

BUY

HCL Tech

Emkay[®]

Your success is our success

Software business seasonality drives outperformance

Information Technology ▶ Result Update ▶ January 13, 2024

TARGET PRICE (Rs): 1,700

HCLT logged a strong operating performance in Q3, aided by its software business. Revenue grew 6% CC QoQ, led by seasonal strength in software (up 32%) and a healthy 3.1% growth in services, propped by the Verizon deal ramp-up and an incremental 2-month contribution from ASAP. EBITM expanded by 130bps QoQ, supported by software business seasonality. Net new-deal intake remained healthy at USD1.9bn in Q3. HCLT has narrowed its overall FY24 revenue growth guidance to 5-5.5% CC (5-6% earlier), implying 0.3-2.1% QoQ revenue growth in Q4; it retains its EBITM guidance at 18-19%. This points to 1.6-3.5% QoQ growth in services, with mgmt target of delivering near the upper end of its guidance. HCLT is not seeing any major uptick in discretionary spend in IT services, but some green shoots are visible in ER&D, along with resilient tech spending in cloud migration, SAP migration, core & data modernization, cyber security, automation, and advance analytics. We tweak FY24-26E EPS by -1.2% to 0.6%, factoring-in the Q3 performance and divestment of stake in its JV with State Street. We retain BUY and TP at Rs1,700, at 23x Dec-25E EPS.

HCL Tech: Financial Snapshot (Consolidated)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	8,56,510	10,14,560	10,99,371	12,11,131	13,42,216
EBITDA	2,05,300	2,26,280	2,43,356	2,69,218	2,99,680
Adj. PAT	1,34,990	1,48,510	1,58,705	1,81,043	2,03,500
Adj. EPS (Rs)	49.7	54.7	58.5	66.7	75.0
EBITDA margin (%)	24.0	22.3	22.1	22.2	22.3
EBITDA growth (%)	(1.2)	10.2	7.5	10.6	11.3
Adj. EPS growth (%)	21.1	10.0	6.9	14.1	12.4
RoE (%)	22.2	23.3	23.7	25.5	26.8
RoIC (%)	28.6	30.7	33.0	37.5	42.4
P/E (x)	31.0	28.2	26.3	23.1	20.5
EV/EBITDA (x)	19.6	17.7	16.3	14.5	12.9
P/B (x)	6.8	6.4	6.1	5.7	5.3
FCFF yield (%)	3.7	4.0	4.0	4.5	4.9

Source: Company, Emkay Research

Results Summary

HCLT's revenue grew 5.9% QoQ (6% QoQ/4.3% YoY in CC terms) to USD3.41bn, at a slight beat to our estimates. IT & Business Services grew 1.9% QoQ, while ER&D Services saw a sharp 8.7% QoQ growth (aided by an incremental two-month contribution by the ASAP acquisition; organic: 2.5%). Software revenue grew 32% QoQ on the back of seasonality. While Services revenue growth was a tad below, Software revenue came ahead of our expectations leading to an overall revenue beat. EBITM expanded by ~130bps QoQ to 19.7%, above our estimates of 19.1%, supported by software seasonality (up 180bps) and currency benefits (up 15bps) negating wage hikes for ~90% of the employee-base (down by 65bps). HCL Tech signed 18 large deals—six in Services and 12 in Software—with total new-deal wins worth USD1.9bn. Among geographies, USA and Europe reported growth of 3.1% and 5% QoQ (CC), respectively, while ROW revenue declined 5.3% QoQ due to higher number of furloughs and select project ramp-downs. Five of the seven verticals reported sequential growth, while Financial Services and Life Sciences clocked a decline. Headcount increased 1.6% QoQ to 224,756, after two quarters of decline. The company declared a dividend of Rs12 per share. **What we liked:** Operating performance beat, healthy deal intake, further moderation in LTM attrition to 12.8%. **What we did not like:** Poor cash conversion (57% OCF/ EBITDA).

