

HCL Technologies

 Estimate change 

TP change

 Rating change 
CMP: INR1,477
TP: INR1,700 (+15%)
Buy
FY25 guidance disappointing, but remains ahead of peer set
Growth in FY25 to remain back-ended; reiterate BUY

Bloomberg	HCLT IN
Equity Shares (m)	2714
M.Cap.(INRb)/(USD\$b)	3999.5 / 48
52-Week Range (INR)	1697 / 1048
1, 6, 12 Rel. Per (%)	-8/1/12
12M Avg Val (INR M)	3588

Financials & Valuations (INR b)

Y/E Mar	2024	2025E	2026E
Sales	1,099	1,149	1,292
EBIT Margin (%)	18.2	18.6	19.3
PAT	157	170	200
EPS (INR)	57.9	62.8	73.6
EPS Gr. (%)	5.6	8.4	17.3
BV/Sh. (INR)	252	249	245

Ratios

RoE (%)	23.5	25.1	29.9
RoCE (%)	21.7	23.2	27.4
Payout (%)	82.9	90.0	90.0

Valuations

P/E (x)	25.4	23.5	20.0
P/BV (x)	5.8	5.9	6.0
EV/EBITDA (x)	16.2	15.2	13.2
Div Yield (%)	3.3	3.8	4.5

Shareholding pattern (%)

As On	Mar-24	Dec-23	Mar-23
Promoter	60.8	60.8	60.8
DII	15.0	15.2	15.3
FII	19.9	19.6	19.2
Others	4.3	4.4	4.7

FII Includes depository receipts

- HCL Technologies (HCLT) reported weak 4QFY24 performance with 0.3% QoQ CC consolidated revenue growth, below our estimate of 0.9% QoQ CC. The weak performance was due to the seasonality in HCL Software (-18.5% QoQ CC) coupled with weakness in ERS (1.6% QoQ CC), while ITBS posted an impressive 4% QoQ growth in CC. Services grew 3.0% QoQ in CC, above our estimate of +2.7% QoQ. The new deal TCW was healthy at USD2.3b (+18.8% QoQ/10.4% YoY) in 4QFY23. HCLT announced disappointing revenue growth guidance of 3-5% CC for FY25, amid weak 1QFY25 expectations (-2% QoQ). The weak expectations are led by the offshoring of a large deal and the transfer of productivity benefits to clients.
- EBIT margin came in lower than expected at 17.6% (-220bp QoQ; missing our estimate of 18.5%) due to the HCL Software seasonality. Services margin contracted 70bp QoQ. Management retained its EBIT margin guidance band of 18-19% for FY25.
- While healthy deal wins and a strong 4QFY24 exit should bode well for a robust FY25 growth, weaker 1QFY25 growth and the impact of the divestment of State Street business in 2QFY24 is dampening the FY25 revenue growth trajectory. More importantly, management indicated that it has built in some caution in its guidance because of the weaker demand environment seen over the recent past. With significant consolidation opportunities at the enterprise level, HCLT is more focused on long-term growth.
- We expect FY25 revenue growth to be near the upper-end of its guidance band, which would put HCLT ahead of its large-cap IT services peer set (barring TCS, which is executing the mega BSNL deal, and LTIM). Over FY24-26E, HCLT should deliver a USD revenue CAGR of 8.3% YoY, which we view as good given the tough demand environment.
- Lack of strong growth in FY25 should limit a meaningful margin expansion. We expect FY25 EBIT margin at 18.6%, near the mid-point of its guidance band of 18-19%, which should translate into an INR PAT CAGR of 12.8% over FY24-26.
- While we expect some near-term pressure on the stock on account of weak FY25 revenue growth guidance, we continue to expect the stock to outperform its peers and reiterate it as our top idea for FY25. We cut our FY25-26 earnings estimates by 6-8% to factor in a weaker-than-expected guidance. **Reiterate BUY with a TP of INR1,700, premised on 23x FY26E EPS.**

Miss on revenue and margin; FY25 guidance disappointing

- HCLT's USD revenue of INR3.4b, up 0.3% QoQ in CC (0.4% QoQ reported), missed our estimates of +0.9% QoQ in CC
- Services business grew 3.0% QoQ in CC, with IT Services growth at 4% QoQ in CC, and ER&D declining 1.6% QoQ in CC. HCL Software (P&P) was down 18.5% QoQ in CC but was flat YoY.

