

IT
January 13, 2023

HCL Technologies

Q3FY23 Result Update

CMP	1078
Sensex	60261

Stock Statistics

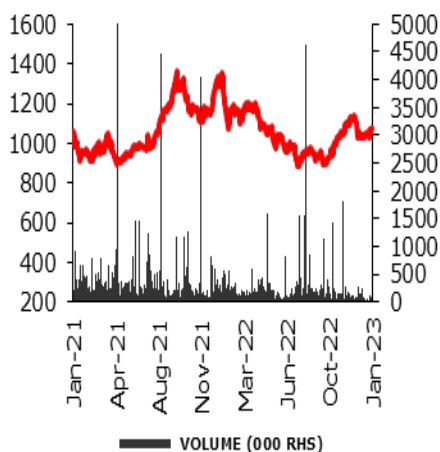
Reuters code	HCLT.BO
Bloomberg code	HCLT IN

Equity Cap (INR cr)	543
Face Value (INR)	2
INR / USD	81.3
Market cap (INR cr)	2,92,520
Market cap (USD bn)	36.0
52 Wk High/Low (INR)	1359/ 876

Shareholding Pattern (%) – Sep'22

Promoter	60.7
Foreign Institutional Investor	17.7
MF / FI / UTI / Banks	16.6
Public & Others	4.6
Bodies & Corporate	0.4

2 yr Price and Volume Chart



Analyst

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Strong seasonality in P&P and consistent TCV wins augurs well

HCL Tech reported Top-line growth of 5.3% qoq to USD3244mn in Q3FY23, while in constant currency (CC) Top-line grew 5% qoq. In INR terms Top-line grew 8.2% qoq to Rs26,700cr.

Amongst segments, IT & Business services and Engineering and R&D grew 2.1% qoq and 2.5% in CC terms. Growth in Services business was despite of furloughs which were higher than in previous year. **As expected, revenues from Products & Platforms segment** (now renamed as HCL Software were down 10% qoq in Q2 due to seasonality and structural weakness) **witnessed seasonal recovery and was up 31.7% qoq in USD terms (30.5% qoq in CC terms) and also aided strongly to EBIT margins at 32.6%.**

The company witnessed 7.2% qoq growth in Europe and 0.5% qoq growth in Americas in CC terms in Q3. Life-sciences, Manufacturing & Telecom vertical grew strong by 5.5%, 4.9% and 4.5% qoq respectively in CC terms. Financial Services and Retail & CPG however de-grew 1.7% and 0.6% qoq respectively in CC terms.

HCL Tech won 17 (7 in Services and 10 in P&P) net new deals with TCV of US\$2,347mn in Q3 slightly lower by 1.6% qoq. Top 3 deals won out of total TCV in Q3 were close to US\$1bn in TCV. 10 large deal wins in HCL Software were both License & SAAS wins.

EBIT margin was up 165bps qoq at 19.6% in Q3FY23. 157bps qoq margin improvement was led by HCL Software seasonal strong performance. However, Salary increment's given to middle Mgmt. had 70bps qoq negative margin impact followed by 60bps qoq impact from Furlough & holidays, while Pyramid optimization and deployment of freshers had 40bps qoq impact. Still overall Services segment margins were up 8-10bps qoq as there was benefit of improved realization and 70bps qoq cross-currency benefit. **Supply chain was very tight earlier which got little easier by Oct 2022 cause of which both growth and margins were good in Q3FY23.**

Other Income was down 8.3% qoq on account of lower Forex gain of Rs3cr (v/s Rs46cr in Q2FY23). Thus, led by robust operational performance, HCL Tech has reported 17.4% qoq spike in PAT to Rs4096cr.

Key Financials (Consolidated)				
Y/E March (Rs cr)	FY2021	FY2022	FY2023E	FY2024E
Net Sales	75,379	85,651	1,02,410	1,14,474
% chg	6.7	13.6	19.6	11.8
Net Profit	12,435	13,499	14,790	16,515
% chg	12.4	8.6	9.6	11.7
EBIT Margin (%)	21.3	18.9	18.2	18.5
FDEPS (Rs)	45.8	49.8	54.6	60.9
P/E (x)	16.6	22.4	19.8	17.7
P/BV (x)	3.4	4.9	4.5	4.3
RoE (%)	20.2	21.8	22.9	24.4
RoCE (%)	27.4	26.2	28.3	30.1
EV/Sales (x)	2.5	3.3	2.7	2.4
EV/EBITDA (x)	9.5	13.9	12.1	10.9
Net Debt/Equity	(0.2)	(0.2)	(0.2)	(0.2)

Source: Company & Anvil Research; Note: Financials in FY21 are in US GAAP and from FY22 onwards are in IND AS format.

