

## Tech Mahindra (TECHM)

HOLD

Macro headwinds in Europe to dent growth

## Summary

Tech Mahindra (TechM) reported CC revenue growth of 2.9% QoQ mainly led by 3.1% QoQ growth in communication and 2.8% QoQ growth in enterprise. Going forward, the company is witnessing some delay in decision making which led to some deal wins flowing into Q3. Further, higher furloughs in Q3 and macro headwinds in Europe will impact company's revenues growth. Hence, we have revised our revenue estimates downwards by 4% and 5% for FY23E & FY24E. Further, furloughs, cross currency impact and weaker margins in H1 has prompted us to revise our eps estimates for FY23E downwards by 1%. This coupled with recent run up in stock price prompt us to downgrade the stock form BUY to HOLD with a target price of Rs 1,175 (15x FY24E EPS).

## Key Highlights and Investment Rationale

- **Deal pipeline is stable but macro headwinds could dent it:** The company continues to win US\$0.7-US\$1 bn net new deal wins on consistent basis. In addition, we believe traction in cloud, 5G and softwarisation of network will boost communication revenues. However, pruning of portfolio, cross currency headwinds, delay in decision making in Europe and higher furloughs is expected to impact revenue growth of the company in the near term. Hence we now expect the company to register 10% YoY growth in FY23E and then growth to further decelerate to 6% YoY in FY24E.
- **EBIT margins to improve in long run:** The company has multiple margin levers in terms of pricing, higher utilization, lower sub con, pruning of low margin portfolio, focus on developed geos, digital engineering, stabilization of large deals, offshoring and pyramid rationalization. Hence we expect the company's FY24E margins to improve by 220 bps to 14.5%.

<b>TP</b>	<b>Rs1,175</b>
<b>CMP</b>	<b>Rs1,072</b>
Potential upside/downside	10%
Previous Rating	BUY

## Price Performance (%)

	<b>-1m</b>	<b>-3m</b>	<b>-12m</b>
Absolute	6.3	2.2	(27.5)
Rel to Sensex	(0.1)	(4.0)	(30.6)

## V/s Consensus

<b>EPS (Rs)</b>	<b>FY23E</b>	<b>FY24E</b>
IDBI Capital	61	77
Consensus	60	71
% difference	2.0	8.8

## Key Stock Data

Bloomberg/Reuters	TECHM IN/TEML.BO
Sector	IT Services
Shares o/s (mn)	973
Market cap. (Rs mn)	1,042,985
3-m daily average value (Rs mn)	208.4
52-week high / low	Rs1,838 / 944
Sensex / Nifty	61,121 / 18,145

## Shareholding Pattern (%)

Promoters	35.2
FII	28.2
DII	22.3
Public	14.3

## Financial snapshot

(Rs mn)

Year	FY20	FY21	FY22	FY23E	FY24E
Revenue	368,677	378,551	446,460	524,815	560,742
Change (yoy, %)	6	3	18	18	7
EBITDA	57,261	68,471	80,201	84,241	101,982
Change (yoy, %)	(10)	20	17	5	21
EBITDA Margin(%)	15.5	18.1	18.0	16.1	18.2
Adj.PAT	42,505	44,788	55,661	53,263	67,600
EPS (Rs)	49	51	63	61	77
Change (yoy, %)	1	5	24	-4	27
PE(x)	22	21	17	18	14
Dividend Yield (%)	1	4	4	4	5
EV/EBITDA (x)	15	12	11	10	8
RoE (%)	20.2	19.2	21.5	19.3	22.9
RoCE (%)	17	19	22	20	24

Source: IDBI Capital Research;

