

CMP: ₹ 1,578

Target: ₹ 1,600 (1%)

Target Period: 12 months

HOLD

July 15, 2024

Soft quarter; recovery likely in H2...

About the stock: HCL Technologies (HCLTech) is a global technology company, employing 219,000+ people across 60 countries, delivering industry-leading capabilities centered around digital, engineering, cloud and AI, powered by a broad portfolio of technology services and products.

Q1FY25 Performance: HCL Tech reported revenue of US\$ 3,364 mn (₹28,057 crore), down 1.6% QoQ & up 5.6% YoY) in CC terms, with sequential decline owing to large deal off-shoring, on expect lines. The EBIT margins at 17.1%, down 50 bps QoQ, largely owing to lower ER&D revenues.

Investment Rationale

- **Revenues to witness recovery ahead:** Notwithstanding 80-bps impact from the State Street divestiture on the overall revenues, it expects a sequential growth in Q2 across segments (barring BFSI) and geographies. Nonetheless, headwinds from the BFSI (discretionary demand led) coupled with impact of ASAP acquisition not contributing meaningfully to the topline continue to pose a near term challenge for the company. **The company has maintained its guidance for 3-5% YoY revenue growth in CC terms and 18-19% margin growth in FY25. We believe the company's revenue will grow at CAGR of 7.2% between FY24-26E, compared to CAGR of 12.7% between FY19-24. We also bake in steady margins recovery and expect EBIT margins of 18.1%/19.2% in FY25/26.**
- **GenAI - a leading driver for medium to long term growth:** The GenAI & automation platform "HCLTech AI Force" (for efficiency improvement projects) along with HCLTech Enterprise AI Foundry (for innovation-based projects) are expected to be key differentiation and growth drivers in the medium to long term. **Currently the company has two double digit million-dollar ongoing engagements in the GenAI segment.** Furthermore, every major product and service is now embedded and infused with AI/GenAI capabilities.
- **Soft TCV: Deal wins acceleration required for medium term growth:** Overall, the TCV this quarter has been soft at US\$1.96 bn (down 14% QoQ), similar to its peers. Going forward, accelerated deal wins are required for medium term growth (including FY26). **Considering HCLTech's diversified presence across various segments, we expect broad based growth once the macroeconomic factors favour discretionary based spending from clients.**

Rating and Target Price

- While we expect earnings growth of ~7.3% over FY24-26, HCL diversified portfolio and increased traction for its GenAI platforms remains a key catalyst of its long-term growth.
- We assign **HOLD** rating on the stock and value it at **target price of ₹ 1,600; at 24x P/E on FY26E EPS.**

Key Financial Summary

Key Financials	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	2 year CAGR FY(24-26E)
Net Sales	85,651	1,01,456	1,09,913	12.7	1,15,183	1,26,337	7.2
EBITDA	20,041	22,628	24,200	11.6	25,197	28,999	9.5
Margins (%)	23.4	22.3	22.0		21.9	23.0	
Net Profit	13,516	14,851	15,702	5.8	16,726	18,074	7.3
EPS (₹)	49.8	54.8	57.9		61.6	66.6	
P/E	31.7	28.8	27.3		25.6	23.7	
RoNW (%)	21.8	22.7	23.0		23.4	24.0	
RoCE (%)	24.2	27.1	27.2		26.4	27.2	

Source: Company, ICICI Direct Research



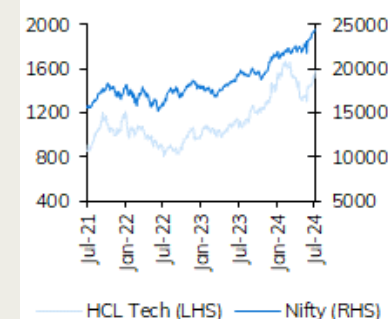
Particulars

Particular	Amount
Market Cap (₹ Crore)	4,28,216.4
Total Debt (₹ Crore)	2,223.0
CC&E (₹ Crore)	27,193.0
EV (₹ Crore)	4,03,246.4
52 week H/L	1697 / 1087
Equity capital	543.0
Face value (₹)	2.0