Quarterly Financial Statement

Q3FY23 Consolidated Financial Performance (IND AS)								
Y/E March (Rs cr)	Q3FY23	Q2FY23	% chg (qoq)	Q3FY22	% chg (yoy)	9MFY23	9MFY22	% chg
Revenues	26,700	24,686	8.2	22,331	19.6	74,850	63,054	18.7
Direct Costs	16,720	15,848	5.5	13,928	20.0	47,634	38,883	22.5
R&D Costs	415	388	7.0	381	8.9	1,194	1,146	4.2
Gross Profit	9,565	8,450	13.2	8,022	19.2	26,022	23,025	13.0
SG&A Expenses	3,200	3,024	5.8	2,780	15.1	9,256	8,037	15.2
EBITDA	6,365	5,426	17.3	5,242	21.4	16,766	14,988	11.9
Other Income	144	157	(8.3)	203	-	646	604	-
Depreciation & Amort.	1,136	998	13.8	991	14.6	3,117	2,890	7.9
PBT	5,373	4,585	17.2	4,454	20.6	14,295	12,702	12.5
Tax	1,276	1,097	16.3	997	28.0	3,429	2,737	25.3
Equity Invest. Share & Minority Int.	(1)	1	(200.0)	(15)	-	2	(43)	-
One-time Milestone Bonus	-	-	-	-	-	-	-	-
Net Income	4,096	3,489	17.4	3,442	19.0	10,868	9,922	9.5
Diluted EPS (Rs)	15.1	12.9	17.3	12.7	19.1	40.1	36.5	9.8
Gross Profit Margin (%)	35.8	34.2	1.6	35.9	(0.1)	34.8	36.5	(1.8)
EBITDA Margin (%)	23.8	22.0	1.9	23.5	0.4	22.4	23.8	(1.4)
EBIT Margin (%)	19.6	17.9	1.6	19.0	0.5	18.24	19.2	(1.0)
Net Profit Margin (%)	15.3	14.1	1.2	15.4	(0.1)	14.5	15.7	(1.2)
Tax rate (%)	23.7	23.9	(0.2)	22.4	1.4	24.0	21.5	2.4

Source: Company and Anvil Research

Key Operational Matrix

New Services split (USD mn)	Revenues (US \$mn)					EBIT Margin (%)		
	Q3FY23	Q2FY23	Q3FY22	% chg qoq	% chg yoy	Q3FY23	Q2FY23	Q3FY22
IT & Business services (A)	2,326	2,269	2,103	2.5	10.6	16.8%	16.7%	16.6%
Engineering and R&D services (B)	538	524	473	2.6	13.7	21.6%	21.4%	18.4%
Total Services (A+B)	2,863	2,793	2,576	2.5	11.2	17.7%	17.6%	16.9%
HCL Software (Products & Platforms)	381	289	402	31.7	(5.3)	32.6%	20.3%	31.6%
Total Revenues	3,244	3,082	2,978	5.26	9.0	19.6%	17.9%	19.0%

Source: Company & Anvil Research

Vertical Split (USD mn)	Q3FY23	Q2FY23	Q3FY22	% chg qoq	% chg yoy
Financial Services	646	635	628	1.7	2.8
Manufacturing	639	592	521	8.0	22.6
Technology & Services	480	465	548	3.2	(12.4)
Lifesciences & Healthcare	555	509	429	9.1	29.4
Public Services	331	314	310	5.3	6.9
Retail & CPG	289	284	301	1.8	(4.0)
Telecom, Media, Publishing & Entert.	305	284	241	7.5	26.4
Total Revenues	3,244	3082	2978	5.3	9.0

Source: Company & Anvil Research

Geographical Split (USD mn)	Q3FY23	Q2FY23	Q3FY22	% chg qoq	% chg yoy
North America	63.5%	64.8%	63.1%	3.1	9.6
Europe	29.1%	27.5%	28.3%	11.4	12.0
ROW	7.4%	7.7%	8.7%	1.2	(7.3)
Total Revenues	100%	100%	100%	5.3	9.0