### Con-call Highlights

- Revenue in CC terms grew 2.9%/16.8% QoQ/YoY; Dollar revenue grew 0.3%/11.2% QoQ/YoY. Software professionals count declined 1.4% QoQ to 86,776, BPO professionals headcount increased 11.4% QoQ to 68,388; total headcount expanded by 3.7% QoQ to 1,41,193. CME & Enterprise grew 3.1% & 2.8% in CC.
- Growth was solely led by North America (up 2.6% QoQ) offset by Europe (down 3.5% QoQ) and ROW. However, Europe and ROW grew 3.5% and 3.4% when adjusted for cross currency. Company anticipates demand from the developed nations to be impacted during the second half of FY24 on the back of challenging macro conditions.
- Among verticals, growth was led by Manufacturing (up 5.1% QoQ), Technology (up 4.5% QoQ), Retail (up 3.4% QoQ) offset by decline in BFSI (down 2.0% QoQ) and Communication (down 1.3% QoQ); BFSI declined because company pulled out from low margin business.
- Company is focused on exiting low margin business. During H1FY23 this impacted revenues to the tune of ~US\$ 60 mn & in H2FY23E a similar impact is expected. Portfolio pruning to continue in FY24E as well.
- Going forward, furlough (anticipated to be marginally higher), and portfolio pruning might impact the revenue growth in the near term which is expected to be offset by strong deal pipeline; anticipated delay in decision making from clients in Europe might have an impact as well.
- New deal win at US\$716 mn, -10.7% QoQ, -4.5% YoY led by delayed decision making. Earlier guidance of new deal TCV of US\$700 mn – US\$ 1 bn remains intact as demand environment remains strong.
- EBIT margin improved by 14 bps QoQ to 11.18%; 120 bps impact of wage hike was offset by improved utilization (+60 bps), portfolio pruning (+20 bps), reduction in SG&A (+60 bps) and price hike (+50 bps).
- Management aspires to exit FY23E with EBIT margin of 14% led by improved utilization, price hikes, reduced sub con cost, portfolio pruning (20-40 bps improvement) & pickup in offshoring. For FY24E, investments in large deals, portfolio pruning & focus on expanding in developed markets to aid margins.
- LTM attrition dropped by 200 bps QoQ to 20%, utilisation up 200 bps QoQ at 85%; current utilisation levels provide room for improvement. DSO at 98, improved by 2 days QoQ on the back of better realization.
- Contribution from top 5 clients declined 7.7% QoQ as few projects came to an end during the quarter.

## Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q2FY23	Q1FY23	QoQ (%)	Q2FY22	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>1,638</b>	<b>1,633</b>	<b>0.3</b>	<b>1,473</b>	<b>11.2</b>
<b>Revenues</b>	<b>131,295</b>	<b>127,079</b>	<b>3.3</b>	<b>108,813</b>	<b>20.7</b>
COGS	94,614	91,162	3.8	74,346	27.3
Gross profit	36,681	35,917	2.1	34,467	6.4
SG&A	16,840	17,116	(1.6)	14,515	16.0
<b>EBITDA</b>	<b>19,841</b>	<b>18,801</b>	<b>5.5</b>	<b>19,952</b>	<b>(0.6)</b>
Depreciation & amortization	5,161	4,767	8.3	3,430	50.5
<b>EBIT</b>	<b>14,680</b>	<b>14,034</b>	<b>4.6</b>	<b>16,522</b>	<b>(11.1)</b>
Other income	2,112	818	158.2	2,467	(14.4)
PBT	16,792	14,852	13.1	18,989	(11.6)
Tax	3,647	3,380	7.9	5,572	(34.5)
Adjusted net profit	(291)	(156)	<i>n.m.</i>	(30)	<i>n.m.</i>
Minority interest	12,854	11,316	13.6	13,387	(4.0)
Exceptional items	0	0	<i>n.m.</i>	0	<i>n.m.</i>
<b>Reported net profit</b>	<b>12,854</b>	<b>11,316</b>	<b>13.6</b>	<b>13,387</b>	<b>(4.0)</b>
<b>Diluted EPS (Rs)</b>	<b>14.6</b>	<b>12.8</b>	<b>14.1</b>	<b>15.3</b>	<b>(4.0)</b>
<b>As % of net revenue</b>					
Gross profit	27.9	28.3		31.7	
SG&A	12.8	13.5		13.3	
EBITDA	15.1	14.8		18.3	
EBIT	11.2	11.0		15.2	
Reported net profit	9.8	8.9		12.3	
Tax rate	21.7	22.8		29.3	

Source: Company; IDBI Capital Research

**Exhibit 2: Actual vs. estimates**

Year to March	Q2FY23	Q2FY23E	Variance (%)
Revenue (US\$ mn)	1,638	1,640	-0.1%
Revenue (Rs mn)	131,295	130,887	0.3%
EBIT (Rs mn)	14,680	14,547	0.9%
EBIT margin (%)	11.2%	11.1%	7bps
Recurring PAT (Rs mn)	12,854	10,983	17.0%
Recurring PAT margin (%)	9.79%	8.39%	140bps
Recurring EPS (Rs)	14.6	12.5	17.2%

