/-18 |
| 12M Avg Val (INR M) | 4039 |
| Free float (%) | 39.3 |

Financials & Valuations (INR b)

| Y/E Mar | 2022 | 2023E | 2024E |
|-----------------|------|-------|-------|
| Sales | 857 | 1,016 | 1,148 |
| EBIT Margin (%) | 18.9 | 18.0 | 18.7 |
| PAT | 135 | 147 | 167 |
| EPS (INR) | 49.8 | 54.3 | 61.8 |
| EPS Gr. (%) | 13.8 | 8.9 | 13.8 |
| BV/Sh. (INR) | 229 | 226 | 223 |

Ratios

| | | | |
|------------|------|------|------|
| RoE (%) | 21.9 | 23.9 | 27.5 |
| RoCE (%) | 19.6 | 21.2 | 25.1 |
| Payout (%) | 88.3 | 90.0 | 90.0 |

Valuations

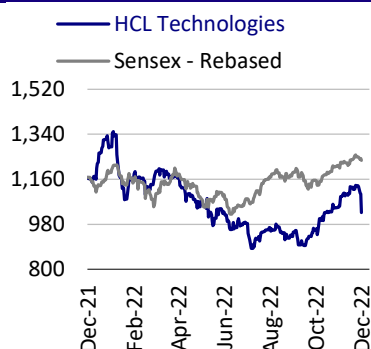
| | | | |
|---------------|------|------|------|
| P/E (x) | 20.6 | 18.9 | 16.6 |
| P/BV (x) | 4.5 | 4.5 | 4.6 |
| EV/EBITDA (x) | 13.5 | 12.2 | 10.7 |
| Div Yield (%) | 4.3 | 4.8 | 5.4 |

Shareholding pattern (%)

| As On | Sep-22 | Jun-22 | Sep-21 |
|----------|--------|--------|--------|
| Promoter | 60.7 | 60.7 | 60.3 |
| DII | 16.5 | 15.6 | 12.5 |
| FII | 17.4 | 18.1 | 22.3 |
| Others | 5.3 | 5.6 | 4.9 |

FII Includes depository receipts

Stock performance (one-year)



CMP: INR1,027 TP: INR1,240 (+21%) BUY

Furlough overhang to hurt FY23E topline growth...

...however, valuations remain attractive; reiterate BUY

We attended HCLT's Investor Day 2022 wherein the management reiterated its five strategic objectives that it laid out in May'22. Management maintained its positive stance on the IT Services and ER&D verticals, and provided its outlook on HCL Software (P&P) business. Though longer term demand remains intact, the management narrowed its growth guidance to the lower end of 13.5-14.5% band due to weaker-than-expected macro, cuts in discretionary spends and higher furloughs. It also aspires the EBIT margin to scale back to 19-20% in the near term. We continue to remain positive on the stock.

Key strategic objectives to drive value creation

- The management reiterated its five strategic objectives laid down in May'22, which it will focus on to create value for all stakeholders:
 - a) Leadership through differentiated services and products: HCLT expects to differentiate its offerings through innovation, Cloud capabilities, integrated solutions, and accelerators.
 - b) Employer of choice in professional services across geographies: It prides itself on being a company of choice for employees.
 - c) Preferred Digital partner for global 2000 enterprises, with 70% of tech spends done by these entities. HCLT will focus on these clients selectively to transform brands at scale.
 - d) ESG is a major focus area of the company, with support at the Board level and a desire to continue to enhance diversity.
 - e) Top quartile TSR over the medium term: The management's focus will be to organically grow the business, while maintaining a high capital allocation and sustainability in growth.

Expect revenue growth to remain strong

- Management narrowed its growth guidance to the lower end of 13.5-14.5% due to weaker-than-expected macro, cuts in discretionary spends and higher furloughs (in BFSI followed by Tech). Despite near-term weakness, the longer term demand for services and ER&D remains intact.
- HCLT has one of the biggest ER&D practices and it is gaining market share in the space (44bp expansion over the last six quarters). The company currently serves ~3% of the market.
- The management suggested that Cloud is the biggest opportunity. By CY25, more than 51% of Enterprises' IT spends will be Cloud-related.
- Vendor consolidation of USD120b is another big opportunity in the next two to five years. HCLT will be one of the biggest beneficiaries of the same.
- About 20% of the tech spends for the industry come from Europe; the management intends to ramp up in Europe to bring it closer to 20% of its revenue v/s 12% currently.
- The company will intensify its focus to cross-sell and up-sell.

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Aspiring strong margin expansion through four margin levers

- HCLT aspires the EBIT margin to scale back to 19-20% in the near term. It shared four margin levers to close the gap:
 1. **Realization:** HCLT is seeing healthy margin for new deals, negotiating in existing deals and optimizing resource deployments to improve realizations.
 2. **Pyramid optimization:** HCLT plans to onboard ~30k freshers in FY23E and might recruit 2x of it in FY24E.
 3. **Operational levers:** Automation, reskilling, improved utilization and moderating attrition to aid margins.
 4. **Right shoring:** Renewed focus on near-shoring and Tier-2 cities in India.