Shareholding pattern

	Jun-23	Sep-23	Dec-23	Mar-24
Promoters	60.8	60.8	60.8	60.8
FII	19.0	18.8	19.4	19.6
DII	15.4	15.7	15.2	15.0
Public	4.8	4.7	4.6	4.6

Price Chart



Key risks

- Delay in synergy benefits from ASAP acquisition
- Better than expected growth

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Performance highlights and Outlook

- Revenue Performance:** HCLTech reported revenue of US\$ 3,364 mn, down 1.9% QoQ & up 5.1% YoY (in CC terms down 1.6% QoQ & up 5.6% YoY). In rupee terms it reported revenue of ₹28,057, down 1.6% QoQ & up 6.7% YoY. **The services business declined 1.9% sequentially but grew 5.8% YoY in CC terms owing to a large deal offshoring impact.** This quarter, growth was led by the Software segment which grew 0.4% sequentially and 3.5% YoY in CC terms with an annual recurring revenue of US\$ 1.01 bn. The IT services and ER&D business reported a decline of 1.5% and 3.5% QoQ in CC terms respectively.
- State Street divestiture impact:** The company reported a higher other income of US\$ 118 mn this quarter (vs US\$ 39 mn in Q1FY24) due to HCL Technologies' step-down wholly-owned subsidiary HCL Investments UK divesting its entire 49% holding in a JV with State Street. It is expected to have 80 bps impact on the overall revenues and a 90-bps impact on the service revenue in Q2. US\$ 70 mn was recognised as other income in this quarter and the remaining US\$ 170 mn consideration is expected in the next quarter.
- Margin performance:** On the margins front, **EBIT margin stood at 17.1%, down 50 bps QoQ due to headwinds from Q1 being a seasonally soft quarter for the company, ~51 bps from a QoQ drop of 3.5% (in CC terms) in the ER&D revenues in the services segment which has impacted the overall margins** while the revenue impact due to decline in annual productivity was offset by efficiencies in business and a 10bps positive exchange benefit. The company's PAT margin stood at 15.2%, up 120 bps QoQ/180 bps YoY.
- Geography performance:** Geography wise on a QoQ basis in US\$ terms Americas (66% of mix) & Europe (27.9% of mix) declined by 0.7% & 5.3% respectively while ROW (6.1% of mix) reported a growth of 1.4%.
- Segment performance:** Segment wise on QoQ basis in US\$ terms, growth was led by TMPE – enabled by the Verizon deal (12.2% of mix), Tech & Services (13% of mix), Public Services (9.1% of mix) and Retail & CPG (9.4% of mix) which grew by 4%, 3.7%, 1.4% & 1.3% respectively while Manufacturing (19.4% of mix), Financial Services (21% of mix) and Lifesciences (15.9% of mix), declined by 6.7%, 4.6% & 4.3% respectively.
 - **BFSI segment:** This quarter was largely impacted by the large deal offshoring and the State Street divestiture. The segment is expected to grow in H2FY25, once the impact of the State Street divestiture (~80 bps) is absorbed in Q2.
 - **Manufacturing segment:** The segment is expected to grow Q2 onwards enabled by the ASAP recovery. While the ASAP acquisition has not contributed meaningfully to the topline in Q1, a turnaround is expected in Q2. Further, the management expects the automotive segment to be stressed, especially in Germany which saw ramp down in certain deals as EV-related investments are being deprioritized due to economic pressures.
- Deal Wins:** HCLTech during Q1FY25 won TCV deals worth US\$ 1,960 mn, down 14% QoQ but up 25% YoY. The management mentioned that there is no meaningful change in the demand environment from the last quarter as the discretionary spending environment continues to be weak.
- AI/GenAI:** The company is seeing a lot of opportunities in the AI/GenAI space and their GenAI & automation platform "HCLTech AI Force" (for efficiency improvement projects) along with HCLTech Enterprise AI Foundry (for innovation-based projects) are expected to be key differentiation and growth drivers. Currently the company has two double digit million-dollar ongoing engagements in the GenAI segment. **The company aims to train 50K employees in this FY on Gen AI skills, of which 33% of the target has already been achieved** in this quarter. Moreover, every major product and service is now embedded and infused

with AI/GenAI capabilities and the Company is collaborating with clients on several GenAI POCs (~200) which are expected to scale up in the near term.