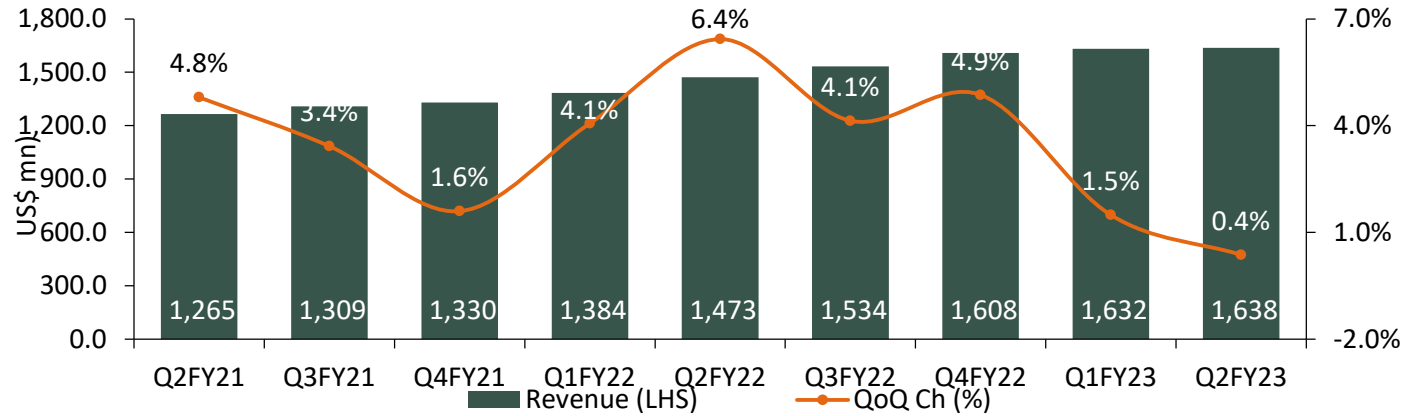
Source: Company, IDBI Capital Research

**Exhibit 3: Earnings Revision**

Year-end: March	FY23E			FY24E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	6,601	6,860	-3.8%	7,009	7,353	-4.7%
Revenue (Rs bn)	524.8	529.6	-0.9%	560.7	577.2	-2.9%
EBIT margin (%)	12.3%	12.8%	(54) bps	14.5%	14.5%	(04) bps
EPS (Rs/sh)	60.7	61.3	-1.0%	77.0	77.1	-0.1%

