

HCL Technologies Ltd

Q2FY25



HCL Technologies Ltd.

Future growth mirrors historical trends, but overly stretched valuations raises concern

CMP* INR 1,870	Target INR 1,887	Potential Upside 0.9%	Market Cap (INR Mn) INR 50,63,699	Recommendation HOLD	Sector Internet Software and Services
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Result Highlights

- HCL Technologies Q2FY25 earnings exceeded our expectations, despite revenue aligning our projections.
- Revenue stood at INR 288,620 Mn, up 6.2% YoY in CC (+1.6% QoQ CC). This was driven by the IT and Business service segment, which increased 6.2% YoY in CC, coupled with the HCL software segment, which increased 9.4% YoY in CC.
- We expect Revenue/PAT to grow at a CAGR of 8.7%/12.0% over FY24-FY26E, respectively, and at a CAGR of 8.6%/10.9% over FY24-FY27E. Accordingly, we increase our FY26E EPS to INR 72.6 (previously: INR 72.5) and P/E multiple to 26.0x (previously 23.0x), driven by improving discretionary spending, robust service revenue performance, and strengthening digital capabilities, resulting in a revised Target Price of INR 1,887.
- However, it is important to note that HCL Tech's historical Revenue/PAT growth from FY21-FY24, is at 13.4%/12.1%, closely aligning with our forecasts for FY24-26E. Despite this, the stock is currently trading at an all-time high 1-Yr Forward P/E multiple of 29.4x, significantly above the three-year average of 18.1x.
- While our estimates align with historical growth rates, the recent rally in HCL Tech's share prices, driven by expectations of improved discretionary spending, has resulted in overstretched valuations, raising concerns regarding the sustainability of these levels. As a result, we downgrade our rating on HCL Tech from "ACCUMULATE" to "HOLD."**

MARKET DATA

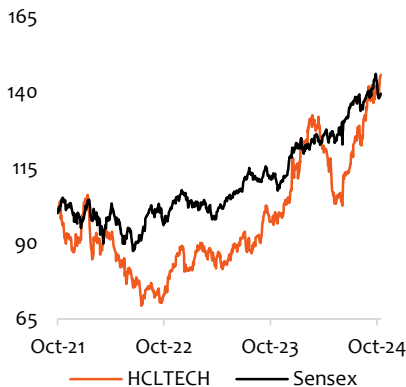
Shares outs (Mn)	2,827
Mkt Cap (INR Mn)	50,63,699
52 Wk H/L (INR)	1,883/1,212
Volume Avg (3m K)	4,228
Face Value (INR)	2
Bloomberg Code	HCLT IN

KEY FINANCIALS

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Revenue	1,014,560	1,099,130	1,177,690	1,298,326	1,406,381
EBIT	184,830	200,250	217,199	244,408	267,741
PAT	148,510	157,020	176,264	196,972	214,115
OPM (%)	18.2%	18.2%	18.4%	18.8%	19.0%
NPM (%)	14.6%	14.3%	15.0%	15.2%	15.2%

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	81,820
NIFTY	25,057

Earnings exceeded expectations, driven by strong margin expansion

- Revenue stood at INR 288,620 Mn, up 6.2% YoY in CC (+1.6% QoQ CC). This was driven by the IT and Business service segment, which increased 6.2% YoY in CC, coupled with the HCL software segment, which increased 9.4% YoY in CC.
- EBIT stood at INR 53,620 Mn, up 9.0% YoY (+11.8% QoQ), exceeding our expectations. EBIT Margin came in at 18.6%, driven by margin expansion in the HCL software business (+54bps), service business (+110bps) due to lower marketing costs, and currency tailwinds (+22bps) QoQ.
- PAT stood at INR 42,350 Mn, up 10.5% YoY (-0.5% QoQ), surpassing our projections by 2.9%, driven by strong operating performance, resulting in PAT margin expansion by 31bps YoY (-50bps QoQ) to 14.7%.

Growth across all verticals and geographies (excl. BFSI)

- HCLTech Q2FY25 services segment reported growth of 1.6% QoQ, driven by IT and Business services up 1.8% QoQ CC, and Engineering and R&D business, up 1.1% QoQ CC, despite a USD 30 Mn impact from the divestment of stake in JV to State Street.
- The product segment saw a sequential CC growth of 1.4% with a margin expansion of 503bps QoQ to 25.6%. Americas/Europe/RoW reported USD revenue growth of 1.0%/4.2%/9.1% QoQ.
- Financial services performance remained muted USD revenue growth QoQ, due to planned divestiture in JV with State Street. Retail & CPG/Public Services/Technology/ Lifesciences & Healthcare / Manufacturing saw a sequential USD growth of 4.6%/3.5%/3.2%/3.1%/2.9%, respectively.