Source: Company & Anvil Research

Revenues USD mn (LTM based)	Q3FY23	Q2FY23	Q3FY22	Chg qoq	Chg yoy
Top 5 client	334	330	363	1.3%	-8.0%
% of revenues	10.3%	10.7%	12.2%		
Top 10 clients	590	579	604	1.9%	-2.3%
% of revenues	18.2%	18.8%	20.3%		
Top 20 clients	915	881	875	3.8%	4.5%
% of revenues	28.2%	28.6%	29.4%		

Source: Company and Anvil Research

Outlook

- IT operating model transformation and Cloud adoption seen as important part of technology journey of clients.
- Cloud opportunities have contributed to significant bookings of TCV win seen in Q3FY23. Cloud adoption, Application data modernization, digital engineering is seen wider demand.
- HCL Software business grew strong in Q3 as the company has built 22 new SAAS deals within it resulting in good momentum.
- More than 25% of 2000 Fortune companies are Clients of HCL Software.
- Well distributed healthy pipeline between large and medium type deals is expected to be seen in coming quarters.
- **3 large deal won in Q3; one is product aligning model and none of these 3 were cost optimization deals rather they are transformation deals.**
- **1 Large deal won in Q3 was of 8 years tenure and other large one was 5-year tenure. ACV growth is 13% YTD basis as on 9MFY23. And Mgmt. sees reasonable market opportunity of 10% ACV overall by FY23 end.**
- **Impact in BFSI vertical is largely due to furloughs which has hit mainly BFSI in Q3. Large deals were won in Q2 and even in Q3 US\$0.5bn win was seen in Q3 giving confidence on good growth in BFSI going forward.**
- **Vendor consolidation deals are not cost take outs they are transformative deals, which will continue to come in pipeline and result in actual revenue booking in Q2 & Q3FY24 as per Mgmt. expectations.**

- **Decisions delays in Europe are expected to start moderating. So Q2 & Q3FY24 we will start seeing improvement from Europe.**
- **HCL Tech will try to maintain its TCV growth trajectory ahead. Pipeline is good. Unqualified pipeline is seeing strong traction, but there is some softness in discretionary spends. More of vendor consolidation, Cloud adoption and cost takeout deals are expected to be there in near term in pipeline, which eventually would translate in good revenues in coming quarters in FY24 is what the company expects. New bookings are strong since past many quarters and that stays steady.**
- **Utilization came under stress due supply side tightness, higher attrition and additional costs to back fill that attrition. However quarterly annualized attrition has started coming of and so going ahead Utilization, reverse of back filling costs, higher offshoring, nearshoring will aid margins.**
- **Moreover, on Pricing front in Q2FY23 HCL saw 1% increase in Pricing and again 0.3% in Q3FY23, which will also help margins going forward depending on the more automation kind of deals if executed will be at better Pricing.**
- **Lot of big clients have already signed up for sizeable Cloud opportunities with Hyperscalers who in turn is behind customers to accelerate their Cloud migration programs. However, the Lift and Shift in Cloud is not very high rather most Clients are looking at application modernization on Cloud environment and this trend HCL Tech expects to only accelerate Cloud spends going forward.**
- **HCL Tech is confident to wither any economic storm with vendor consolidation, Cloud adoption and digital engineering opportunities going forward.**
- **No one has grip to what extent there would be moderation in discretionary spends, for e.g., discretionary work that HCL Tech is doing for clients in BFSI they have not yet cut down on their expected work.**
- **Moreover, HCL Tech is eyeing US\$150bn vendor consolidation opportunities expected in next 2 year down the line, where it expects to play key role.**
- **HCL had made definitive change in rate cards in Jan 22, which had improved Pricing across all deals since then. But no change in Pricing seen after that.**
- **IT Services Attrition (LTM) stood at 21.7% on Q3FY23, down 210bps qoq. Mgmt. said attrition will continue to come off in coming quarters as well.**
- **Net additions stood lean at 2,945 with total headcount of 2,22,270 as on Q3FY23. HCL Tech added 5892 freshers in Q3FY23 (v/s 10339 in Q2 and total 22,254 in 9MFY23).**
- **Cash & Investments of HCL Tech were up 11% qoq to Rs20,387cr in Q3, while the Debt was up 2.4% qoq to Rs4305cr.**
- **HCL Tech has announced new Dividend Payout policy that entails investor payouts of not less than 75% of Net Income cumulatively over 5 years from FY22 to FY26. In line with this policy, HCL Tech has announced interim dividend of Rs10/share for Q3FY23 (total Rs30/share in 9MFY23).**