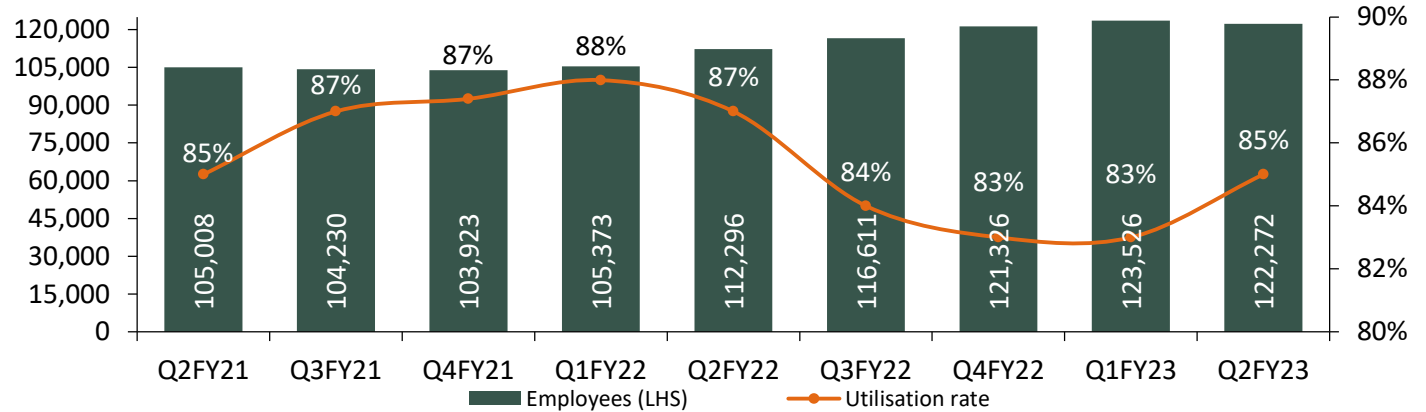
Source: Company; IDBI Capital Research

**Exhibit 4: Q2FY23 revenue was in line with our expectation**



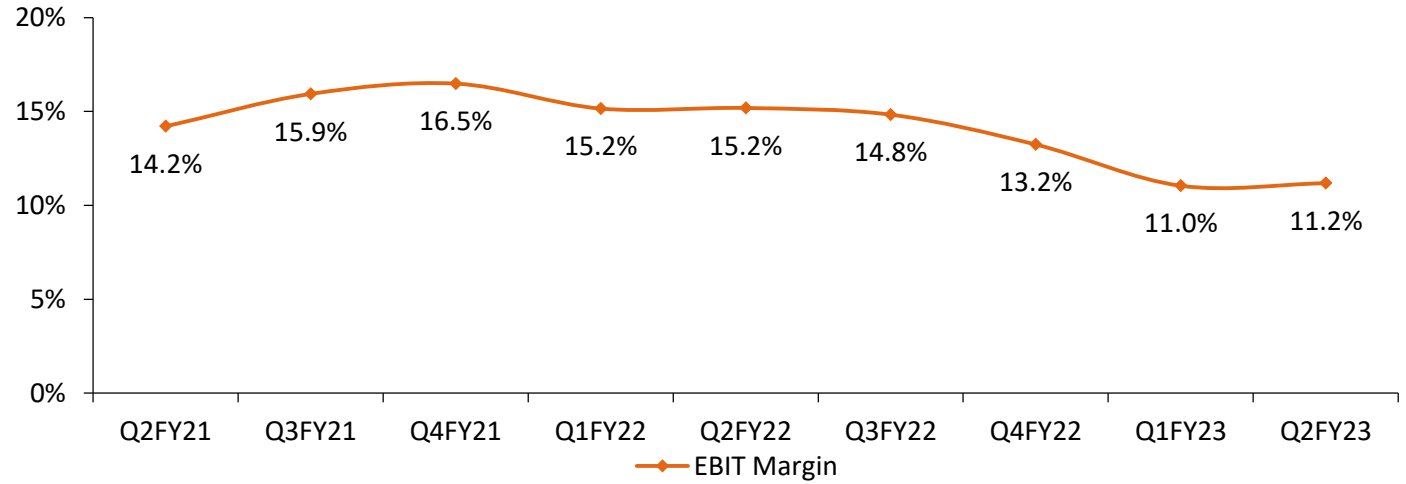
Source: Company; IDBI Capital Research

**Exhibit 5: Utilisation improved QoQ**



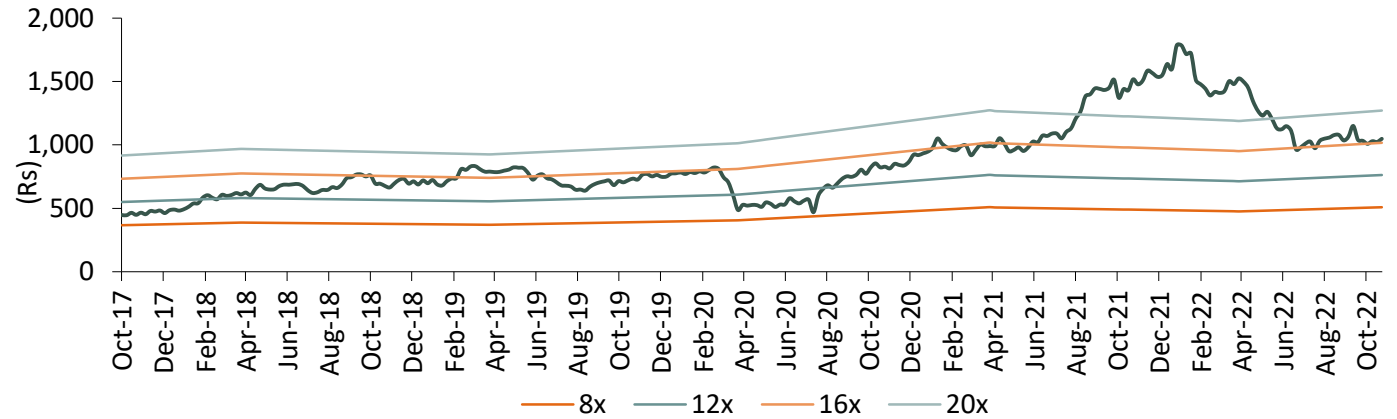
Source: Company; IDBI Capital Research

**Exhibit 6: EBIT Margin improved QoQ**



Source: Company; IDBI Capital Research

**Exhibit 7: One-year forward PER trend**



Source: Company; IDBI Capital Research

## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Net sales</b>	<b>347,421</b>	<b>368,677</b>	<b>378,551</b>	<b>446,460</b>	<b>524,815</b>	<b>560,742</b>
<i>Change (yoy, %)</i>	13	6	3	18	18	7
Operating expenses	(284,053)	(311,416)	(310,080)	(366,260)	(440,574)	(458,760)
<b>EBITDA</b>	<b>63,368</b>	<b>57,261</b>	<b>68,471</b>	<b>80,201</b>	<b>84,241</b>	<b>101,982</b>
<i>Change (yoy, %)</i>	34	-10	20	17	5	21
<i>Margin (%)</i>	18.2	15.5	18.1	18.0	16.1	18.2
Depreciation	(11,292)	(14,458)	(14,577)	(15,204)	(19,923)	(20,908)
<b>EBIT</b>	<b>52,076</b>	<b>42,803</b>	<b>53,894</b>	<b>64,997</b>	<b>64,318</b>	<b>81,074</b>
Interest paid	(1,332)	(1,919)	(1,740)	(1,626)	(2,773)	(1,282)
Other income	5,342	11,924	7,871	11,123	9,393	10,903
<b>Pre-tax profit</b>	<b>56,086</b>	<b>52,808</b>	<b>60,025</b>	<b>74,494</b>	<b>70,938</b>	<b>90,696</b>
Tax	(12,544)	(11,604)	(15,999)	(18,221)	(17,243)	(23,127)
<i>Effective tax rate (%)</i>	22.4	22.0	26.7	24.5	24.3	25.5
Minority Interest	(567.0)	(874.0)	255.0	(612.0)	(431.0)	32.0
<b>Net profit</b>	<b>42,975</b>	<b>40,330</b>	<b>44,281</b>	<b>55,661</b>	<b>53,263</b>	<b>67,600</b>
Exceptional items	-	(2,175)	(507)	-	-	-
<b>Adjusted net profit</b>	<b>42,975</b>	<b>42,505</b>	<b>44,788</b>	<b>55,661</b>	<b>53,263</b>	<b>67,600</b>