SHARE HOLDING PATTERN (%)

Particulars (%)	Jun-24	Mar-24	Dec-23
Promoters	60.8	60.8	60.8
FIIIs	18.5	19.7	19.4
DIIIs	15.8	15.0	15.1
Others	4.9	4.6	4.7
Total	100	100	100

*Based on the today's closing
Note: All the market data is as of previous closing

8.7%

Revenue CAGR between FY24 and FY26E

12.0%

Adj. PAT CAGR between FY24 and FY26E

HCL Technologies Ltd.

Key Concall Highlights:

Lower end of growth guidance revised; EBIT margin guidance remains intact

- HCL Tech has revised its revenue growth guidance to 3.5%-5.0% CC YoY, with a similar outlook for the services segment, while EBIT margins are expected to remain in the range of 18.0 – 19.0%.
- This guidance does not factor in potential revenue from the acquisition of certain assets from HPE's Communication Technology Group (CTG), expected to close in December 2024.
- We anticipate strong growth in the product business, improved utilization rates, reductions in subcontractor costs, and lower SG&A expenses, which are likely to drive margin improvements in H2FY25E, though partially offset by wage hike pressures.

TCV remains muted, Clients added in larger bracket

- TCV for the quarter stood at USD 2,218 Mn, down 44.1% YoY (+13.2% QoQ), indicating moderation in growth in the near to medium term and the need for mega deals to drive revenue growth in FY26E.
- The company reported the addition of four new clients each in the USD 50mn+ and USD 20mn+ categories on a sequential basis.
- However, the company experienced a net reduction of five clients in the USD 10mn+ category, along with a decrease of two clients in the USD 5mn+ segment.

HCLTech's AI force gains momentum, Accelerating GenAI adoption and transforming services

- HCLTech's AI capabilities are becoming integral to most deals, with its GenAI platform, AI Force, seeing widespread adoption for service transformation.
- Currently, the platform is gaining traction with over 25 clients, with a target to expand to 50. The company
- has secured key wins in GenAI-related projects, which are driving technology change and reducing technology debt across industries.
- The company's AI Force platform, integrated with Anthropic Cloud through Amazon Bedrock, is also part of strategic collaborations with AWS and Google Cloud, aimed at accelerating GenAI adoption.
- A notable project includes the deployment of HCLTech's Enterprise AI Foundry to build and operationalize AI models that enhance aftermarket sales operations for a major U.S.-based automotive client.
- The company continues to leverage AI to reduce operational timelines, improve efficiency, and displace competitors in GenAI-related contracts.

Interim dividend announced; Payment set for October 30

- HCLTech's Board of Directors has declared an interim dividend of INR 12 per share. The record date has been confirmed as October 22, 2024, with the dividend payment scheduled for October 30, 2024.

Headcount shrinks, Attrition inches up; Focus shifts to specialized hiring

- Despite strong revenue growth and significant fresher hiring, HCLTech's total headcount for Q2FY25 decreased by 780 employees, bringing the workforce to 218,621.
- The company added 2,932 freshers during Q2FY25. However, the attrition rate edged up slightly by 10 bps to 12.9%.
- HCLTech is increasingly focusing on workforce quality, aiming to shift its hiring strategy towards specialized skills, particularly in areas like data and AI, rather than purely expanding based on revenue growth.
- The company plans phased wage hikes over Q3FY25 and Q4FY25, which are expected to impact margins by 65-80 bps in Q3, followed by an additional 50-60 bps impact in Q4.
- In India, salary increments will average 7.0%, with top performers receiving increases between 12.0% and 15.0%.
- HCLTech has factored in similar furloughs to last year, based on ongoing client discussions and evolving priorities.

Valuation and view:

HCL Tech delivered robust results for Q2FY25, with earnings surpassing our expectations, driven by significant growth in its service and software sectors. While management expressed optimism regarding the improving demand landscape across various verticals, it remains cautious amid ongoing uncertainty and volatility. We maintain a positive outlook on HCL Tech's ability to achieve the upper end of its revenue guidance, supported by increased discretionary spending and broad-based growth across verticals, including a potential revival in the BFSI segment influenced by interest rate cuts, and strong growth in the HCL software business projected for Q3FY25E. However, muted deal total contract values (TCVs), challenges in the aerospace and automotive sectors, and a weak near-term outlook for the software business may hinder growth momentum.

In light of these developments, we have slightly increased our FY26E EPS to INR 72.6 (previously: INR 72.5) and increased our P/E multiple to 26.0x (previously: 23.0x) due to improved discretionary spending, strong service revenue performance, and enhancing digital capabilities. As a result, we have raised our target price to INR 1,887 (previously INR 1,668).

