

October 15, 2024

Software segment boosts performance

About the stock: HCL Technologies (HCLTech) is a global technology company, employing 218,000+ 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.

Q2FY25 Performance: HCL Tech reported revenue of US\$3,445 mn, up 1.6% QoQ & 6.2% YoY in CC terms. The EBIT margins at 18.6%, was up 149 bps QoQ/8 bps YoY, owing to operating leverage in services (110 bps), software business tailwind (52 bps) and currency tailwind (24 bps).

Investment Rationale

- IT services recovery & Software business boosts performance:** All the segments reported a sequential growth on a QoQ basis, barring financial services (which was flat). Adjusting for State Street divestment impact, the BFSI was also healthy. Software segment growth of 1.4% QoQ and 9.4% YoY, was also a boost to revenue growth. Going ahead, while broad based recovery is seen in most segment, there remains challenges in Auto and Aero segments. **The company has now raised its guidance to 3.5-5% YoY (vs. 3-5% YoY, earlier) for revenue growth in CC terms (implying a CQGR of 0-2% QoQ for H2FY25) and 18-19% margin growth in FY25. We believe the company's revenue will grow at CAGR of 7.6% between FY24-27E, compared to CAGR of 12.7% between FY19-24. We also bake in steady margins recovery and expect EBIT margins of 18.2%/18.7%/19.2% in FY25/26/27.**
- Margin bounces back; H2 to witness wage hike impact:** Margin expansion of 149 bps QoQ to 18.6%, was aided by operating leverage in services (110 bps), software business tailwind (52 bps) and currency tailwind (24 bps). **While the margins are expected to be within the previously guided margin band of 18-19%. Going ahead, an impact of 65- 80 bps in Q3 and 50-60 bps in Q4 will be seen in the margins owing to wage hike.**
- TCV wins improves QoQ; warrants a higher win ahead:** HCL Tech during Q2FY25 won TCV deals worth US\$2,218 mn, up 13.2% QoQ but down 44.1% YoY. Considering HCLTech's diversified presence across various segments, we expect broad based growth once the macroeconomic factors favour discretionary based spending from clients. **Nonetheless, accelerated deal wins are required ahead for medium term growth (in FY26 and beyond).**

Rating and Target Price

- We expect earnings growth of ~10.6% over FY24-27 with diversified portfolio and increased traction for its GenAI platforms to be a key catalyst of its long-term growth.
- With ~24% return in last 6 month, the stock has priced in most of the positives, in our view. We assign **HOLD** rating on the stock, valuing it at target price of ₹ 1,840; at 25x P/E on average of FY26E & FY27E EPS



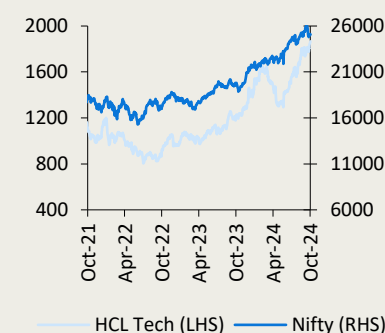
Particulars

Particular	Amount
Market Cap (₹ Crore)	5,07,455
Total Debt (₹ Crore)	2,223
CC&E (₹ Crore)	27,193
EV (₹ Crore)	4,82,485
52 week H/L	1893 / 1212
Equity capital	543.0
Face value (₹)	2.0

Shareholding pattern

	Sep-23	Dec-23	Mar-24	Jun-24
Promoters	60.8	60.8	60.8	60.8
FII	18.8	19.4	19.6	18.5
DII	15.7	15.2	15.0	15.8
Public	4.7	4.6	4.6	5.0

Price Chart



Key risks

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

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Key Financial Summary

Key Financials	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	FY27E	3 year CAGR FY(24-27E)
Net Sales	85,651	1,01,456	1,09,913	12.7	1,16,144	1,27,355	1,39,951	8.4
EBITDA	20,041	22,628	24,200	11.6	25,222	28,400	31,909	9.7
Margins (%)	23.4	22.3	22.0		21.7	22.3	22.8	
Net Profit	13,516	14,851	15,702	5.8	16,949	18,739	21,239	10.6
EPS (₹)	49.8	54.8	57.9		62.5	69.1	78.3	
P/E	37.5	34.1	32.3		29.9	27.1	23.9	
RoNW (%)	21.8	22.7	23.0		23.7	24.9	26.7	
RoCE (%)	24.2	27.1	27.2		28.4	29.9	32.4	