- 4QFY24 EBIT margin was weak at 17.6%, missing our estimate of 18.5%. The margin contraction was led by seasonality in HCL Software and weak margins in both IT Services and ER&D businesses.
- The 4Q new Deal TCV was healthy at USD2.3b (+18.8% QoQ/ 10.4% YoY).
- FY25 revenue growth guidance came in lower than expected at +3-5% CC for the company and the Services business each. Management reiterated its EBIT margin guidance at 18.0-19.0%.
- Net employee count rose 2.7k, which was positive. Attrition, at 12.4%, was down 40bp QoQ.
- PAT of INR40b, declined 8.4% QoQ/flat YoY and missed our estimate of INR42.5b because of the weak revenue and margin performance.
- The Board declared a final dividend of INR18/share.

Key highlights from the management commentary

- Management highlighted a sequential decline in 1QFY25 revenue of 2% due to the annual productivity transfer and the impact of a large deal moving to offshore.
- The full impact from the divestment of the JV with State Street will start from Jul'24, thereby impacting 2QFY25.
- Consequently, management has provided a weak revenue growth guidance for FY25 at 3-5% CC. It has assumed the same level of run-off and business environment as in FY24. The growth in FY25 should remain back-ended.
- HCLT has retained its margin guidance band of 18-19% for FY25, and continues to aspire for 19-20% margin in the longer run.

Valuation and View

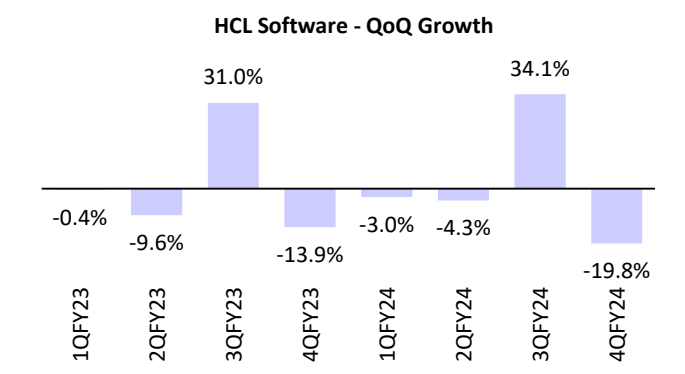
- Higher exposure to Cloud, which comprises a larger share of non-discretionary spending, offers better resilience to its portfolio in the current context, with higher demand for Cloud, Network, Security, and Digital workplace services.
- Given its capabilities in the IMS and Digital space, along with strategic partnerships and investments in Cloud, we expect HCLT to emerge stronger on the back of healthy demand for these services in the medium term. The stock is trading at ~20x FY26E EPS, which offers a margin of safety. Our TP of INR1,700 is based on 23x FY26E EPS. We reiterate our **BUY** rating on the stock.