HCL Tech's historical Revenue/ PAT growth for FY21-FY24 stands at 13.4%/12.1%, respectively, which is largely in line with our projections for FY24-FY26E. However, the recent rally in the share price has resulted in HCL Tech trading at an all-time high 1-Year Forward P/E multiple of 29.4x, well above the three-year average of 18.1x.

While our forecasts are consistent with the company's historical growth trajectory, the recent surge in HCL Tech's share prices, fueled by expectations of increased discretionary spending, has led to stretched valuations. This raises concerns about the sustainability of these elevated levels. Consequently, we revise our rating on HCL Tech from "ACCUMULATE" to "HOLD."

HCL Technologies Ltd.

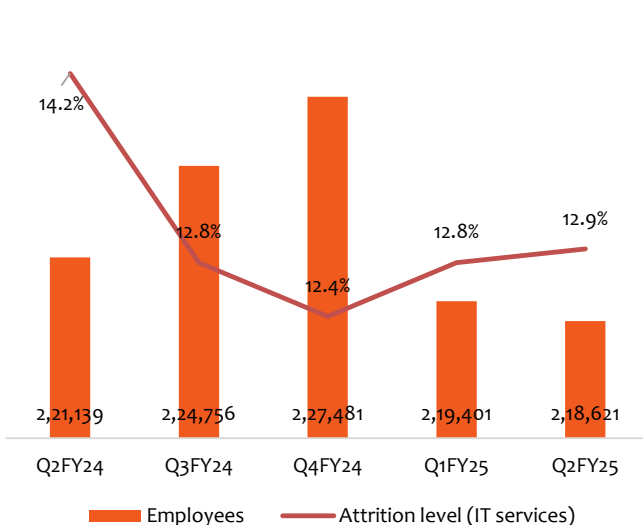
RESULT SNAPSHOT

Particulars (Mn)	Q2FY25	Q1FY25	Q2FY24	QoQ	YoY
Revenue	288,620	280,570	266,720	2.9%	8.2%
Employee benefits expense	165,230	164,100	152,530		
Purchase of stock-in-trade	4,800	4,040	3,770		
Changes in inventories of stock-in-trade	-140	250	250		
Outsourcing costs	37,480	35,410	35,080		
Other expenses	17,560	18,840	15,800		
Total expenses	224,930	222,640	207,430		
EBITDA	63,690	57,930	59,290		
EBITDA margin (%)	22.1%	20.6%	22.2%		
Depreciation and amortization expense	10,070	9,980	10,100		
EBIT	53,620	47,950	49,190	11.8%	9.0%
EBIT margin (%)	18.6%	17.1%	18.4%	149bps	14bps
Finance Cost	1,310	1,910	1,560		
Other Income	4,560	11,030	3,650		
Profit before tax	56,870	57,070	51,280		
Tax expense	14,500	14,480	12,950		
Minority Interest	20	20	10		
Net profit	42,350	42,570	38,320	(0.5%)	10.5%
Net profit (%)	14.7%	15.2%	14.4%	-50bps	31bps
Diluted EPS (INR)	15.6	15.7	14.1		

Source: Company, KRChoksey Research

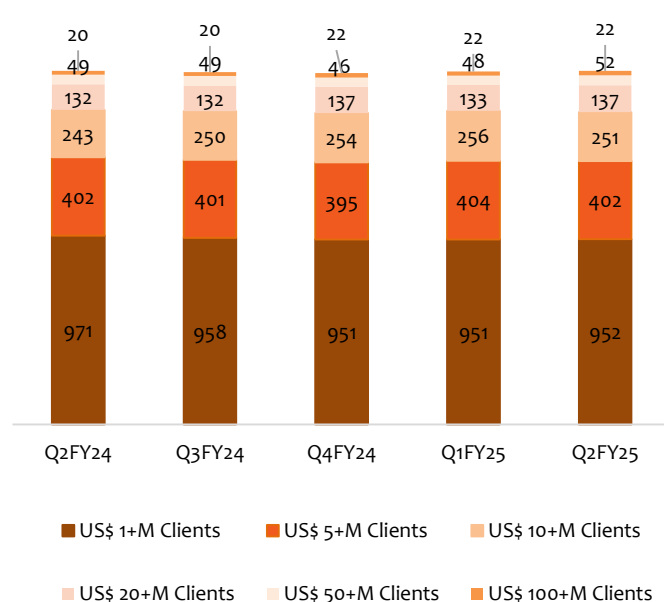
QUARTERLY SNAPSHOT

Attrition rate increased after a continuous trend of decline.