- **HCLtech AI Force** - Initial AI Force implementations for efficiency led projects are underway. Expected cost savings include up to 50% in outsourcing costs and productivity gains of 10-30% with tools like GitHub Copilot.
- **HCLtech Enterprise AI Foundry** - The Enterprise AI Foundry is aligned with tech OEMs like Dell & HPG. It leverages internal data for GenAI & innovation and is recognized by hyperscalers for infra creation.
- **Revenue and Margin Guidance/Aspiration:** The management for FY25 maintained its revenue growth and service revenue growth guidance in the range of 3-5% YoY in CC terms while the margins are expected to be within the previously guided margin band of 18-19%. All verticals (barring financial services) and geographies are expected to grow sequentially in Q2. The company expects growth in Q2 over Q1 despite an impact of -80bps on financial services revenues from the State Street JV divestiture in Q2 and some impact from the HPE acquisition. The company expresses confidence in achieving growth despite challenges on the back of increased client spend on GenAI & other emerging technologies and its strong operational execution.
- **Attrition & Employee addition:** The attrition rate during the quarter expanded by 40 bps QoQ / declined by 350bps YoY to 12.8%. The company's headcount reduced by ~8K employees, largely due to the State Street JV exit, bringing the total employee headcount to 2,19,401. This decline included ~7,398 employees lost because of the divestiture. HCLTech onboarded 1,078 freshers and plans to add 10,000 freshers during FY25.
- **Dividend:** The Company declared an interim dividend of ₹12 per share This marks the company's 86th consecutive quarter of dividend pay-out.

Exhibit 1: Quarter Performance

	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)	Comments
Revenue (US\$ mn)	336	320	5.1	343	-1.9	In CC terms, revenue declined by 1.6% QOQ and grew by 5.6% YoY
Revenue (₹ crore)	28,057	26,296	6.7	28,499	-1.6	In CC terms, Software business reported growth of 0.4% QoQ while IT services and ER&D revenue declined by 1.5% & 3.5% QoQ
Cost of sales (including employee expenses)	18,771	17,330	8.3	18,962	-1.0	
Gross Margin	9,286	8,966	3.6	9,537	-2.6	
Gross margin (%)	33.1	34.1	-100 bps	33.5	-37 bps	
Selling & marketing costs	3,492	3,579	-2.4	3,426	1.9	
EBITDA	5,794	5,387	7.6	6,111	-5.2	
EBITDA Margin (%)	20.7	20.5	16 bps	21.4	-79 bps	
Depreciation	998	927	7.7	1,093	-8.7	
EBIT	4,796	4,460	7.5	5,018	-4.4	
EBIT Margin (%)	17.1	17.0	13 bps	17.6	-51 bps	Negative impact of ~51 bps from QoQ drop of 3.5% (in CC terms) in ER&D revenues in services segment which has impacted the overall margins while the revenue impact due to decline in annual productivity was offset by efficiencies in business & a 10bps positive exchange benefit.
Other income	912	236	286.4	251	263.3	
PBT	5,708	4,696	21.6	5,269	8.3	
Tax paid	1,448	1,165	24.3	1,274	13.7	
PAT	4,258	3,534	20.5	3,986	6.8	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement					₹ crore
Year-end March	FY23	FY24	FY25E	FY26E	
Total operating Income	1,01,456	1,09,913	1,15,183	1,26,337	
Growth (%)	18.5	8.3	4.8	9.7	
Direct costs	66,155	72,125	75,690	81,799	
S,G&A expenses	12,673	13,588	14,296	15,539	
Total Operating Expenditure	78,828	85,713	89,986	97,338	
EBITDA	22,628	24,200	25,197	28,999	
Growth (%)	12.9	6.9	4.1	15.1	
Depreciation	4,145	4,173	4,352	4,772	
Amortisation	-	-	-	-	
Net Other Income	1,005	940	1,512	(128)	
PBT	19,488	20,967	22,356	24,098	
Forex adjustments	-	-	-	-	
Total Tax	4,643	5,257	5,630	6,025	
PAT	14,851	15,702	16,726	18,074	
Growth (%)	9.9	5.7	6.5	8.1	
EPS (₹)	54.8	57.9	61.6	66.6	
EPS (₹)	54.8	57.9	61.6	66.6	

