

Tech Mahindra

Estimate change

TP change

Rating change



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Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USD b)	988.9 / 12.4
52-Week Range (INR)	1811 / 930
1, 6, 12 Rel. Per (%)	-2/-29/-15
12M Avg Val (INR M)	4647

Financials & Valuations (INR b)

Y/E Mar	2022	2023E	2024E
Sales	446	537	594
EBIT Margin (%)	14.6	12.3	13.2
PAT	56	54	65
EPS (INR)	62.6	61.3	73.9
EPS Gr. (%)	21.2	(2.0)	20.5
BV/Sh. (INR)	305.2	321.4	341.0

Ratios

RoE (%)	21.5	19.7	22.4
RoCE (%)	21.0	19.7	22.1
Payout (%)	71.9	75.0	75.0

Valuations

P/E (x)	16.1	16.5	13.7
P/BV (x)	3.3	3.2	3.0
EV/EBITDA (x)	10.9	10.3	8.8
Div Yield (%)	4.4	4.5	5.5

Shareholding pattern (%)

As On	Jun-22	Mar-22	Jun-21
Promoter	35.2	35.3	35.7
DII	20.9	18.2	16.7
FII	30.4	34.3	36.2
Others	13.4	12.3	11.4

FII Includes depository receipts

CMP: INR1,017

TP: INR1,035 (+2%)

Neutral

Awaiting greater comfort on a margin recovery

5G unlikely to drive the upside in near term growth

- TECHM reported a 1QFY23 revenue of USD1.63b, up 3.5% QoQ CC (including an inorganic component of 40bp), ahead of our estimate of 2.8% QoQ. Reported growth was 1.5% QoQ in 1QFY23, led by a 1.8%/1% growth in enterprise (Technology and Retail)/Communications. While its revenue performance was good, it saw a big dip in its EBIT margin (down 220bp QoQ to 11%, 30bp below our estimate) due to a partial wage revision, lower utilization, and a normalization in SG&A spend. It reported a TCV of USD802m in 1QFY23, down 21% QoQ.
- Performance in 1QFY23 was aided by continued strength in the demand environment (in line with its peers), along with strong deal wins in 4QFY22. While we expect the company to sustain its good revenue performance over FY23 (MOFSL of over 16% YoY), we continue to factor in a growth moderation in FY24, despite the continued positive commentary on 5G spends. This spend is likely to be in the medium term on account of growth and monetization uncertainty on the telco side, which will have a near to medium term impact. TECHM should deliver a USD revenue CAGR of 12% over FY22-24.
- We are concerned about TECHM's weak margin performance in 1QFY23 as it has twice missed its margin expectations in the last two quarters. As the company starts its recovery process, we see a high probability of it missing its 4Q exit margin rate of 14%, due to: a) a 100bp impact from a wage hike in 2QFY23, and b) relatively less support from utilization and fresher addition as levers as compared to its peers. We expect margin to remain at 12.3% in FY23, with the exit margin of 13.6%, 40bp below its guidance. We don't expect TECHM to normalize margin to 14% in FY24.
- We continue to stay on the sidelines on TECHM as we feel the current valuations fairly factor in better business dynamics against a moderation in profitability. We marginally tweak our estimates to account for lower margin. Our TP implies 14x FY24E EPS. We **remain Neutral** on the stock.

Revenue beat in 1QFY23, but large margin drop hits earnings

- TECHM reported a revenue of USD1.63b (up 3.5% QoQ in CC terms, up 1.5% QoQ, and up 3.1% in organic CC terms; est. 2.8% in CC terms).
- EBIT margin fell 220bp QoQ and 420bp YoY to 11%, 30bp below our estimate.
- PAT fell 25% QoQ to INR11.3b, 7% below our estimate, despite a lower tax rate (down 22.8%).