Quarterly performance

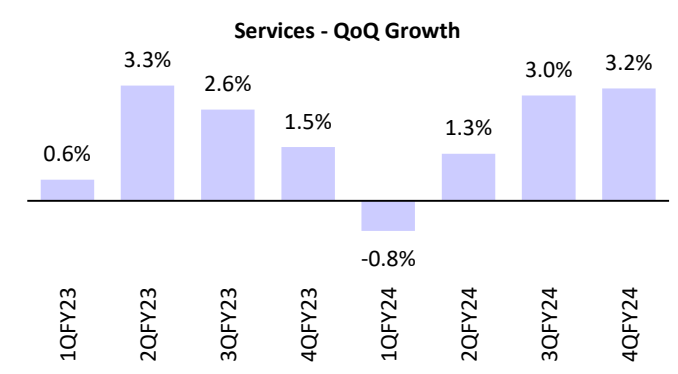
Y/E March	FY23				FY24				FY24	FY25E	FY24 4QE	Var. (%/bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Revenue (USD m)	3,025	3,082	3,244	3,235	3,200	3,225	3,415	3,430	13,270	13,840	3,459	-0.9
QoQ (%)	1.1	1.9	5.3	-0.3	-1.1	0.8	5.9	0.4	5.4	4.3	1.3	-86bp
Revenue (INR b)	235	247	267	266	263	267	284	285	1,099	1,149	287	-0.7
YoY (%)	16.9	19.5	19.6	17.7	12.1	8.0	6.5	7.1	8.3	4.5	7.9	-80bp
GPM (%)	35.8	35.8	37.4	36.5	35.6	36.2	36.7	35.0	35.9	36.2	36.1	-115bp
SGA (%)	12.9	12.2	12.0	12.8	13.6	12.4	11.5	12.0	12.4	12.3	12.2	-18bp
EBITDA	50	54	63	59	55	59	67	61	242	258	64	-4.9
EBITDA margin (%)	21.1	22.0	23.7	22.3	20.8	22.3	23.5	21.4	22.0	22.5	22.3	-93bp
EBIT	40	44	52	48	45	49	56	50	200	214	53	-5.5
EBIT margin (%)	17.0	17.9	19.6	18.2	17.0	18.5	19.7	17.6	18.2	18.6	18.5	-88bp
Other income	3	2	1	4	2	2	3	3	9	11	3	-12.6
ETR (%)	24.3	23.9	23.8	23.4	24.8	25.3	25.9	24.2	25.1	24.2	24.0	18bp
Adjusted PAT	33	35	41	40	35	38	44	40	157	170	43	-6.2
QoQ (%)	-8.7	6.3	17.4	-2.8	-11.2	8.4	13.5	-8.4			-2.3	-610bp
YoY (%)	2.1	6.9	19.0	10.8	7.6	9.8	6.2	0.1	5.7	8.4	6.8	-667bp
EPS	12.1	12.9	15.1	14.7	13.0	14.1	16.0	14.7	57.9	62.8	15.7	-6.2

Key performance indicators

Y/E March	FY23			FY24				FY24	FY25E	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q			4Q
Revenue (QoQ CC %)	2.7	3.8	5.0	-1.2	-1.3	1.0	6.0	0.3		
Costs (as a percentage of revenue)										
COGS	64.2	64.2	62.6	63.5	64.4	63.8	63.3	65.0	64.1	63.8
SGA	12.9	12.2	12.0	12.8	13.6	12.4	11.5	12.0	12.4	12.3
Margins										
Gross margin	35.8	35.8	37.4	36.5	35.6	36.2	36.7	35.0	35.9	36.2
EBIT margin	17.0	17.9	19.6	18.2	17.0	18.5	19.7	17.6	18.2	18.6
Net margin	14.0	14.1	15.3	15.0	13.4	14.4	15.3	14.0	14.3	14.8
Operating metrics										
Headcount (k)	211	219	222	226	223	221	225	227	227	
Attrition (%)	23.8	23.8	21.7	19.5	16.3	14.2	12.8	12.4	12.4	
Key verticals (YoY CC %)										
BFSI	16.4	15.4	8.8	9.6	14.4	12.5	12.9	12.1		
Manufacturing	19.1	21.8	21.2	11.8	16.5	3.3	5.8	9.8		
Key geographies (YoY CC %)										
North America	17.5	18.2	12.3	10.0	7.3	3.9	6.7	6.8		
Europe	22.5	21.8	23.3	14.6	10.5	3.9	1.7	5.5		