<i>Change (yoy, %)</i>	13	(1)	5	24	(4)	27
EPS	48	49	51	63	61	77
Dividend per sh	14.0	15.0	45.0	45.0	43.0	53.0
<i>Dividend Payout %</i>	35	37	88	71	71	69

**Balance Sheet**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Shareholders' funds</b>	<b>202,844</b>	<b>218,131</b>	<b>248,650</b>	<b>268,857</b>	<b>284,384</b>	<b>305,471</b>
Share capital	4,437	4,359	4,370	4,388	4,388	4,388
Reserves & surplus	198,407	213,772	244,280	264,469	279,996	301,083
<b>Total Debt</b>	<b>14,047</b>	<b>24,282</b>	<b>16,928</b>	<b>15,817</b>	<b>13,817</b>	<b>11,817</b>
Other liabilities	3,334	21,076	19,027	22,761	22,761	22,761
<b>Curr Liab &amp; prov</b>	<b>109,456</b>	<b>105,757</b>	<b>107,619</b>	<b>131,766</b>	<b>156,298</b>	<b>166,781</b>
Current liabilities	77,224	72,193	71,051	93,494	105,973	113,011
Provisions	32,232	33,564	36,568	38,272	50,325	53,770
<b>Total liabilities</b>	<b>126,837</b>	<b>151,115</b>	<b>143,574</b>	<b>170,344</b>	<b>192,876</b>	<b>201,359</b>
<b>Total equity &amp; liabilities</b>	<b>334,458</b>	<b>373,179</b>	<b>396,019</b>	<b>444,155</b>	<b>482,644</b>	<b>512,183</b>
Net fixed assets	71,667	76,047	80,405	139,318	134,395	128,487
Investments	9,228	3,804	6,648	5,276	5,276	5,276
Other non-curr assets	37,905	61,605	56,367	55,004	55,004	55,004
<b>Current assets</b>	<b>215,658</b>	<b>231,723</b>	<b>252,599</b>	<b>244,557</b>	<b>287,969</b>	<b>323,415</b>
Inventories	752	358	242	405	476	509
Sundry Debtors	69,586	75,772	90,317	119,334	140,909	150,555
Cash and Bank	118,550	87,606	124,971	84,104	98,390	120,858
Loans and advances	26,770	30,632	29,331	33,964	40,260	43,016
<b>Total assets</b>	<b>334,458</b>	<b>373,179</b>	<b>396,019</b>	<b>444,155</b>	<b>482,644</b>	<b>512,183</b>