Key highlights from the management commentary

- In the CME vertical, while a weakening macro environment is coming up in client conversations, TECHM is not seeing any budget cuts and the deal pipeline remains strong.
- 5G spends remain robust. There is a strong focus on capacity building and carrier additions. It is not seeing any impact from macro-related concerns.
- The management aims to raise margin by 100-150bp per quarter to reach 14% exit margin in 4QFY23.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Valuation and view

- TECHM's high exposure to the Communications vertical remains a potential opportunity as a broader 5G rollout can result in a new spending cycle in this space. The company is seeing traction in 5G investments.
- We expect TECHM to deliver mid-teen growth in FY23. We value the stock at 14x FY24E EPS. **We maintain our Neutral rating.**

Quarterly performance

Y/E March	FY22				FY23				FY22	FY23E	FY23E 1QE	(INR b) Var. (%/bp)
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE				
Revenue (USD m)	1,384	1,473	1,534	1,608	1,633	1,685	1,722	1,778	5,998	6,817	1,627	0.3
QoQ (%)	4.1	6.4	4.1	4.9	1.5	3.2	2.2	3.2	17.4	13.7	1.1	35bp
Revenue (INR b)	102	109	115	121	127	133	136	140	446	537	125	1.4
YoY (%)	12.0	16.1	18.7	24.5	24.6	22.3	18.8	15.9	17.9	20.2	22.8	178bp
GPM (%)	31.7	31.7	30.1	29.3	28.3	28.6	29.5	30.4	30.6	29.2	27.8	46bp
SGA (%)	13.3	13.3	12.1	12.1	13.5	13.2	13.0	13.0	12.7	13.2	12.5	97bp
EBITDA	19	20	21	21	19	21	22	24	80	86	19	-1.9
EBITDA Margin (%)	18.4	18.3	18.0	17.2	14.8	15.4	16.5	17.4	18.0	16.1	15.3	-51bp
EBIT	15	17	17	16	14	15	17	19	65	66	14	-0.9
EBIT Margin (%)	15.2	15.2	14.8	13.2	11.0	11.6	12.7	13.6	14.6	12.3	11.3	-26bp
Other income	2	2	2	3	1	2	2	3	10	8	2	-65.5
ETR (%)	23.9	29.4	26.9	17.5	22.8	26.5	26.5	26.5	24.4	25.7	26.0	-325bp
Adj. PAT	14	13	14	15	11	13	14	16	56	54	12	-6.9
QoQ (%)	11.7	-1.1	2.2	10.0	-24.8	14.5	10.7	9.6			-19.2	-560bp
YoY (%)	39.2	25.7	4.5	24.3	-16.4	-3.2	4.8	4.3	22.1	-2.4	-10.2	-623bp
Extra-Ordinary Item	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Reported PAT	14	13	14	15	11	13	14	16	56	54	12	-6.9
EPS (INR)	15.3	15.1	15.5	16.9	12.8	14.6	16.2	17.7	62.6	61.3	13.7	-6.6

E: MOFSL estimates

Key performance indicators

Y/E March	FY22				FY23				FY22	FY23E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Revenue (QoQ CC %)	3.9	7.2	4.7	5.4	3.5					
Margins (%)										
Gross Margin	31.7	31.7	30.1	29.3	28.3	28.6	29.5	30.4	30.6	29.2
EBITDA margin	18.4	18.3	18.0	17.2	14.8	15.4	16.5	17.4	18.0	16.1
EBIT Margin	15.2	15.2	14.8	13.2	11.0	11.6	12.7	13.6	14.6	12.3
Net Margin	13.3	12.3	12.0	12.4	8.9	9.7	10.5	11.2	12.5	10.1
Operating Metrics										
Headcount (k)	126	141	145	151	158				151	
Utilization excl. trainees (%)	89.0	89.0	86.0	84.0	83.0				87.0	
Attrition (%)	17.0	21.0	24.0	24.0	22.0				24.0	
Offshore rev. (%)	38.0	39.0	39.0	38.0	0.0				38.5	
Deal TCV (USD m)	815	750	704	1011	802				3,280	
Key Verticals (QoQ %)										
Communication	3.1	6.7	6.2	4.1	1.0				17.2	
Enterprise	4.7	6.3	2.7	5.4	1.8				17.5	
Key Geographies (QoQ %)										
North America	6.8	8.9	6.5	3.6	4.2				18.6	
Europe	6.8	1.3	2.5	8.6	-2.0				18.5	