Source: Company, ICICI Direct Research

Performance highlights and Outlook

- Revenue Performance:** HCL Tech reported revenue of US\$3,445 mn, up 2.4% QoQ & up 6.8% YoY (in CC terms up 1.6% QoQ & 6.2% YoY). In rupee terms it reported revenue of ₹28,862 crore, up 2.9% QoQ & 8.2% YoY. The services business improved by 1.6% sequentially and 5.9% YoY in CC terms, owing to the balanced increase in the discretionary and non-discretionary spends. Growth was led by the Software segment which grew 1.4% QoQ and 9.4% YoY in CC terms. The IT services and ER&D business also saw a growth of 1.8% and 1.1% QoQ in CC terms respectively.
- Software Business:** Owing to the management's effort of executing its three-year roadmap, this business reported a growth of 9.4% YoY & 1.4% QoQ in CC terms, in what is said to be a seasonally weak quarter for it. The software business saw healthy wins as 8 of the 20 wins reported for the quarter were from this segment.
- Margin Performance:** The company reported EBIT margin of 18.6%, up 149 bps QoQ/8 bps YoY. The tailwinds were software business contributing 52 bps improvement, services margins 110 bps driven by operating leverage alongwith positive improvement of 24 bps led by exchange.
- Geography performance:** Geography wise on a QoQ basis in US\$ terms Americas (65% of mix), Europe (28.4% of mix) and ROW (6.5% of mix) reported a growth of 1%, 4.2% and 9.1% respectively.
- Segment Performance:** All the segments reported a sequential growth on a QoQ basis, barring financial services. TMPE (12.1% of mix), Tech & Services (13.1% of mix), Public Services (9.2% of mix) and Retail & CPG (9.6% of mix), Manufacturing (19.5% of mix), and Lifesciences (16% of mix) grew by 1.6%, 3.2%, 3.5%, 4.6%, 2.9%, 3.1% respectively. Whereas BFSI (20.5% of the mix) remained flat sequentially.
- Manufacturing segment:** The management mentioned that the automotive (in Europe) and the aerospace clients have witnessed some pressure which has also resulted in cancellation of certain programs. However, the same is being offset by the growth in the SAP business.
- BFSI Segment:** This segment has witnessed a recovery, as adjusted for state street divestment (around ~4%), it grew at a healthy rate.
- Deal Wins:** HCL Tech during Q2FY25 won TCV deals worth US\$2,218 mn, up 13.2% QoQ but down 44.1% YoY. The management mentioned that they're seeing balanced demand for the discretionary and non-discretionary deals. For the quarter they won 20 deals, 12 from services and 8 deals from HCL software. The management further mentioned that SAP is emerging to be a strong area of growth. There were no mega deal wins in Q2 however, the pipeline is near its all-time high with a good mix of small and large deal wins.
- AI/GenAI:** The company has recently acquired Zeenea, the Paris based acquisition, which will enable HCL Software to accelerate its GenAI and data engineering capabilities. The management further mentioned that they started with a goal of implementing the AI Force platform for 50 clients, of which ~50% is already achieved. Going ahead, legacy modernization along with data management will be a key growth driver.
- Revenue and Margin Guidance/Aspiration:** The management has revised its lower end revenue growth guidance and services growth guidance for FY25 to 3.5-5% YoY in CC terms vs (3-5%) earlier, implying a CQGR of 0-2% QoQ for H2FY25. While the margins are expected to be within the previously guided margin band of 18-19%. Going ahead, an impact of 65-80 bps in Q3 and 50-60 bps in Q4 will be seen in the margins. The company remains confident of delivering a strong Q3 on the back of strong deal pipeline, growing traction for GenAI, incremental revenue from it HPE CTG

acquisition (which will be incremental revenue above the revenue guidance provided)

- **Attrition & Employee addition:** The company's headcount reduced marginally by 780 employees bringing the total employee headcount to 2,18,621. The attrition further declined by 130 bps YoY to 12.9%. The company's headcount has reduced while wage bill has increase as it is focusing on skill-based hiring.
- **Dividend:** The Company declared an interim dividend of ₹12 per share. This marks the company's 87th consecutive quarter of dividend pay-out

Exhibit 1: Quarter Performance

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
Revenue (US\$ mn)	345	323	6.8	336	2.4	In CC terms, revenue expanded by 1.6% QOQ and grew by 6.2% YoY
Revenue (₹ crore)	28,862	26,672	8.2	28,057	2.9	In CC terms, Software business reported growth of 1.4% QoQ while IT services and ER&D revenue grew by 1.8% & 1.1% QoQ
Cost of sales (including employee expenses)	19,184	17,417	10.1	18,771	2.2	
Gross Margin	9,678	9,255	4.6	9,286	4.2	
Gross margin (%)	33.5	34.7	-117 bps	33.1	44 bps	
Selling & marketing costs	3,309	3,311	-0.1	3,492	-5.2	
EBITDA	6,369	5,944	7.2	5,794	9.9	
EBITDA Margin (%)	22.1	22.3	-22 bps	20.7	142 bps	
Depreciation	1,007	1,010	-0.3	998	0.9	
EBIT	5,362	4,934	8.7	4,796	11.8	
EBIT Margin (%)	18.6	18.5	8 bps	17.1	148 bps	Margin expansion owing to operating leverage in services (110 bps), software business tailwind (52 bps) and currency tailwind (24 bps).
Other income	325	194	67.5	912	-64.4	
PBT	5,687	5,128	10.9	5,708	-0.4	
Tax paid	1,450	1,295	12.0	1,448	0.1	
PAT	4,235	3,832	10.5	4,258	-0.5	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement					₹ crore
Year-end March	FY24	FY25E	FY26E	FY27E	
Total operating income	1,09,913	1,16,144	1,27,355	1,39,951	
Growth (%)	8.3	5.7	9.7	9.9	
Direct costs	72,125	77,488	84,309	92,088	
S,G&A expenses	13,588	13,434	14,646	15,954	
Total Operating Expenditure	85,713	90,922	98,955	1,08,042	
EBITDA	24,200	25,222	28,400	31,909	
Growth (%)	6.9	4.2	12.6	12.4	
Depreciation	4,173	4,137	4,557	4,977	
Amortisation	-	-	-	-	
Net Other Income	940	1,607	1,142	1,387	
PBT	20,967	22,692	24,985	28,319	
Forex adjustments	-	-	-	-	
Total Tax	5,257	5,743	6,246	7,080	
PAT	15,702	16,949	18,739	21,239	
Growth (%)	5.7	7.9	10.6	13.3	
EPS (₹)	57.9	62.5	69.1	78.3	