Earnings Call KTAs

i) Company is not seeing an uptick in discretionary spend, but some portion of the tech spends (like cloud migration, SAP, data modernization, cybersecurity, automation and advanced analytics) remain resilient. ii) Gen AI holds immense potential and near-term programs in this segment are likely to be small, albeit expected to become sizable in the next 2-3 quarters. HCLT has signed 31 deals in Gen AI, most of which are valued at sub-USD1mn. iii) Reversal of furloughs, one additional month of the Verizon deal ramp-up, other large-deal ramp-ups, and continued momentum in ER&D are likely to drive growth in Services revenue in Q4, thus negating seasonal weakness in the software business. iv) The management expects some furloughs in the APAC region in Q4 as well. v) Financial Services declined 1.3% QoQ, impacted by the higher number of furloughs. vi) The telecom vertical grew 25.9% (CC) QoQ, backed by the Verizon deal, and contributed 2/3rds of incremental Services revenue in Q3. vii) The management remains confident of achieving its medium-term EBITM goal of 19-20%. viii) HCLT rolled out wage hikes for ~90% of its employee-base in Q3, with average pay hike of 5-7%. This wage hike is expected to impact margin by 20-25bps in Q4. ix) DSO (incl. unbilled) was 86 days, hit QoQ by the seasonality in the software business.

Target Price – 12M	Dec-24
Change in TP (%)	-
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	10.3
CMP (12-Jan-24) (Rs)	1,540.8

Stock Data	Ticker
52-week High (Rs)	1,555
52-week Low (Rs)	1,016
Shares outstanding (mn)	2,713.7
Market-cap (Rs bn)	4,181
Market-cap (USD mn)	50,425
Net-debt, FY24E (Rs mn)	0
ADTV-3M (mn shares)	2
ADTV-3M (Rs mn)	3,377.6
ADTV-3M (USD mn)	40.7
Free float (%)	39.0
Nifty-50	21,895
INR/USD	82.9
Shareholding, Sep-23	
Promoters (%)	60.8
FPIs/MFs (%)	18.8/15.7

Price Performance

(%)	1M	3M	12M
Absolute	12.0	25.9	43.8
Rel. to Nifty	7.0	13.8	17.3

1-Year share price trend (Rs)



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Exhibit 1: Quarterly snapshot

(Rs mn)	Q3 FY24	Q2 FY24	QoQ (%)	Q3 FY23	YoY (%)
Net sales (USD mn)	3,415	3,225	5.9	3,244	5.3
Net sales	2,84,460	2,66,720	6.7	2,67,000	6.5
Operating expenses	2,16,880	2,07,280	4.6	2,03,350	
EBITDA	67,580	59,440	13.7	63,650	6.2
Margins (%)	23.8	22.3	150	23.8	-10.0
Depreciation	11,430	10,100		11,360	
EBIT	56,150	49,340	13.8	52,290	7.4
Margins (%)	19.7	18.5	120	19.6	20.0
Other income	2,590	1,940		1,440	
Pre-tax profit	58,740	51,280	14.5	53,730	
Tax provided	15,230	12,950		12,760	
Profit after tax	43,510	38,330	13.5	40,970	6.2
Emkay Net profit	43,510	38,330	13.5	40,970	6.2
EPS (Rs)	16.0	14.1	13.5	15.1	6.2

Source: Company, Emkay Research

Exhibit 2: Changes in estimates

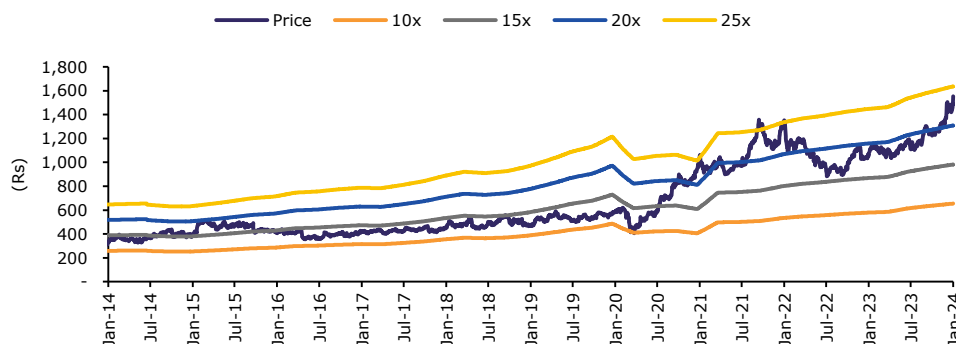
(Rs mn)	FY24E			FY25E			FY26E		
	Old	New	% change	Old	New	% change	Old	New	% change
Revenue (USD mn)	13,267	13,276	0.1	14,513	14,418	-0.7	15,897	15,791	-0.7
YoY growth	5.4%	5.5%		9.4%	8.6%		9.5%	9.5%	
Revenue	10,98,601	10,99,371	0.1	12,19,058	12,11,131	-0.7	13,51,279	13,42,216	-0.7
EBIT	1,99,711	2,02,332	1.3	2,29,604	2,26,020	-1.6	2,55,507	2,53,495	-0.8
EBIT margin (%)	18.2	18.4		18.8	18.7		18.9	18.9	
Net profit	1,57,709	1,58,705	0.6	1,83,252	1,81,043	-1.2	2,04,501	2,03,500	-0.5
EPS (Rs)	58.1	58.5	0.6	67.5	66.7	-1.2	75.4	75.0	-0.5