Exhibit 1: Seasonality in P&P led to a sharp decline

Source: MOFSL, Company

Exhibit 2: Service business posted a strong show

Source: MOFSL, Company



Key highlights from the management commentary

Demand and industry outlook

- HCLT has integrated sales teams for ITBS and ERS businesses. With this revised GTM, HCLT will be able to target a broader reach for its ERS offerings.
- The ARR for HCLT Software business was hit by discontinuation of certain telecom product offerings.
- Though management is seeing strong traction in GenAI with strong POCs, GenAI is still in early days and will take time before larger adoption. Though GenAI will cannibalize certain discretionary spends, it will create opportunities around data and cloud that are essential to leverage GenAI.
- The demand environment for IT Services remains moderate to healthy going forward. Discretionary spending continues to remain under pressure.
- GenAI budgets are being created by cutting on the IT budgets.
- The outlook for ER&D spending remains robust as spending continues to grow globally.
- The management believes that FY25 will be the year of consolidation, both in terms of demand and supply. This will bring good vendor consolidation opportunities to the table.
- The management highlighted sequential decline in 1QFY25 revenue to the tune of 2% due to the annual productivity transfer and the impact of a large deal moving to offshore.
- The full impact from the divestment of JV with State Street will be seen from Jul'24, thereby impacting 2QFY25 adversely.
- Consequently, the management has provided a weak revenue growth guidance for FY25 at 3-5% CC. It has assumed the same level of run-off and business environment as in FY24. The growth in FY25 should remain back-ended.
- Management highlighted that its Tech vertical is very concentrated with Top-10 clients contributing to 60% of the revenue. These clients faced cost pressures in FY24. This vertical should grow in FY25 as clients have started spending on R&D.

Margin performance

- The 4QFY24 company-level margin was hurt by seasonal slowdown in HCL Software – 156bp impact. Services margin was hit by usual wage hikes along with higher bonuses on account of a better year – 20bp, higher travel cost – 25bp and some impact of Fx.
- The management has retained its margin guidance band of 18-19% for FY25 and continues to aspire for 19-20% margins in the longer run.

Exhibit 3: Strong growth in key geographies

Geographies	Contribution to revenue (%)	CC QoQ growth (%)	CC YoY growth (%)
Americas	65.2	4.2	6.8
Europe	28.9	2.3	5.5
RoW	5.9	-5.9	-7.1

Source: Company, MOFSL

Exhibit 4: Telecom and Manufacturing drove the growth in 4QFY24

Verticals	Contribution to revenue (%)	CC QoQ growth (%)	CC YoY growth (%)
Financial Services	21.6	2.8	12.1
Manufacturing	20.4	4.1	9.8
Technology	12.3	-1.1	-8.6
Life Sciences and Healthcare	16.3	2.0	5.4
Telecom MP&E	8.8	21.6	6.5
Retail and CPG	9.1	-1.5	8.2
Public Services	8.8	-6.3	0.1

Source: Company, MOFSL

Exhibit 5: ITBS showed remarkable 4% QoQ CC growth

Segments	Contribution to revenue (%)	CC QoQ growth (%)	CC YoY growth (%)
IT and Business Services	74.4	4.0	6.7
Engineering and R&D Services	16.1	-1.6	6.4
HCL Software (P&P)	9.5	-18.5	0.0

Source: Company, MOFSL

Valuations offer a margin of safety

- Higher exposure to Cloud, which comprises a larger share of non-discretionary spending, offers better resilience to its portfolio in the current context, with higher demand for Cloud, Network, Security, and Digital workplace services.
- Given its capabilities in the IMS and Digital space, along with strategic partnerships and investments in Cloud, we expect HCLT to emerge stronger on the back of healthy demand for these services in the medium term. The stock is trading at ~20x FY26E EPS, which offers a margin of safety. Our TP of INR1,700 is based on 23x FY26E EPS. We reiterate our **BUY** rating on the stock.

Exhibit 6: Revisions to our estimates

	Revised			Earlier			Change		
	FY24	FY25E	FY26E	FY24	FY25E	FY26E	FY24	FY25E	FY26E
USD:INR	82.8	83.0	83.0	82.8	83.0	83.0	0.0%	0.0%	0.0%
Revenue (USD m)	13,270	13,840	15,568	13,299	14,673	16,584	-0.2%	-5.7%	-6.1%
Growth (%)	5.4	4.3	12.5	5.7	10.3	13.0	-20bps	-600bps	-50bps
EBIT margin (%)	18.2	18.6	19.3	18.4	18.8	19.1	-20bps	-10bps	10bps
PAT (INR b)	157	170	200	160	183	211	-1.7%	-6.7%	-5.5%
EPS	57.9	62.8	73.6	58.9	67.3	77.9	-1.7%	-6.7%	-5.5%