Source: Company, KRChoksey Research

Client added in USD 50 Mn+ and USD 20 Mn+ bracket



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KEY FINANCIALS

Exhibit 1: Profit & Loss Statement

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Revenue	1,014,560	1,099,130	1,177,690	1,298,326	1,406,381
Employee Cost	645,230	624,800	766,863	836,106	903,989
SG&A and Other Cost	143,050	232,350	153,100	172,028	186,345
EBITDA	226,280	241,980	257,727	290,192	316,046
Depreciation	41,450	41,730	40,529	45,784	48,305
EBIT	184,830	200,250	217,199	244,408	267,741
Other income	13,580	14,950	23,911	20,383	20,477
Finance costs	3,530	5,530	4,406	3,795	3,911
PBT	194,880	209,670	236,704	260,996	284,307
Tax expense	46,430	52,570	60,359	63,944	69,655
PAT before	148,450	157,100	176,344	197,052	214,652
Minority Interest, MI	-60	80	80	80	80
Net profit	148,510	157,020	176,264	196,972	214,115
Diluted EPS (INR)	54.7	57.9	65.0	72.6	78.9
Shares in Million	2,714	2,714	2,714	2,714	2,714

Exhibit 3: Cash Flow Statement

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
CFFO	180,090	224,480	243,258	283,413	312,343
CFFI	-39,310	-67,230	-55,212	-71,671	-76,440
CFFF	-158,810	-154,640	-167,601	-166,205	-194,303
Net Inc/Dec	-18,030	2,610	20,446	45,537	41,600
Opening Cash	105,100	90,650	94,410	114,856	160,392
Exchange Rate Difference	3,580	1,150	0	0	0
Closing Cash	90,650	94,410	114,856	160,392	201,992

Exhibit 4: Key Ratios

Key Ratios	FY23	FY24	FY25E	FY26E	FY27E
EBIT Margin (%)	18.2%	18.2%	18.4%	18.8%	19.0%
Tax rate (%)	23.8%	25.1%	25.5%	24.5%	24.5%
Net Profit Margin (%)	14.6%	14.3%	15.0%	15.2%	15.2%
RoE (%)	23.3%	23.2%	22.2%	22.1%	22.1%
RoCE (%)	21.1%	21.2%	20.5%	20.6%	20.6%
EPS (INR)	54.7	57.9	65.0	72.6	78.9

Source: Company, KRChoksey Research

Exhibit 2: Balance Sheet

INR Millions	FY23	FY24	FY25E	FY26E	FY27E
Equity					
Equity Capital	5,430	5,430	5,430	5,430	5,430
Other Equity	648,620	677,200	758,215	850,412	937,528
Non controlling interest	-70	80	80	80	80
Total Equity	653,980	682,710	763,725	855,922	943,038
Non-Current Liabilities					
Borrowings	21,110	22,230	21,563	20,916	20,289
Other Financial Liabilities	28,070	42,180	30,855	34,016	36,847
Operating Lease Liability	16,640	23,390	18,254	20,124	21,799
Total Non-Current Liabilities	65,820	87,800	70,673	75,056	78,935
Current Liabilities					
Borrowings	10,110	11,940	11,777	12,983	14,064
Trade Paybles	64,280	58,530	75,613	82,860	89,617
Income Tax Liabilities	21,500	23,130	26,557	28,134	30,582
Other current liabilities	118,420	133,660	130,253	143,595	155,546
Total Current Liabilities	214,310	227,260	244,200	267,573	289,808
Total Liabilities	934,110	997,770	1,078,598	1,198,552	1,311,781
Non-Current Assets					
PPE	53,710	48,910	53,133	72,266	94,280
Right of use of Assets	23,370	29,700	30,042	30,418	30,826
Goodwill	185,670	201,320	201,320	201,320	201,320
Intangible Assets	83,440	71,300	71,300	71,300	71,300
Other current assets	52,150	53,230	63,348	69,726	75,440
Total Non-Current Assets	398,340	404,460	419,143	445,031	473,165
Current Assets					
Investments	53,850	70,430	70,430	70,430	70,430
Trade Receivables	255,060	255,210	306,522	337,920	366,044
Cash and Bank	147,240	201,500	114,856	160,392	201,992
Oher current assets	79,620	66,170	167,647	184,778	200,149
Total Current Assets	535,770	593,310	659,455	753,521	838,616
Total Assets	934,110	997,770	1,078,598	1,198,552	1,311,781

HCL Technologies Ltd.

HCL Technologies Ltd.			
Date	CMP (INR)	TP (INR)	Recommendation
15-Oct-24	1,870	1,887	HOLD
15-Jul-24	1,570	1,668	ACCUMULATE
29-Apr-24	1,387	1,546	ACCUMULATE
08-Feb-24	1,615	1,756	ACCUMULATE
17-Jan-24	1,576	1,683	ACCUMULATE

Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

ANALYST CERTIFICATION:

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