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement					₹ crore
Year-end March	FY23	FY24	FY25E	FY26E	
PBT	19,488	20,967	22,356	24,098	
Depreciation & Amortisation	4,145	4,173	4,352	4,772	
(Inc)/dec in Current Assets	(2,360)	472	(97,753)	(12,578)	
Inc/(dec) in CL and Provisions	1,055	1,833	74,028	9,525	
Taxes paid	(3,698)	(4,212)	(5,630)	(6,025)	
CF from operating activities	18,009	22,448	(4,158)	19,921	
(Inc)/dec in Investments	(1,788)	(3,669)	1,512	(128)	
(Inc)/dec in Fixed Assets	(1,444)	(1,016)	(2,304)	(2,527)	
CF from investing activities	(3,931)	(6,723)	(792)	(2,655)	
Issue/(Buy back) of Equity	-	-	-	-	
Inc/(dec) in loan funds	(1,848)	(181)	(500)	(500)	
Dividend paid & dividend tax	(12,995)	(14,073)	(13,381)	(14,459)	
Inc/(dec) in debentures	-	-	-	-	
Others	(1,007)	(1,212)	-	-	
CF from financing activities	(15,881)	(15,464)	(13,881)	(14,959)	
Net Cash flow	(1,803)	261	(18,831)	2,308	
Exchange difference	358	130	-	-	
Opening Cash	10,510	9,065	9,456	(9,375)	
Cash & bank c/f to balance sheet	9,065	9,456	(9,375)	(7,067)	

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet					₹ crore
Year-end March	FY23	FY24	FY25E	FY26E	
Liabilities					
Equity Capital	543	543	543	543	
Reserve and Surplus	64,862	67,720	71,065	74,680	
Total Shareholders funds	65,405	68,263	71,608	75,223	
Total Debt	2,111	2,223	1,723	1,223	
Other liabilities+Provisions	4,471	6,557	11,460	12,091	
Minority Interest / Others	(7)	8	8	8	
Total Liabilities	71,980	77,051	84,799	88,545	
Assets					
Net Block+ CWIP	7,748	7,909	6,948	5,896	
Intangible assets+ Goodwill	26,911	27,262	26,174	24,981	
Investments	110	94	94	94	
Liquid investments	5,385	7,043	7,043	7,043	
Inventory	228	185	748	820	
Debtors	19,572	19,483	78,744	86,369	
Loans and Advances	2,603	795	3,213	3,524	
Other Current Assets	11,065	11,675	47,186	51,756	
Cash & Bank	14,724	20,150	1,319	3,627	
Total Current Assets	53,577	59,331	1,38,253	1,53,138	
Total Current Liabilities	21,431	22,726	91,851	1,00,745	
Net Current Assets	32,146	36,605	46,402	52,393	
Other non current assets	5,065	5,181	5,181	5,181	
Application of Funds	71,980	77,051	84,799	88,545	

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios				
Year-end March	FY23	FY24	FY25E	FY26E
Per share data (₹)				
EPS	54.8	57.9	61.6	66.6
Cash EPS	70.0	73.2	77.7	84.2
BV	241.2	251.6	263.9	277.2
DPS	48.0	46.3	49.3	53.3
Cash Per Share	54.3	74.3	4.9	13.4
Operating Ratios (%)				
EBIT Margin	18.2	18.2	18.1	19.2
PBT Margin	19.2	19.1	19.4	19.1
PAT Margin	14.6	14.3	14.5	14.3
Debtor days	70	65	250	250
Return Ratios (%)				
RoE	22.7	23.0	23.4	24.0
RoCE	27.1	27.2	26.4	27.2
RoIC	35.6	40.2	27.3	31.1
Valuation Ratios (x)				
P/E	28.8	27.3	25.6	23.7
EV / EBITDA	18.1	16.7	16.7	14.4
EV / Net Sales	4.0	3.7	3.7	3.3
Market Cap / Sales	4.2	3.9	3.7	3.4
Price to Book Value	6.5	6.3	6.0	5.7
Solvency Ratios				
Debt/EBITDA	0.1	0.1	0.1	0.0
Debt/EBITDA	0.1	0.1	0.1	0.0
Current Ratio	1.6	1.4	1.4	1.4
Quick Ratio	1.6	1.4	1.4	1.4

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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