Source: Company, Emkay Research

Exhibit 3: Actuals vs estimates

(Rs mn)	Actual	Estimate		% variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenue (USD mn)	3,415	3,395	3,374	0.6%	1.2%	Revenue beat estimates due to software business outperformance.
Sales	2,84,460	2,82,782	2,81,063	0.6%	1.2%	
EBIT	56,150	53,873	53,402	4.2%	5.1%	Margin beat estimates on the back of the software business.
EBIT margin	19.7%	19.1%	19.0%	70 bps	70 bps	
PAT	43,510	42,765	41,878	1.7%	3.9%	Profit came ahead of estimates due to operating performance beat.

Source: Company, Bloomberg, Emkay Research

Exhibit 4: HCL – One year forward P/E

Source: Company, Emkay Research

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HCL Tech: Consolidated Financials and Valuations

Profit & Loss

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	8,56,510	10,14,560	10,99,371	12,11,131	13,42,216
Revenue growth (%)	13.6	18.5	8.4	10.2	10.8
EBITDA	2,05,300	2,26,280	2,43,356	2,69,218	2,99,680
EBITDA growth (%)	(1.2)	10.2	7.5	10.6	11.3
Depreciation & Amortization	43,260	41,450	41,024	43,198	46,186
EBIT	1,62,040	1,84,830	2,02,332	2,26,020	2,53,495
EBIT growth (%)	0.2	14.1	9.5	11.7	12.2
Other operating income	0	0	0	0	0
Other income	4,280	6,520	10,413	16,990	19,660
Financial expense	(3,190)	(3,530)	0	0	0
PBT	1,69,510	1,94,880	2,12,745	2,43,011	2,73,155
Extraordinary items	0	0	0	0	0
Taxes	34,280	46,430	54,050	61,968	69,655
Minority interest	(240)	60	10	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	1,34,990	1,48,510	1,58,705	1,81,043	2,03,500
PAT growth (%)	21.1	10.0	6.9	14.1	12.4
Adjusted PAT	1,34,990	1,48,510	1,58,705	1,81,043	2,03,500
Diluted EPS (Rs)	49.7	54.7	58.5	66.7	75.0
Diluted EPS growth (%)	21.1	10.0	6.9	14.1	12.4
DPS (Rs)	44.0	48.0	46.0	50.0	56.0
Dividend payout (%)	88.5	87.7	78.7	74.9	74.7
EBITDA margin (%)	24.0	22.3	22.1	22.2	22.3
EBIT margin (%)	18.9	18.2	18.4	18.7	18.9
Effective tax rate (%)	20.2	23.8	25.4	25.5	25.5
NOPLAT (pre-IndAS)	1,29,271	1,40,794	1,50,927	1,68,385	1,88,853
Shares outstanding (mn)	2,713.7	2,713.7	2,713.7	2,713.7	2,713.7