**Cash Flow Statement**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Pre-tax profit	56,086	52,808	60,025	74,494	70,938	90,696
Depreciation	25,946	9,343	14,577	15,204	19,923	20,908
Tax paid	(12,916)	(13,611)	(16,284)	(13,488)	(17,243)	(23,127)
Chg in working capital	17,187	(13,353)	(11,266)	(9,666)	(3,410)	(1,952)
Other operating activities	(27,320)	(50,579)	58,648	5,372	(6,371)	(4,613)
<b>Cash flow from operations (a)</b>	<b>58,983</b>	<b>(15,392)</b>	<b>105,700</b>	<b>71,916</b>	<b>63,836</b>	<b>81,911</b>
Capital expenditure	(20,896)	(13,723)	(18,935)	(74,117)	(15,000)	(15,000)
Chg in investments	5,136	5,424	(2,844)	1,372	-	-
Other investing activities	-	-	-	-	-	-
<b>Cash flow from investing (b)</b>	<b>(15,760)</b>	<b>(8,299)</b>	<b>(21,779)</b>	<b>(72,745)</b>	<b>(15,000)</b>	<b>(15,000)</b>
Equity raised/(repaid)	20	(78)	11	18	-	-
Debt raised/(repaid)	(3,213)	10,235	(7,354)	(1,111)	(2,000)	(2,000)
Dividend (incl. tax)	(14,908)	(15,692)	(39,330)	(39,492)	(37,737)	(46,513)
Chg in minorities	(881)	(1,718)	117	547	-	-
Other financing activities	-	-	-	-	-	-
<b>Cash flow from financing (c)</b>	<b>(18,982)</b>	<b>(7,253)</b>	<b>(46,556)</b>	<b>(40,038)</b>	<b>(39,737)</b>	<b>(48,513)</b>
<b>Net chg in cash (a+b+c)</b>	<b>24,241</b>	<b>(30,944)</b>	<b>37,365</b>	<b>(40,867)</b>	<b>9,099</b>	<b>18,398</b>

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	229	250	284	306	324	348
Adj EPS (Rs)	48	49	51	63	61	77
Adj EPS growth (%)	13	1	5	24	-4	27
EBITDA margin (%)	18	16	18	18	16	18
Pre-tax margin (%)	16	14	16	17	14	16
Net Debt/Equity (x)	-1	0	0	0	0	0
ROCE (%)	23	17	19	22	20	24
ROE (%)	22.0	20.2	19.2	21.5	19.3	22.9
<b>DuPont Analysis</b>						
Asset turnover (x)	1.1	1.0	1.0	1.1	1.1	1.1
Leverage factor (x)	1.6	1.7	1.6	1.6	1.7	1.7
Net margin (%)	12.4	11.5	11.8	12.5	10.1	12.1
<b>Working Capital &amp; Liquidity ratio</b>						
Inventory days	1	0	0	0	0	0
Receivable days	73	75	87	98	98	98
Payable days	32	38	33	41	40	41

### Valuations

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
PER (x)	22.1	22.0	20.9	16.9	17.7	13.9
Price/Book value (x)	4.7	4.3	3.8	3.5	3.3	3.1
EV/Net sales (x)	2.4	2.4	2.2	2.0	1.6	1.5
EV/EBITDA (x)	13	15	12	11	10	8
Dividend Yield (%)	1	1	4	4	4	5

Source: Company; IDBI Capital Research



# Notes

Dealing

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**Key to Ratings Stocks:****BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

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