

Equity Research Desk



ALPHA

29 SEP 2022

HCL Technologies Ltd. – Supercharging Progress

Market Data	
CMP	Rs. 921
Date	28-Sep-22
Target Price	Rs. 1123
Upside Potential	22.00%
52 Week High/Low	1359/877
Market Cap	Large Cap
NSE Code	HCLTECH
Sector	IT Software
Rating	Buy

HCL Tech is a global technology company, home to 210,000+ people across 52 countries, delivering industry-leading capabilities centered around digital, engineering and cloud, powered by a broad portfolio of technology services and products. While HCL started off as a hardware organization, manufacturing the country's first indigenous computers and introducing them to the Indian consumer, it eventually evolved into a more comprehensive software services organization. HCL is, in fact, one of the few global IT companies founded in the 1970s that remains in existence to date. They work with clients across all major verticals, providing industry solutions for Financial Services, Manufacturing, Life Sciences and Healthcare, Technology and Services, Telecom and Media, Retail and CPG, and Public Services.



Products & Services: The company's services comes under three divisions.

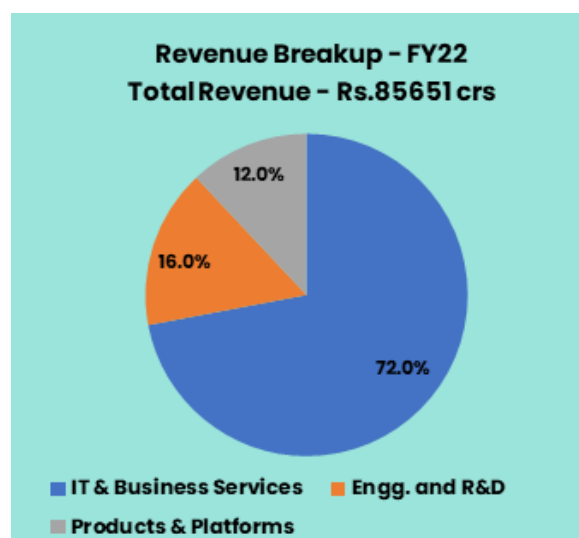
IT & Business Services – Offerings of Hybrid Cloud, Digital Workplace, Unified Service Management and Cybersecurity/Governance, and Risk and Compliance group under Digital Foundation, which is the evolution of Infrastructure services. Consulting, Applications, Insights, and IoT form offerings under Digital Business. IT Operations, Managed Cybersecurity Services (CSFC), and Process Operations are the offerings under Digital Operations.

Engineering and R&D Services – Product Engineering services, Platform Engineering Services, Operational Technology Services and Next-Gen Engineering.

Products & Platforms – The Products & Platforms segment comprises the HCL Software Division, Action software, ERX, and an IP partnership with DXC.

SHP	Jun - 22 (%)	Mar - 22 (%)	Change
Promoters	60.72	60.72	0.00
FPI	17.91	18.97	-1.06
DII	15.79	14.93	0.86
Public & Others	5.59	5.38	0.21
Pledged	0.00	0.00	0.00

Subsidiaries: As on March 31, 2022, the Company has 120 subsidiaries and 8 associate companies.





Key Rationale

- **Strong Position** – HCL Technologies is the third-largest, listed Indian IT services provider, in terms of revenue. It has an established and diversified industry-vertical portfolio, with the financial services segment accounting for 21.3% of revenue during fiscal 2022, followed by manufacturing (17.7%), technology & services (17.4%) and other segments such as life sciences & healthcare, retail & consumer packaged goods forming the balance (43.6%). The company has further strengthened its capabilities in the IT products and platforms segment by acquiring the intellectual property rights of IBM for seven product suites in FY20. This has facilitated access to a large addressable market across geographies and niche technological capabilities. Over the past two years, the company has been steadily increasing its share of digital revenue (39.3% in FY22, from 23.4% in FY18), driven by the Mode 2 and Mode 3 segments. Major acquisitions of Actian and C3i Solutions (in Apr 2019) and DWS (in Sep 2020) will further support the business expansion plans with focus on digital solutions.
- **Deal Wins** – HCLT remains confident on the demand environment with new TCV deal wins of US\$2 billion (bn), up 23.4% YoY of which US\$1.9 bn was in services segment & US\$104 mn was in P&P. The company won 16 new large deals of which 7 were in services and 9 in P&P. HCLT, so far, did not see any slowdown in tech spending from the clients. On a QoQ basis, \$100 Mn+ clients are up by 1, \$20 Mn+ clients by 9, \$10 Mn+ clients by 10, \$5 Mn+ clients by 4. Hiring continued at a brisk pace with a net addition of 2,089 during the quarter. The total headcount now stands at 210966. HCL Tech Q1FY23 attrition in IT Services increased by 190bps to 23.8%. The company hired ~6,000 freshers in the quarter ended and plans to hire 10,000 freshers in Q2FY23 with the overall target of 30,000–35,000 of fresher hiring.
- **Q1FY23** – It reported rupee revenues of Rs.23,464 crs, up 3.8% QoQ, 16.9% YoY while dollar revenues came in at US\$3,038 million (mn), up 1.5% QoQ, 11.7% YoY. IT business revenue increased 0.1% QoQ to US\$2,201 mn, ER&D business reported revenues of US\$503 mn, up 2.7% QoQ & P&P business reported revenue of US\$334 mn, up 9.9% QoQ. Vertical wise, in CC terms, technology & services, telecommunications, life sciences reported strong growth of 10.9%, 4.3%, 2.7%, respectively, while BFSI, retail & manufacturing reported weak/muted growth of 0.8%, -1.4%, -0.5% QoQ, respectively. HCL management has announced a dividend of Rs.10/Share in Q1FY23.
- **Financial Performance** – The company generated a Revenue and PAT CAGR of 18% and 23% over the period of 10 years (FY12–22). Capital structure is marked by a large networth of over Rs.60,000, respectively, and cash and cash equivalents of Rs.18,980 crs as on March 31, 2022. Debt protection metrics are also robust, with interest coverage ratio around 60 times.