Highlights from the management commentary

Demand and industry outlook

- TECHM posted a robust revenue growth of 3.5% QoQ in CC terms in 1QFY23.
- The deal pipeline remains strong. It saw net new deal wins of USD802 (TCV) in 1QFY23.
- In the CME vertical, while a weakening macro environment is coming up in client conversations, TECHM is not seeing any budget cuts and the deal pipeline remains strong.
- For enterprise clients, the focus is on Digital transformation. It is seeing no slowdown in core modernization initiatives.
- 5G spends remain robust. There is a strong focus on capacity building and carrier additions. It is not seeing any impact from macro-related concerns.
- There are some conversations around accelerating Digital transformation with some telcos. Re-prioritization of certain projects may happen.
- Softness in the top five clients were on account of FX and certain projects, which will only start in 2QFY23.

Margin performance

- Margin in 1QFY23 fell materially due to higher salary and sub-contractor expenses (100bp), visa and seasonality in mobility (80bp), and G&A normalization (100bp), but was partly offset by better pricing (50bp).
- The management aims to raise margin by 100-150bp per quarter to reach 14% exit margin in 4QFY23.
- Utilization (aims to bring it back to 87-88% by the end of FY23), increased offshoring (8-10% gap v/s its peers), pricing (good pricing uptick expected in 2Q), and automation are key levers for margin in FY23.
- Increase in provisions (USD 6m) and an absence of one-time SG&A gains from 4Q caused a spike in SG&A expenses in 1QFY23.
- The management does not expect any material savings from amortization expenses in FY23.
- Wage hikes are expected to have a 100bp impact on margin in 2QFY23.

Exhibit 1: Technology and Retail verticals see a strong rebound

Verticals	Contribution to revenue (%)	Growth (QoQ %)
Comm., Media, and Ent.	40.4	1.0
Manufacturing	15.3	4.2
Technology	9.7	5.9
BFSI	16.7	-2.6
Retail, Transport, and Logistics	7.9	5.5
Others	10.0	-0.5

Exhibit 2: Americas registered strong growth, Europe soft

Geographies	Contribution to revenue (%)	Growth (QoQ %)
Americas	49.6	4.2
Europe	25.5	-2.0
Rest of the World	24.9	-0.1

Valuation and view

- TECHM's high exposure to the Communications vertical remains a potential opportunity as a broader 5G rollout can result in a new spending cycle in this space. The company is seeing traction in 5G investments.
- We expect TECHM to deliver mid-teen growth in FY23. We value the stock at 14x FY24E EPS. We maintain our Neutral rating.

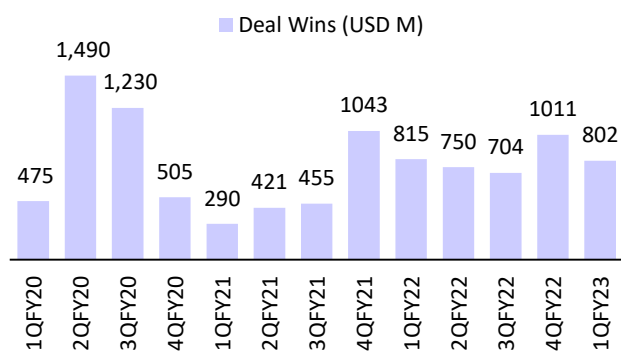
Exhibit 3: Revisions to our estimates

	Revised estimate		Earlier estimate		Change	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
USD:INR	78.7	79.0	78.5	79.0	0.2%	0.0%
Revenue (USD m)	6,817	7,524	6,768	7,557	0.7%	-0.4%
Growth (%)	13.7	10.4	12.8	11.6	80bp	-130bp
EBIT margin (%)	12.3	13.2	12.5	13.3	-20bp	0bp
PAT (INR b)	54	65	56	67	-3.4%	-1.7%
EPS	61.3	73.9	63.2	74.9	-3.0%	-1.3%