➤ **FY23 Guidance**

HCL Tech is very optimistic in terms of TCV booking and strong pipeline of deals witnessed in 9MFY23, where the aggregate TCV is up 12.3% yoy. And hence HCL Tech has revised its FY23 Top-line growth guidance to be between 13.5% to 14% yoy in constant currency. Moreover, growth guidance for IT Services segment for FY23 stands in the range of 16-16.5% in CC terms led by strong order bookings and deals under pipeline. The guidance also considers furloughs in Q3 & Q4FY23 and macro-economic concerns.

In Q3 HCL Tech gave salary increase plus there was furloughs impact on Services margins. However, Forex helped in easing pressures. Mgmt. however guided that Services margins are improving and that will be the near-term trajectory.

Thus, for FY23E we expect HCL Tech to register Top-line growth of 20% yoy (growth of 10.5% yoy in USD terms), PAT growth of 9.6% yoy and EPS of Rs54.6. For FY24E we expect HCL Tech to register Top-line growth of 11.8% yoy (growth of 10% yoy in USD terms), PAT growth of 11.7% yoy and EPS of Rs60.9. Thus, we expect HCL Tech's Top-line to witness 15.6% CAGR, while PAT to witness 10.6% CAGR from FY22-FY24E.

Assumptions for Revenue Projections	FY22	FY23E	FY24E
IT & Business Services	14.9%	11.1%	8.7%
Engineering and R&D Services	14.5%	17.1%	10.6%
Product & Platforms	0.2%	-1.1%	16.9%
Revenue growth (in USD)	12.8%	10.5%	9.9%
Revenue growth (in INR)	13.6%	19.6%	11.8%

Source: Company and Anvil Research

HCL Technologies

P&L (Rs cr)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Net sales	50,570	60,427	70,678	75,379	85,651	1,02,410	1,14,474
Other income	1,111	805	178	657	747	792	640
Total Income	51,681	61,232	70,856	76,036	86,398	1,03,202	1,15,113
Cost of revenue	33,237	39,241	45,294	45,974	54,286	65,338	73,034
SG&A	5,894	7,218	8,690	9,348	10,835	14,293	16,161
Cost of sales	39,131	46,459	53,984	55,322	65,121	79,631	89,195
PBIDT	11,439	13,968	16,694	20,057	20,530	22,780	25,278
PBDT	12,550	14,773	16,872	20,714	21,277	23,572	25,918
Depreciation	1,453	2,147	2,841	3,985	4,326	4,095	4,044
PBT	11,097	12,626	14,031	16,729	16,951	19,476	21,874
Provision for tax	2,317	2,481	2,938	3,663	3,428	4,687	5,359
PAT	8,780	10,145	11,093	13,066	13,523	14,789	16,515
Minority Interest/ext.	-	(21)	(31)	(631)	(24)	1	-
Adjusted PAT	8,780	10,124	11,062	12,435	13,499	14,790	16,515

Source: Company and Anvil Research; Note: Financials in FY18-FY21 are in US GAAP and from FY22 are in IND AS format.

Balance Sheet (Rs cr)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Equity capital	281	275	542	543	543	542	542
Reserve & Surplus	36,536	41,495	51,144	60,963	61,371	63,979	67,093
Total Long term Debt	437	3,986	5,092	3,907	3,985	4,348	4,391
Other Liabilities & Minority Interest	1,267	1,992	5,548	5,535	5,120	5,478	5,758
Capital Employed	38,521	47,748	62,326	70,948	71,019	74,347	77,784
Goodwill and other intangible assets	14,406	17,695	29,421	29,150	27,160	27,460	27,660
Gross block	13,080	15,844	19,128	23,114	26,936	30,700	35,000
Accumulated depreciation	7,896	10,043	12,884	16,869	21,195	25,290	29,334
Net block	5,185	5,801	6,244	6,245	5,741	5,410	5,666
Total fixed assets	5,185	5,801	6,244	6,245	5,741	5,410	5,666
Investments (Long-term)	522	390	38	47	312	275	245
Other non-current assets	3,768	5,293	9,088	9,209	7,779	7,079	6,679
Sundry debtors	12,258	14,610	17,772	17,525	20,671	27,216	31,363
Cash & bank	7,421	9,171	8,385	13,717	15,644	15,772	16,400
Unbilled rev. & other current assets	2,520	3,716	5,279	5,037	5,487	5,707	5,877
Investments (Short term)	2,357	2,220	6,988	6,773	6,239	4,539	4,409
Sundry creditors	92	131	117	173	187	200	220
Other current liabilities	9,823	11,018	20,772	16,582	17,827	18,911	20,295
Net current assets	14,641	18,569	17,535	26,297	30,027	34,122	37,534
Capital Deployed	38,521	47,748	62,326	70,948	71,019	74,347	77,784