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement					₹ crore
Year-end March	FY24	FY25E	FY26E	FY27E	
PBT	20,967	22,692	24,985	28,319	
Depreciation & Amortisation	4,173	4,137	4,557	4,977	
(Inc)/dec in Current Assets	472	(1,822)	(3,278)	(3,683)	
Inc/(dec) in CL and Provisions	1,833	1,380	2,482	2,789	
Taxes paid	(4,212)	(5,743)	(6,246)	(7,080)	
CF from Op. Activities	22,448	19,037	21,358	23,935	
(Inc)/dec in Investments	(3,669)	1,607	1,142	1,387	
(Inc)/dec in Fixed Assets	(1,016)	(2,323)	(2,547)	(2,799)	
CF from Inv activities	(6,723)	(716)	(1,405)	(1,412)	
Issue/(Buy back) of Equity	-	-	-	-	
Inc/(dec) in loan funds	(181)	(500)	(500)	(500)	
Dividend paid & dividend tax	(14,073)	(13,559)	(14,991)	(16,991)	
Inc/(dec) in debentures	-	-	-	-	
Others	(1,212)	-	-	-	
CF from Financing	(15,464)	(14,059)	(15,491)	(17,491)	
Net Cash flow	261	4,262	4,462	5,032	
Exchange difference	130	-	-	-	
Opening Cash	9,065	9,456	13,718	18,180	
Closing Cash	9,456	13,718	18,180	23,212	

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet					₹ crore
Year-end March	FY24	FY25E	FY26E	FY27E	
Liabilities					
Equity Capital	543	543	543	543	
Reserve and Surplus	67,720	71,110	74,857	79,105	
Total Shareholders funds	68,263	71,653	75,400	79,648	
Total Debt	2,223	1,723	1,223	723	
Other liabilities+Provisions	6,557	6,648	6,813	6,998	
Minority Interest / Others	8	8	8	8	
Total Liabilities	77,051	80,032	83,444	87,377	
Assets					
Net Block+ CWIP	7,909	7,129	6,258	5,325	
Intangible assets+ Goodwill	27,262	26,228	25,088	23,844	
Investments	94	94	94	94	
Liquid investments	7,043	7,043	7,043	7,043	
Inventory	185	195	214	236	
Debtors	19,483	20,588	22,575	24,807	
Loans and Advances	795	840	921	1,012	
Other Current Assets	11,675	12,337	13,528	14,866	
Cash & Bank	20,150	24,412	28,874	33,906	
Total Current Assets	59,331	65,415	73,155	81,870	
Total Current Liabilities	22,726	24,014	26,332	28,937	
Net Current Assets	36,605	41,400	46,822	52,933	
Other non current assets	5,181	5,181	5,181	5,181	
Application of Funds	77,051	80,032	83,444	87,377	

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios				
Year-end March	FY24	FY25E	FY26E	FY27E
Per share data (₹)				
EPS	57.9	62.5	69.1	78.3
Cash EPS	73.2	77.7	85.8	96.6
BV	251.6	264.0	277.9	293.5
DPS	46.3	50.0	55.2	62.6
Cash Per Share	74.3	90.0	106.4	124.9
Operating Ratios (%)				
EBIT Margin	18.2	18.2	18.7	19.2
PBT Margin	19.1	19.5	19.6	20.2
PAT Margin	14.3	14.6	14.7	15.2
Debtor days	65	65	65	65
Return Ratios (%)				
RoE	23.0	23.7	24.9	26.7
RoCE	27.2	28.4	29.9	32.4
RoC	40.2	43.4	50.2	58.0
Valuation Ratios (x)				
P/E	32.3	29.9	27.1	23.9
EV / EBITDA	19.9	18.9	16.6	14.6
EV / Net Sales	4.4	4.1	3.7	3.3
Market Cap / Sales	4.6	4.4	4.0	3.6
Price to Book Value	7.4	7.1	6.7	6.4
Solvency Ratios				
Debt/EBITDA	0.1	0.1	0.0	0.0
Debt/EBITDA	0.1	0.1	0.0	0.0
Current Ratio	1.4	1.4	1.4	1.4
Quick Ratio	1.4	1.4	1.4	1.4

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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