Source: MOFSL, Company

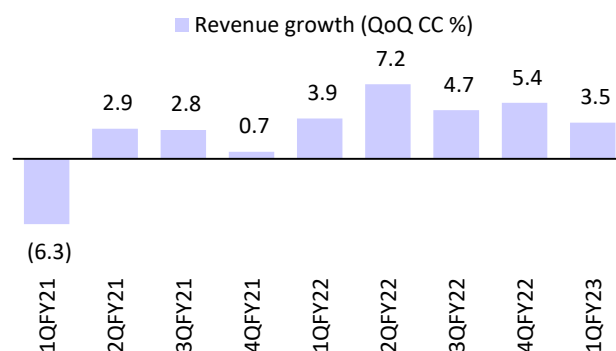
Story in charts

Exhibit 4: Deal wins moderate in 1QFY23



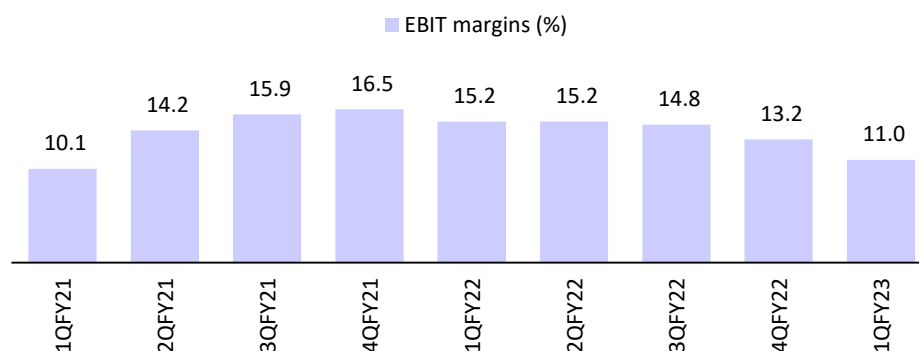
Source: Company, MOFSL

Exhibit 5: Revenue grew 3.5% QoQ in CC terms in 1QFY23



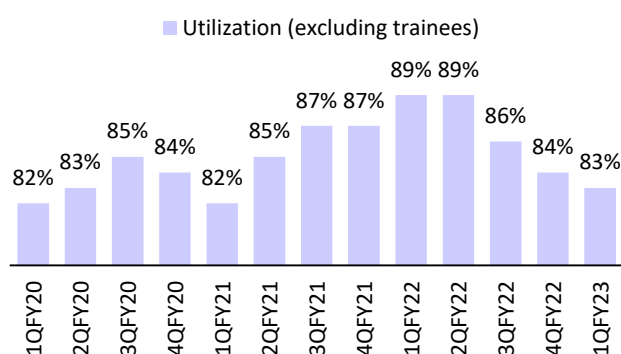
Source: Company, MOFSL

Exhibit 6: EBIT margin falls to 11% in 1QFY23



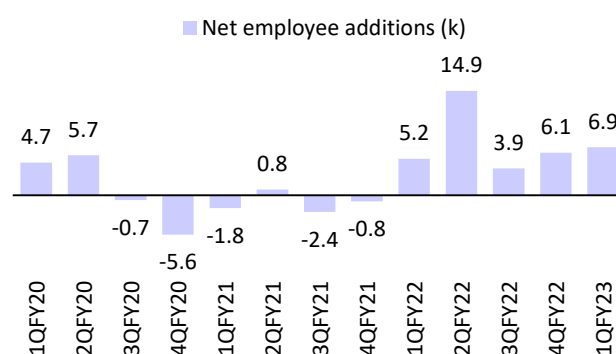
Source: Company, MOFSL

Exhibit 7: Utilization, excluding trainees, again moderates



Source: Company, MOFSL

Exhibit 8: Good headcount additions in 1QFY23



Source: Company, MOFSL

Exhibit 9: Operating metrics

	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23
Revenue by Geography (%)									
Americas	49.3	48.4	46.8	45.5	46.7	47.8	48.9	48.3	49.6
Europe	25.8	25.2	26.4	26.5	27.2	25.9	25.5	26.4	25.5
Rest of World	24.9	26.4	26.8	28.0	26.1	26.3	25.6	25.3	24.9
Client Metrics									
No. of active clients	981	988	997	1,007	1,058	1,123	1,191	1,224	1,262
As a percentage of repeat business	97.0	95.0	94.0	92.0	96.0	93.0	92.0	87.0	98.0
Number of USD m clients									
Over USD1m	451	460	454	451	466	488	502	524	549
Over USD5m	161	165	162	169	168	169	173	174	176
Over USD10m	81	82	83	85	86	90	96	97	104
Over USD20m	48	50	50	50	51	50	50	54	60
Over USD50m	21	21	21	21	22	22	22	23	23
Client concentration (%)									
Top five Clients	22.0	22.0	22.0	22.0	22.0	22.0	23.0	22.0	21.0
Top six to 10	9.0	8.0	9.0	9.0	9.0	9.0	8.0	9.0	9.0
Top 11-20	12.0	13.0	11.0	12.0	12.0	12.0	11.0	12.0	11.0
Headcount									
Software professionals	71,020	69,512	68,734	68,427	69,877	76,800	81,115	85,830	88,030