Source: MOFSL

Story in charts

Exhibit 7: HCLT reports a strong 0.3% sequential CC growth

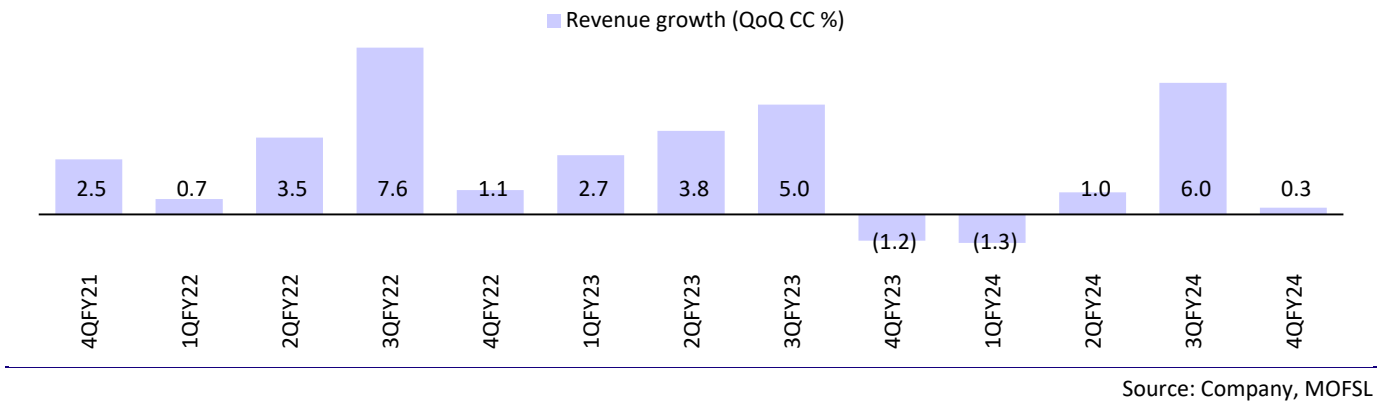


Exhibit 8: HCL Software and wage hikes hit margin

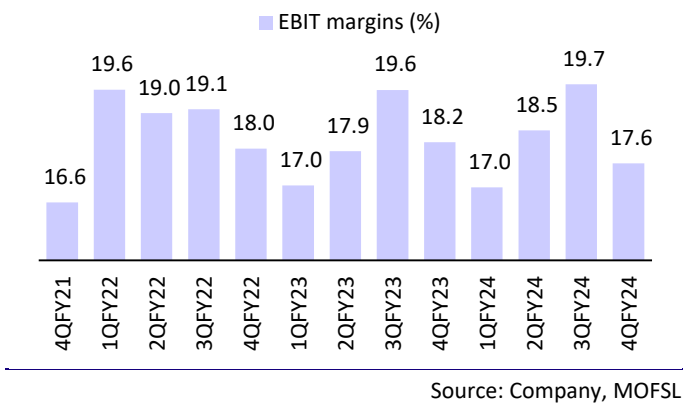


Exhibit 9: Gross margin drops on account of wage hikes

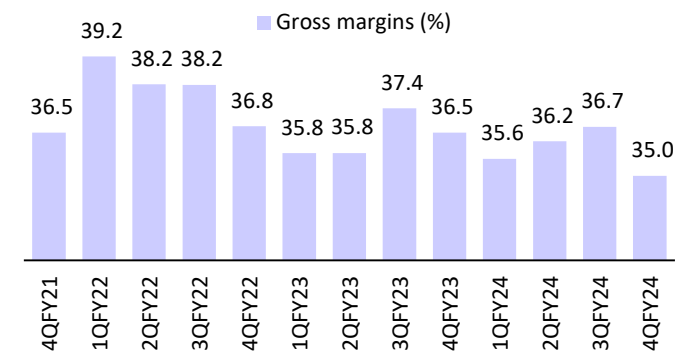


Exhibit 10: SG&A expenses saw 50bp expansion in 4QFY25

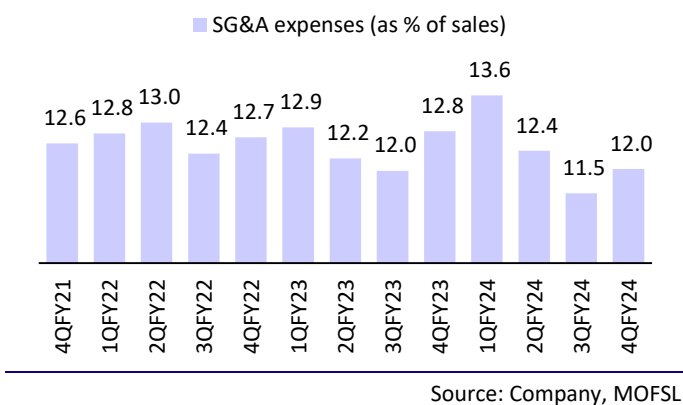
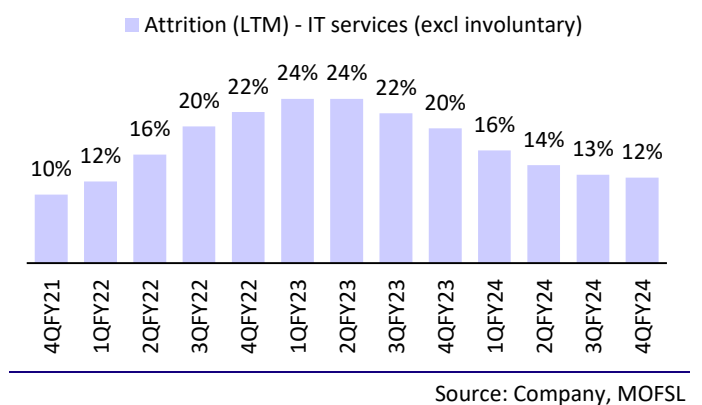


Exhibit 11: Attrition continues to moderate



Operating metrics

Exhibit 12: Operating metrics

	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
Service-wise (%)									
IT and Business Services	73.4	72.8	73.6	71.7	73.8	74.7	74.6	71.7	74.4
Engineering and R&D Services	16.4	16.6	17.0	16.6	16.1	15.4	16.0	16.4	16.1
Products and Platform	10.3	10.6	9.4	11.7	10.1	9.9	9.4	11.9	9.5
Vertical-wise (%)									
BFSI	21.6	21.1	20.6	19.9	21.2	22.6	22.6	21.7	21.6
Manufacturing	18.0	18.3	18.3	18.3	19.0	19.0	19.0	20.1	20.4
Technology and Services	17.5	15.4	15.4	15.4	14.4	14.4	14.4	12.8	12.3
Retail and CPG	9.8	9.4	9.2	8.9	9.0	9.1	9.6	9.6	9.1
Telecom MP&E	9.0	9.2	9.2	9.4	8.8	7.6	8.0	9.7	8.8
Life Sciences	16.2	16.4	16.5	17.1	17.5	17.5	17.5	16.4	16.3
Public Services	10.5	10.2	10.2	10.2	10.2	10.0	9.9	9.7	8.8