Source: Company, Emkay Research

Cash flows

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	1,69,510	1,94,880	2,12,745	2,43,011	2,73,155
Others (non-cash items)	73,810	81,592	41,034	43,198	46,186
Taxes paid	(34,280)	(46,430)	(54,050)	(61,968)	(69,655)
Change in NWC	(39,183)	(49,899)	(8,133)	(14,391)	(16,879)
Operating cash flow	1,69,127	1,80,143	1,91,596	2,09,850	2,32,807
Capital expenditure	(15,592)	(14,430)	(23,244)	(21,229)	(28,900)
Acquisition of business	(746)	(9,109)	0	0	0
Interest & dividend income	5,900	6,360	6,360	6,360	6,360
Investing cash flow	14,697	(39,742)	(58,774)	(21,229)	(28,900)
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	(4,325)	(18,863)	9,910	9,270	9,270
Payment of lease liabilities	(10,670)	(9,270)	(9,270)	(9,270)	(9,270)
Interest paid	3,190	3,530	0	0	0
Dividend paid (incl tax)	(1,22,051)	(1,30,109)	(1,24,829)	(1,35,683)	(1,51,965)
Others	(10,078)	(138)	0	0	0
Financing cash flow	(1,43,934)	(1,54,851)	(1,24,189)	(1,35,683)	(1,51,965)
Net chg in Cash	39,890	(14,450)	8,633	52,937	51,941
OCF	1,69,127	1,80,143	1,91,596	2,09,850	2,32,807
Adj. OCF (w/o NWC chg.)	2,09,040	2,30,042	1,99,728	2,24,241	2,49,686
FCFF	1,53,535	1,65,713	1,68,351	1,88,620	2,03,906
FCFE	1,62,625	1,75,603	1,74,711	1,94,980	2,10,266
OCF/EBITDA (%)	82.4	79.6	78.7	77.9	77.7
FCFE/PAT (%)	120.5	118.2	110.1	107.7	103.3
FCFF/NOPLAT (%)	118.8	117.7	111.5	112.0	108.0

Source: Company, Emkay Research

Balance Sheet

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	5,427	5,427	5,427	5,427	5,427
Reserves & Surplus	6,13,713	6,48,623	6,82,499	7,27,858	7,79,393
Net worth	6,19,140	6,54,050	6,87,926	7,33,286	7,84,821
Minority interests	920	(70)	(70)	(70)	(70)
Deferred tax liability (net)	(10,641)	(10,908)	(10,920)	(10,920)	(10,920)
Total debt	65,790	47,860	48,500	48,500	48,500
Total liabilities & equity	6,75,209	6,90,932	7,25,436	7,70,796	8,22,331
Net tangible fixed assets	57,410	54,110	53,282	43,216	37,869
Net intangible assets	95,940	81,903	67,164	52,566	38,367
Net ROU assets	23,050	23,370	25,000	25,000	25,000
Capital WIP	0	0	0	0	0
Goodwill	1,94,990	1,90,987	1,87,145	1,89,840	1,92,100
Investments [JV/Associates]	0	0	0	0	0
Cash & equivalents	2,19,950	2,28,220	2,72,383	3,25,320	3,77,261
Current assets (ex-cash)	2,87,230	3,43,000	3,64,449	4,01,498	4,44,954
Current Liab. & Prov.	2,03,361	2,30,658	2,43,986	2,66,644	2,93,220
NWC (ex-cash)	83,869	1,12,342	1,20,463	1,34,854	1,51,733
Total assets	6,75,209	6,90,932	7,25,436	7,70,796	8,22,331
Net debt	(1,54,160)	(1,80,360)	(2,23,883)	(2,76,820)	(3,28,761)
Capital employed	6,75,209	6,90,932	7,25,436	7,70,796	8,22,331
Invested capital	4,55,259	4,62,712	4,53,053	4,45,476	4,45,070
BVPS (Rs)	228.2	241.0	253.5	270.2	289.2
Net Debt/Equity (x)	(0.2)	(0.3)	(0.3)	(0.4)	(0.4)
Net Debt/EBITDA (x)	(0.8)	(0.8)	(0.9)	(1.0)	(1.1)
Interest coverage (x)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	25.0	28.0	30.0	32.5	34.3