BPO	45,554	48,462	46,832	46,125	49,668	57,058	56,297	57,315	61,392
Sales and support	6,842	6,284	6,335	6,502	6,718	7,335	7,655	8,028	8,613
Total	1,23,416	1,24,258	1,21,901	1,21,054	1,26,263	1,41,193	1,45,067	1,51,173	1,58,035
IT Attrition (LTM %)	17	14	12	13	17	21	24	24	22
IT Utilization (%)	82	85	87	87	88	87	84	83	83
IT Utilization (excluding trainees)	82	85	87	87	89	89	86	84	83
DSO including unbilled	107	97	95	92	93	92	101	97	101
Borrowings (USD m)	280.0	230.0	262.0	232.0	218.0	206.0	210.0	209.0	220.0
Cash and Cash Equivalent (USD m)	1,378.0	1,564.0	1,625.0	1,781.0	1,818.0	1,626.0	1,346.0	1,140.7	1,114.0
Capital Expenditure (USD m)	26.0	34.0	16.0	20.0	22.0	23.0	26.0	46.0	20.0

Source: Company, MOFSL

Financials and valuations

Income Statement

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Sales	291	308	347	369	379	446	537	594
Change (%)	10.0	5.6	12.9	6.1	2.7	17.9	20.2	10.7
COGS	206	215	234	260	259	310	380	414
SGA expenses	44	45	50	52	52	57	71	79
Total Expenses	250	261	284	311	310	366	451	493
EBITDA	42	47	63	57	68	80	86	101
As a percentage of Net Sales	14.4	15.3	18.2	15.5	18.1	18.0	16.1	17.0
Depreciation	10	11	11	14	15	15	20	23
Other Income	6	12	3	10	6	10	8	11
PBT	39	49	55	53	60	75	74	90
Tax	10	11	13	12	15	18	19	24
Rate (%)	25.4	22.4	22.6	22.0	25.3	24.4	25.7	26.5
PAT	29	38	43	41	45	56	55	66
Minority interest	0	0	0	-1	-1	1	1	1
Share from associates	0	0	0	0	0	0	0	0
PAT before EO	28	38	43	43	46	56	54	65
Change (%)	-7.4	33.9	13.1	-1.1	7.2	22.1	-2.4	20.5
Extraordinary Items (EO)	0	0	0	-2	-1	0	0	0
Reported PAT	28	38	43	40	44	56	54	65
Change (%)	-7.4	33.9	13.1	-6.2	9.8	25.7	-2.4	20.5