Geography-wise (%)									
US	63.1	63.1	64.8	63.5	63.8	64.5	64.5	64.5	65.2
Europe	28.7	28.6	27.5	29.1	28.9	28.7	28.5	29.0	28.9
RoW	8.2	8.3	7.7	7.4	7.3	6.8	7.0	6.4	5.9
Client-wise (%)									
Top five clients	11.6	11.2	10.7	10.3	10.1	9.8	9.8	9.8	10.4
Top 10 clients	19.8	19.4	18.8	18.2	17.7	17.2	17.2	17.7	18.8
Top 20 clients	29.1	28.9	28.6	28.2	27.8	27.2	27.3	28.0	29.0

Source: Company, MOFSL:

Financials and valuations

Income Statement								(INR b)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Sales	604	707	754	857	1,015	1,099	1,149	1,292
Change (%)	19.5	17.0	6.7	13.6	18.5	8.3	4.5	12.5
Cost of Goods Sold	393	453	467	546	662	721	749	831
Gross Profit	212	254	287	311	353	378	400	461
Selling and Admin Exp.	72	87	93	109	127	136	141	162
EBITDA	140	167	193	202	226	242	258	299
As a percentage of Net Sales	23.1	23.6	25.6	23.6	22.3	22.0	22.5	23.2
Depreciation	21	28	40	40	41	42	44	50
EBIT	118	139	153	162	185	200	214	249
As a percentage of Net Sales	19.6	19.6	20.4	18.9	18.2	18.2	18.6	19.3
Other Income	8	2	7	8	10	9	11	14
PBT	126	140	160	170	195	210	225	263
Tax	25	29	41	34	46	53	54	63
Rate (%)	19.6	20.9	25.4	20.3	23.8	25.1	24.2	24.0
PAT	101	111	119	136	148	157	171	200
Net Income	101	111	119	135	148	157	170	200
Change (%)	15.3	9.3	7.4	13.7	9.9	5.7	8.4	17.3