HCL Software (P&P) outlook

- HCL Software (P&P) secures two-thirds of the revenue from support & subscription that is recurring in nature. It is a 24% EBIT margin business (Sep'22 LTM).
- It has reported strong 18% post-tax IIR return and HCLT has already recovered 65% of its investments.
- It has good synergy benefits and helped HCLT to get USD125m ACV mega deal in 2QFY23.
- HCLT has undertaken strategic initiatives such as shifting to XaaS model, evolution of customer success program (will see results in three to six quarters), IP restructuring (will see impact in next quarter) and leveraging the installed base for service expansion (USD1b synergy; large portion already converted in FY23).

Valuations offer a margin of safety; reiterate BUY

- Higher exposure to Cloud, which comprises a larger share of non-discretionary spends, offers a better resilience to its portfolio in the current context, with higher demand for Cloud, Network, Security, and Digital workplace services.
- Strong growth within Services and ER&D, robust headcount addition, healthy deal wins, and a solid pipeline indicate an improved outlook.
- Given its capabilities in the IMS, Digital space and strategic partnerships, as well as investments in Cloud, we expect HCLT to emerge stronger on the back of a likely increase in enterprise demand for these services. The stock is trading at ~17x FY24E EPS, which offers a margin of safety. Our TP of INR1,240 is based on 20x FY24E EPS. We reiterate our **BUY** rating.

Financials and valuations

| Income Statement | | | | | | | (INR b) | |
|------------------------------|------------|------------|------------|------------|------------|------------|--------------|--------------|
| Y/E March | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23E | FY24E |
| Sales | 467 | 506 | 604 | 707 | 754 | 857 | 1,016 | 1,148 |
| Change (%) | 14.2 | 8.2 | 19.5 | 17.0 | 6.7 | 13.6 | 18.6 | 13.0 |
| Cost of Goods Sold | 309 | 332 | 393 | 453 | 467 | 546 | 665 | 744 |
| Gross Profit | 158 | 173 | 212 | 254 | 287 | 311 | 351 | 404 |
| Selling and Admin Exp. | 55 | 59 | 72 | 87 | 93 | 109 | 127 | 144 |
| EBITDA | 103 | 114 | 140 | 167 | 193 | 202 | 224 | 260 |
| As a percentage of Net Sales | 22.1 | 22.6 | 23.1 | 23.6 | 25.6 | 23.6 | 22.1 | 22.7 |
| Depreciation | 8 | 15 | 21 | 28 | 40 | 40 | 41 | 46 |
| EBIT | 95 | 100 | 118 | 139 | 153 | 162 | 183 | 214 |
| As a percentage of Net Sales | 20.3 | 19.8 | 19.6 | 19.6 | 20.4 | 18.9 | 18.0 | 18.7 |
| Other Income | 9 | 11 | 8 | 2 | 7 | 8 | 10 | 6 |
| PBT | 104 | 111 | 126 | 140 | 160 | 170 | 193 | 220 |
| Tax | 23 | 23 | 25 | 29 | 41 | 34 | 47 | 53 |
| Rate (%) | 21.7 | 20.9 | 19.6 | 20.9 | 25.4 | 20.3 | 24.1 | 24.0 |
| PAT | 82 | 88 | 101 | 111 | 119 | 136 | 147 | 167 |
| Net Income | 85 | 88 | 101 | 111 | 119 | 135 | 147 | 167 |
| Change (%) | 13.5 | 3.8 | 15.3 | 9.3 | 7.4 | 13.7 | 8.8 | 13.8 |

| Balance Sheet | | | | | | | (INR b) | |
|--------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Y/E March | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23E | FY24E |
| Reserves | 335 | 368 | 422 | 517 | 615 | 620 | 612 | 604 |
| Net Worth | 335 | 368 | 422 | 517 | 615 | 620 | 612 | 604 |
| Loans | 5 | 4 | 40 | 51 | 39 | 39 | 39 | 39 |
| Other liabilities | 13 | 13 | 15 | 55 | 55 | 43 | 71 | 77 |
| Capital Employed | 353 | 385 | 477 | 623 | 709 | 703 | 722 | 720 |
| Gross Block | 225 | 274 | 335 | 511 | 546 | 560 | 601 | 647 |
| Less: Depreciation | 64 | 78 | 100 | 128 | 168 | 208 | 249 | 295 |
| Net Block | 161 | 196 | 235 | 383 | 378 | 352 | 352 | 352 |
| Other assets | 39 | 40 | 57 | 65 | 69 | 57 | 86 | 94 |
| Investments | 114 | 83 | 55 | 105 | 140 | 85 | 85 | 85 |
| Curr. Assets | 151 | 165 | 243 | 279 | 291 | 397 | 396 | 395 |
| Debtors | 108 | 123 | 146 | 178 | 175 | 207 | 246 | 276 |
| Cash and Bank Balance | 13 | 17 | 59 | 38 | 65 | 105 | 82 | 42 |
| Other Current Assets | 30 | 25 | 37 | 64 | 50 | 85 | 68 | 77 |
| Current Liab. and Prov. | 111 | 99 | 111 | 209 | 168 | 188 | 195 | 204 |
| Net Current Assets | 40 | 66 | 131 | 70 | 123 | 209 | 200 | 191 |
| Application of Funds | 353 | 385 | 477 | 623 | 709 | 703 | 723 | 721 |