Source: Company, Emkay Research

Valuations and key Ratios

Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	31.0	28.2	26.3	23.1	20.5
P/CE (x)	23.5	22.0	20.9	18.6	16.7
P/B (x)	6.8	6.4	6.1	5.7	5.3
EV/Sales (x)	4.7	3.9	3.6	3.2	2.9
EV/EBITDA (x)	19.6	17.7	16.3	14.5	12.9
EV/EBIT(x)	24.9	21.6	19.6	17.3	15.2
EV/IC (x)	8.8	8.6	8.7	8.8	8.7
FCFF yield (%)	3.7	4.0	4.0	4.5	4.9
FCFE yield (%)	3.9	4.2	4.2	4.7	5.0
Dividend yield (%)	2.9	3.1	3.0	3.2	3.6
DuPont-RoE split					
Net profit margin (%)	15.8	14.6	14.4	14.9	15.2
Total asset turnover (x)	1.3	1.5	1.6	1.6	1.7
Assets/Equity (x)	1.1	1.1	1.1	1.1	1.0
RoE (%)	22.2	23.3	23.7	25.5	26.8
DuPont-RoIC					
NOPLAT margin (%)	15.1	13.9	13.7	13.9	14.1
IC turnover (x)	1.9	2.2	2.4	2.7	3.0
RoIC (%)	28.6	30.7	33.0	37.5	42.4
Operating metrics					
Core NWC days	35.7	40.4	40.0	40.6	41.3
Total NWC days	35.7	40.4	40.0	40.6	41.3
Fixed asset turnover	2.3	2.8	3.2	3.8	4.4
Opex-to-revenue (%)	76.0	77.7	77.9	77.8	77.7

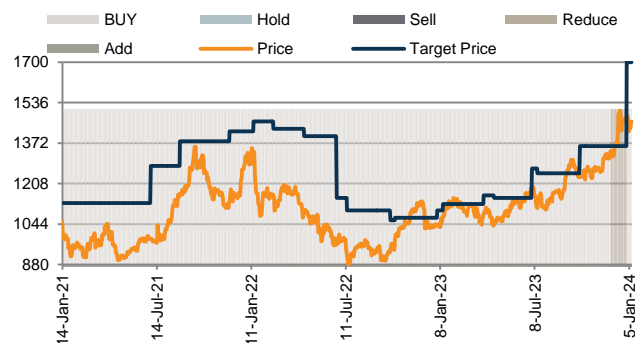
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
31-Dec-23	1,466	1,700	Buy	Dipeshkumar Mehta
30-Nov-23	1,341	1,360	Reduce	Dipeshkumar Mehta
13-Oct-23	1,256	1,360	Buy	Dipeshkumar Mehta
02-Oct-23	1,235	1,360	Buy	Dipeshkumar Mehta
13-Jul-23	1,109	1,250	Buy	Dipeshkumar Mehta
02-Jul-23	1,188	1,270	Buy	Dipeshkumar Mehta
21-Apr-23	1,049	1,150	Buy	Dipeshkumar Mehta
01-Apr-23	1,085	1,160	Buy	Dipeshkumar Mehta
13-Jan-23	1,078	1,125	Buy	Dipeshkumar Mehta
02-Jan-23	1,039	1,100	Buy	Dipeshkumar Mehta
13-Oct-22	982	1,070	Buy	Dipeshkumar Mehta
04-Oct-22	946	1,060	Buy	Dipeshkumar Mehta
13-Jul-22	918	1,100	Buy	Dipeshkumar Mehta
23-Jun-22	971	1,150	Buy	Dipeshkumar Mehta
12-May-22	1,059	1,400	Buy	Dipeshkumar Mehta
22-Apr-22	1,102	1,400	Buy	Dipeshkumar Mehta
01-Apr-22	1,170	1,430	Buy	Dipeshkumar Mehta
22-Feb-22	1,150	1,430	Buy	Dipeshkumar Mehta
15-Jan-22	1,337	1,460	Buy	Dipeshkumar Mehta
01-Jan-22	1,319	1,420	Buy	Dipeshkumar Mehta
30-Nov-21	1,139	1,420	Buy	Dipeshkumar Mehta
15-Oct-21	1,251	1,380	Buy	Dipeshkumar Mehta
02-Oct-21	1,274	1,380	Buy	Dipeshkumar Mehta
27-Aug-21	1,163	1,380	Buy	Dipeshkumar Mehta
20-Jul-21	977	1,280	Buy	Dipeshkumar Mehta
02-Jul-21	985	1,280	Buy	Dipeshkumar Mehta
24-Apr-21	956	1,130	Buy	Dipeshkumar Mehta
05-Apr-21	1,034	1,130	Buy	Dipeshkumar Mehta
18-Mar-21	948	1,130	Buy	Dipeshkumar Mehta
15-Jan-21	990	1,130	Buy	Dipeshkumar Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Company, Bloomberg, Emkay Research

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