**Ratios - FY22**

ROE	22%
ROCE	25%
Div. Yield	3.49%
PE Ratio	19.00
Face Value	2.00
EPS	Rs. 49.74

Industry Analysis

The IT & BPM sector has become one of the most significant growth catalysts for the Indian economy, contributing significantly to the country's GDP and public welfare. The IT industry accounted for 8% of India's GDP in 2020, and it is expected to contribute 10% to India's GDP by 2025. India is the leading sourcing destination across the world, accounting for approximately 55% market share of the US\$ 200-250 billion global services sourcing business in 2019-20. The Indian IT industry's revenue touched US\$ 227 billion in FY22, a 15.5% YoY growth. In FY21, the Indian IT sector exported goods worth US\$ 149 billion. The largest contributor, accounting for more than 51% of all IT exports, has been the export of IT services (including hardware). The IT industry added 4.45 lakh new employees in FY22, bringing the total employment in the sector to 50 lakh employees.

Growth Drivers

New IT-based technologies such as Tele-medicine, remote monitoring, etc. are expanding and boosting the demand in the digital economy. The roll out of fifth-generation (5G) communication technology, growing adoption of artificial intelligence, Big Data analytics, cloud computing and the Internet of Things (IoT) will further expand the size of the IT industry in India.

The government introduced the STP Scheme, which is a 100% export-oriented scheme for the development and export of computer software, including export of professional services.

The computer software and hardware sector in India attracted cumulative foreign direct investment (FDI) inflows worth US\$ 81.31 billion between April 2000 and December 2021.



Peer Analysis

Competitors: Tech Mahindra, Wipro, etc.

The IT stocks are mostly trading at the same P/E, with HCL a bit more comfortable position when compared with the fundamentals of the company. The employee expense of the company is well handled by HCL than the others.

Company	CMP	Mcap.	ROE	ROCE	5 Yr Avg. Employee cost as a % of Sales	P/E	EPS
HCL Tech	921	249576	22.00%	25.00%	50.00%	19	49.74
Wipro	398	218212	19.00%	20.00%	53.00%	18	22.31
Tech Mahindra	1030	100060	21.00%	25.00%	51.00%	18	57.27

Outlook

The Digital and Cloud transformation continues to be the central theme for growth. Digital operation services, CX transformation, and Cloud smart led the growth in IT Services. Management has retained its revenue guidance of 12-14% YoY CC for FY23 driven by strong deal pipeline, deal win momentum and no signs of slowdowns as of now. It mentioned that deal pipeline is near record-high and is confident on bookings in Q2FY23. The company maintains the EBIT margin guidance from 18-20% to 18%. Management aspires to grow the Digital Foundation business 2x-3x of the average market growth in the mid to long term as following are the opportunities available (a) 40%-50% potential growth in newer locations (b) \$70-80 bn potential market with first time outsourcers (c) \$100 bn renewal market size in next 3 years (d) expanding offerings to existing clients.

Margins - FY22	
EBITDA	24%
EBIT	20%
PAT	16%



Valuation

Given its deep capabilities in the IMS (Information Management System) space and strategic partnerships, investments in the Cloud, and Digital capabilities, we expect HCL to emerge stronger on the back of an expected increase in enterprise demand for these services. Hence, we recommend a BUY rating in the stock with the target price (TP) of Rs.1123, 18x FY24E EPS.

Risks

- **Competitive risk** - HCL Technologies competes with Indian IT majors such as TCS, Infosys, Cognizant, and Wipro; and global players such as IBM, Accenture and DXC Technology.
- **Cost related Risk** - INR appreciation against the USD, pricing pressure, retention of the skilled headcount, strict immigration norms and rise in visa costs are key concerns.
- **Execution Risk** - The large size as well as multiple acquisitions and increased participation in the products business as against services, which is its core strength, could cause execution challenges. However, the management's track record of integrating and scaling up acquired businesses gives comfort.

Source – Tickertape, Company's Website, BSE Website.

Thanks & Regards

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