Financials and valuations

Ratios

| Y/E March | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23E | FY24E |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Diluted (INR) | | | | | | | | |
| EPS | 28.9 | 31.3 | 36.8 | 40.7 | 43.8 | 49.8 | 54.3 | 61.8 |
| Cash EPS | 32.9 | 36.4 | 44.6 | 51.2 | 58.5 | 64.6 | 69.5 | 78.7 |
| Book Value | 118.6 | 131.4 | 153.5 | 190.4 | 226.7 | 228.6 | 226.2 | 222.9 |
| DPS | 12.0 | 6.0 | 4.0 | 8.0 | 26.0 | 44.0 | 48.8 | 55.6 |
| Payout (%) | 41.6 | 23.1 | 50.4 | 19.6 | 59.4 | 88.3 | 90.0 | 90.0 |
| Valuation (x) | | | | | | | | |
| P/E | 35.6 | 32.8 | 27.9 | 25.2 | 23.5 | 20.6 | 18.9 | 16.6 |
| Cash P/E | 31.2 | 28.2 | 23.0 | 20.1 | 17.6 | 15.9 | 14.8 | 13.0 |
| EV/EBITDA | 28.0 | 25.1 | 20.1 | 16.8 | 14.3 | 13.5 | 12.2 | 10.7 |
| EV/Sales | 6.2 | 5.7 | 4.6 | 4.0 | 3.7 | 3.2 | 2.7 | 2.4 |
| Price/Book Value | 8.7 | 7.8 | 6.7 | 5.4 | 4.5 | 4.5 | 4.5 | 4.6 |
| Dividend Yield (%) | 1.2 | 0.6 | 0.4 | 0.8 | 2.5 | 4.3 | 4.8 | 5.4 |
| Profitability Ratios (%) | | | | | | | | |
| RoE | 26.5 | 25.0 | 25.6 | 23.6 | 21.0 | 21.9 | 23.9 | 27.5 |
| RoCE | 23.6 | 22.2 | 22.8 | 21.3 | 18.7 | 19.6 | 21.2 | 25.1 |
| Turnover Ratios | | | | | | | | |
| Debtors (Days) | 84 | 88 | 88 | 92 | 85 | 88 | 88 | 88 |
| Asset Turnover (x) | 2.9 | 2.6 | 2.6 | 1.8 | 2.0 | 2.4 | 2.9 | 3.3 |

Cash Flow Statement

| Y/E March | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23E | FY24E |
|-----------------------------|------------|------------|------------|-------------|-------------|-------------|-------------|-------------|
| (INR b) | | | | | | | | |
| CF from Operations | 90 | 102 | 123 | 149 | 166 | 174 | 188 | 213 |
| Chg. in Working Capital | 5 | -35 | -34 | -16 | 30 | -5 | -17 | -31 |
| Net Operating CF | 95 | 68 | 88 | 134 | 196 | 169 | 172 | 182 |
| Net Purchase of FA | -62 | -49 | -61 | -18 | -18 | -16 | -41 | -46 |
| Net Purchase of Invest. | -2 | 30 | 29 | -105 | -40 | 30 | 0 | 0 |
| Net Cash from Inv. | -64 | -19 | -32 | -124 | -57 | 15 | -40 | -46 |
| Issue of shares/other adj. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Proceeds from LTB/STB | 9 | -1 | 35 | -15 | -79 | -31 | 0 | 0 |
| Dividend Payments | -34 | -20 | -51 | -16 | -33 | -114 | -155 | -176 |
| Net CF from Finan. | -25 | -21 | -16 | -32 | -112 | -145 | -155 | -176 |
| Free Cash Flow | 33 | 18 | 28 | 115 | 179 | 153 | 131 | 136 |
| Net Cash Flow | 6 | 27 | 41 | -22 | 27 | 39 | -23 | -40 |
| Forex difference | 0 | -27 | 5 | 0 | 1 | 1 | 0 | 0 |
| Opening Cash Balance | 7 | 13 | 13 | 60 | 38 | 66 | 106 | 82 |
| Closing Cash Balance | 13 | 13 | 60 | 38 | 66 | 106 | 82 | 43 |

NOTES

| Explanation of Investment Rating | |
|----------------------------------|--|
| Investment Rating | Expected return (over 12-month) |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | > - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

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