Source: Company and Anvil Research; Note: Financials in FY18-FY21 are in US GAAP and from FY22 are in IND AS format.

Key Ratios	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Absolute Growth (%)							
Revenue	8.2	19.5	17.0	6.7	13.6	19.6	11.8
EBITDA	11.0	22.1	19.5	20.1	2.4	11.0	11.0
PAT	3.8	15.3	9.3	12.4	8.6	9.6	11.7
Profitability Ratios (%)							
EBITDA margins	22.6	23.1	23.6	26.6	24.0	22.2	22.1
EBIT margins	19.7	19.6	19.6	21.3	18.9	18.2	18.5
PAT margins	17.4	16.8	15.7	16.5	15.8	14.4	14.4
ROCE	29.3	28.7	25.8	27.4	26.2	28.3	30.1
ROIC	47.3	45.5	44.7	44.7	45.8	45.6	47.5
ROA	18.1	17.2	13.3	14.9	15.2	15.8	16.8
ROE	23.8	24.2	21.4	20.2	21.8	22.9	24.4
Valuation Ratio (x)							
P/E (on FDEPS)	14.1	13.5	13.4	16.6	22.4	19.8	17.7
P/CEPS	12.1	11.1	10.7	12.6	17.0	15.5	14.2
P/BV	3.4	3.3	2.9	3.4	4.9	4.5	4.3
Dividend yield (%)	1.4	0.8	1.5	3.7	3.8	4.2	4.6
EV/Sales	2.3	2.1	2.0	2.5	3.3	2.7	2.4
EV/EBITDA	10.0	9.3	8.3	9.5	13.9	12.1	10.9
EV / Total Assets	2.4	2.2	1.7	2.2	3.2	3.0	2.8
Per Share Data (Rs)							
EPS (Basic)	62.7	73.6	40.8	45.8	49.8	54.6	61.0
EPS (fully diluted)	62.6	73.6	40.8	45.8	49.8	54.6	60.9
Cash EPS	73.1	89.2	51.3	60.5	65.7	69.8	75.9
DPS	12.0	8.0	8.0	28.0	42.0	45.0	49.5
Book Value per share	262.5	303.7	190.6	226.7	228.0	238.1	249.5
Dupont Analysis							
EBIT margin (a)	21.9	20.9	19.9	22.2	19.8	19.0	19.1
Tax retention ratio (b)	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Assets Turnover ©	1.0	1.0	0.8	0.9	1.0	1.1	1.2
ROA (a*b*c)	18.1	17.2	13.3	14.9	15.2	15.8	16.8
Net Profit AT/Total Assets (a1)	18.1	17.2	13.3	14.2	15.2	15.8	16.8
Total Assets/Stockholders. Equity (b1)	1.3	1.4	1.6	1.4	1.4	1.4	1.5
ROE (a1*b1)	23.8	24.2	21.4	20.2	21.8	22.9	24.4
Liquidity ratios (x)							
Asset Turnover (Gross Block)	4	4	4	3	3	3	3
Debtors days	83	81	84	85	81	85	93
Creditors days	3	1	1	1	1	1	1
Working capital cycle (ex-cash days)	40	50	48	53	57	58	63
Leverage ratios (x)							
Gross debt to equity	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Net debt to equity	(0.2)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
Net debt to EBITDA	(0.6)	(0.4)	(0.2)	(0.5)	(0.6)	(0.5)	(0.5)

Source: Company and Anvil Research; Note: 1. EPS in FY18 exhibits Equity dilution from 3.5cr of Equity Buyback done by HCL Tech in May'17, 2. EPS in FY20 is after considering 1:1 Bonus issue effective from Dec'19 onwards.

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