Balance Sheet								(INR b)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Reserves	422	517	615	620	654	683	674	664
Net Worth	422	517	615	620	654	683	674	664
Loans	40	51	39	39	21	22	22	22
Other liabilities	15	55	55	43	45	66	66	72
Capital Employed	477	623	709	703	720	771	763	758
Gross Block	335	511	546	560	596	643	689	741
Less: Depreciation	100	128	168	208	249	291	336	386
Net Block	235	383	378	352	347	352	353	354
Other assets	57	65	69	57	51	52	51	53
Investments	55	105	140	85	112	178	178	178
Curr. Assets	243	279	291	397	425	416	418	439
Debtors	146	178	175	207	255	255	264	295
Cash and Bank Balance	59	38	65	105	91	95	84	67
Other Current Assets	37	64	50	85	80	66	69	78
Current Liab. and Prov.	111	209	168	188	214	227	238	267
Net Current Assets	131	70	123	209	211	189	180	172
Application of Funds	477	623	709	703	720	771	763	758

Financials and valuations

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Diluted (INR)								
EPS	36.8	40.7	43.8	49.8	54.8	57.9	62.8	73.6
Cash EPS	44.6	51.2	58.5	64.6	70.1	73.3	79.2	92.2
Book Value	153.5	190.4	226.7	228.6	241.6	252.1	248.9	245.2
DPS	4.0	8.0	26.0	44.0	48.0	48.0	56.5	66.2
Payout (%)	50.4	19.6	59.4	88.3	87.6	82.9	90.0	90.0
Valuation (x)								
P/E	40.0	36.1	33.6	29.5	26.9	25.4	23.5	20.0
Cash P/E	33.0	28.8	25.2	22.8	21.0	20.1	18.6	16.0
EV/EBITDA	28.8	24.0	20.5	19.4	17.3	16.2	15.2	13.2
EV/Sales	6.7	5.7	5.3	4.6	3.9	3.6	3.4	3.1
Price/Book Value	9.6	7.7	6.5	6.4	6.1	5.8	5.9	6.0
Dividend Yield (%)	0.3	0.5	1.8	3.0	3.3	3.3	3.8	4.5
Profitability Ratios (%)								
RoE	25.6	23.6	21.0	21.9	23.3	23.5	25.1	29.9
RoCE	22.8	21.3	18.7	19.6	21.1	21.7	23.2	27.4
Turnover Ratios								
Debtors (Days)	88	92	85	88	92	85	84	83
Asset Turnover (x)	2.6	1.8	2.0	2.4	2.9	3.1	3.3	3.6

Cash Flow Statement

(INR b)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
CF from Operations	123	149	166	174	193	201	215	250
Chg. in Working Capital	-34	-16	30	-5	-13	23	0	-6
Net Operating CF	88	134	196	169	180	224	215	244
Net Purchase of FA	-61	-18	-18	-16	-14	-10	-46	-52
Net Purchase of Invest.	29	-105	-40	30	-25	-57	0	0
Net Cash from Inv.	-32	-124	-57	15	-39	-67	-46	-52
Issue of shares/other adj.	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	35	-15	-79	-31	-29	-14	0	0
Dividend Payments	-51	-16	-33	-114	-130	-141	-179	-210
Net CF from Finan.	-16	-32	-112	-145	-159	-154	-179	-210
Free Cash Flow	28	115	179	153	166	214	169	192
Net Cash Flow	41	-22	27	39	-18	3	-10	-18
Forex difference	5	0	1	1	4	1	0	0
Opening Cash Balance	13	60	38	66	106	91	95	85
Closing Cash Balance	60	38	66	106	91	95	85	67

Investment in securities market are subject to market risks. Read all the related documents carefully before investing

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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