Balance Sheet

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Share Capital	4	4	4	4	4	4	4	4
Reserves	160	184	198	214	244	264	279	296
Net Worth	164	188	203	218	249	269	283	300
Minority Interest	5	5	5	4	4	5	5	5
Loans	12	17	14	24	17	16	16	16
Other long-term liabilities	12	12	9	28	28	36	43	47
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	205	235	243	287	309	338	359	380
Applications								
Assets	68	79	73	89	91	149	138	125
Investments	7	15	12	2	6	4	4	4
Other non-current assets	22	30	33	50	47	50	60	67
Curr. Assets	163	181	216	232	253	245	288	328
Debtors	53	65	70	76	65	75	90	101
Cash and Bank Balance	20	20	20	30	27	38	23	17
Investments	63	75	98	57	98	46	71	96
Other Current Assets	27	22	28	68	63	86	103	114
Current Liab. and Prov.	56	70	91	87	88	111	131	143
Net Current Assets	108	111	124	145	165	134	157	185
Application of Funds	205	235	243	287	309	338	359	380

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)								
EPS	32.4	43.0	48.5	48.7	52.1	63.2	61.6	74.3
Diluted EPS	31.9	42.7	47.7	48.3	51.7	62.6	61.3	73.9
Cash EPS	42.9	54.8	60.3	62.3	66.7	79.7	84.3	99.5
Book Value	187.9	213.4	228.7	249.9	284.4	305.2	321.4	341.0
DPS	9.0	14.0	14.0	15.0	45.0	45.0	46.0	55.5
Payout (%)	28.2	32.8	29.3	31.0	87.1	71.9	75.0	75.0
Valuation (x)								
P/E ratio	31.3	23.6	21.0	20.9	19.5	16.1	16.5	13.7
Cash P/E ratio	23.7	18.5	16.9	16.3	15.2	12.7	12.1	10.2
EV/EBITDA ratio	21.1	19.0	14.1	15.4	12.8	10.9	10.3	8.8
EV/Sales ratio	3.0	2.9	2.6	2.4	2.3	2.0	1.7	1.5
Price/Book Value	5.4	4.8	4.4	4.1	3.6	3.3	3.2	3.0
Dividend Yield (%)	0.9	1.4	1.4	1.5	4.4	4.4	4.5	5.5
Profitability Ratios (%)								
RoE	18.4	21.5	22.0	20.2	19.5	21.5	19.7	22.4
RoCE	17.7	17.2	22.8	17.3	19.3	21.0	19.7	22.1
Turnover Ratios								
Debtors (Days)	67	77	73	75	62	61	61	62
Fixed Asset Turnover (x)	4.3	3.9	4.7	4.1	4.1	3.0	3.9	4.8
Leverage Ratio								
Debt/Equity Ratio (x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Cash Flow Statement

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
CF from Operations	35	43	55	49	65	67	75	89
Change in Working Capital	6	-8	-11	-5	16	-14	-16	-12
Net Operating CF	41	36	44	44	81	53	59	77
Net Purchase of FA	-8	-8	-8	-8	-6	-8	-9	-10
Free Cash Flow	33	28	37	35	75	45	51	67
Net Purchase of Invest.	-21	-26	-13	19	-49	13	-25	-25
Net Cash from Invest.	-29	-34	-21	10	-55	5	-34	-35
Inc./ (Dec.) in Equity	0	0	0	0	1	1	0	0
Proceeds from LTB/STB	-4	6	-6	-20	-13	-8	0	0
Dividend Payments	-12	-9	-17	-25	-18	-40	-41	-49
Cash Flow from Fin.	-16	-3	-23	-45	-30	-47	-41	-49
Other adjustments	0	0	0	1	0	0	0	0
Net Cash Flow	-4	0	1	10	-3	11	-15	-7
Opening Cash Balance	24	20	20	20	30	27	38	23
Add: Net Cash	-4	0	1	10	-3	11	-15	-7
Closing Cash Balance	20	20	20	30	27	38	23	17

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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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