

Tech Mahindra (TECHM)

BUY

Growth and margin improvement to continue

Summary

Tech Mahindra (TechM) reported strong Q3FY22 numbers. The company's revenues grew by 4.1% QoQ mainly led by 6.2% QoQ growth in communication services and 2.7% QoQ led by enterprise segment. Going forward, we expect communication segment to improve led by traction in 5G, network modernisation and software transformation. In addition, in enterprise segment we expect BFSI and Hi Tech to bounce back in coming quarters led by traction in digital technologies. This coupled with healthy client mining, consistent deal wins and headcount addition (of freshers and lateral) will lead to 15% CAGR revenue growth over FY21-24E. Further, we expect margins to improve in coming years led by rationalisation of sub-contracting expense and SG&A. Hence, we maintain BUY rating with a target price of Rs 1800 (22x PE on FY24E EPS).

Key Highlights and Investment Rationale

- Communication segment drove Q3FY22:** Going forward, the company expects BFSI to bounce back led by absence of furloughs and acquisition. The company is also focusing on sub vertical (insurance) to drive BFSI growth. In addition, we expect retail, manufacturing and technology to be driven by digitization. Further, the company is seeing traction in communication led by softwarisation of network and cloud. This coupled with client mining, consistent deal wins of ~US\$700 million and robust demand outlook we expect strong growth in revenues in long term.
- EBIT margins on improving trend:** Going forward, we expect margins to improve led by rationalising SG&A (due to right sizing portfolio companies), lower subcontracting cost, revenue growth, near shoring and pyramid rationalization (by hiring more fresher). Hence, we expect margins to improve 141 bps to 15.6% over FY21-24.

TP	Rs1,800
CMP	Rs1,507
Potential upside/downside	+19%
Previous Rating	BUY

Price Performance (%)

	-1m	-3m	-12m
Absolute	(17.4)	0.0	53.8
Rel to Sensex	(17.0)	2.2	28.5

V/s Consensus

EPS (Rs)	FY22E	FY23E	FY24E
IDBI Capital	64	74	82
Consensus	64	74	83
% difference	(0.6)	0.6	(0.9)

Key Stock Data

Bloomberg/Reuters	TECHM IN/TEML.BO
Sector	IT Services
Shares o/s (mn)	971
Market cap. (Rs mn)	1,436,403
3-m daily average value (Rs mn)	265.5
52-week high / low	Rs1,838 / 915
Sensex / Nifty	58,863 / 17,577

Shareholding Pattern (%)

Promoters	35.7
FII	35.4
DII	17.1
Public	11.8

Financial snapshot

Year	FY20	FY21	FY22E	FY23E	FY24E
Revenue	3,68,677	3,78,551	4,46,760	5,19,229	5,71,694
Change (yoy, %)	6	3	18	16	10
EBITDA	57,261	68,471	83,235	98,443	1,09,205
Change (yoy, %)	(10)	20	22	18	11
EBITDA Margin(%)	15.5	18.1	18.6	19.0	19.1
Adj.PAT	42,505	44,788	56,243	64,368	71,694
EPS (Rs)	49	51	64	74	82
Change (yoy, %)	1	5	26	14	11
PE(x)	31	29	23	20	18
Dividend Yield (%)	1	3	3	4	4
EV/EBITDA (x)	22	18	15	12	11
RoE (%)	20.2	19.2	22.1	24.0	25.3
RoCE (%)	17	19	23	26	28

Source: IDBI Capital Research;

Concall Highlights

- In Q3FY22, TechM grew 4.7% in CC terms with 4% organic basis and 60 bps inorganic.
- EBIT had a decline of 40bps mainly due to supply side challenge, increase in subcontracting cost and lower utilization, which was offset by operating leverage and tailwinds in SG&A.
- During the quarter, SG&A declined slightly due to one off cost which is expected to normalize going forward.
- Subcontractor cost increased during the quarter mainly due to increased demand, travel restriction, deal ramping up leading the increase in subcon cost.
- Other Income declined due to lower investment and mark to market adjustment
- Retail and other had a healthy growth, while, technology and BFSI had blip this quarter due seasonality and furloughs, and is confident of bouncing back strongly in coming quarters.
- Overall, continued pace of large deal wins, continue to build on connectivity experiences, continued bets on cloud on engineering, management continues to remain optimistic about the future.
- Continue to invest in a very discipline manner by acquiring or filling gaps in engineering or domain capability
- Acquisition of talent from Tier 2 cities has been in focus as company expanded its foot print in 9 new cities in India. Management is optimistic of this strategy doing well and will continue to implement this as it results in lesser attrition rate (-15%) and lower employee costs (-15%) for the Company.
- Partnered with Mahindra racing to develop their next generation racing cars, continuously focusing on sports tech by managing stadiums and virtual experience during pandemic times
- Company is also expanding in near shore locations like Latvia, Costa Rica etc.
- Company hired ~10k fresher YTD and expect to increase this number going forward.
- Reduction in SG&A expenses (little below 13%) and sub-contracting costs in the coming future and operating leverage are expected to have a positive impact on the margins going forward. However, there might be an increase in the travel costs with Covid normalizing

Exhibit 1: Financial snapshot

(Rs mn)

Q3FY22 revenue growth of 4.7% QoQ CC was higher than our forecast

EBIT margin of 14.8%, declined 40bps QoQ and inline with our estimate.

Year-end: March	Q3FY22	Q2FY22	QoQ (%)	Q3FY21	YoY (%)
Revenues (US\$ mn)	1,534	1,473	4.1	1,309	17.2
Revenues	1,14,508	1,08,813	5.2	96,471	18.7
COGS	80,088	74,346	7.7	64,708	23.8
Gross profit	34,420	34,467	(0.1)	31,763	8.4
SG&A	13,819	14,515	(4.8)	12,808	7.9
EBITDA	20,601	19,952	3.3	18,955	8.7
Depreciation & amortization	3,621	3,430	5.6	3,584	1.0
EBIT	16,980	16,522	2.8	15,371	10.5
Other income	1,892	2,467	(23.3)	1,788	5.8
PBT	18,872	18,989	(0.6)	17,159	10.0
Tax	5,082	5,572	(8.8)	4,263	19.2
Adjusted net profit	-104	-30	246.7	202	n.m.
Minority interest	13,685	13,387	2.2	13,098	4.5
Exceptional items	0	0	n.m.	0	n.m.
Reported net profit	13,685	13,387	2.2	13,098	4.5
Diluted EPS (Rs)	15.6	15.3	2.3	15.0	4.1
As % of net revenue					
Gross profit	30.1	31.7		32.9	
SG&A	12.1	13.3		13.3	
EBITDA	18.0	18.3		19.6	
EBIT	14.8	15.2		15.9	
Reported net profit	12.0	12.3		13.6	
Tax rate	26.9	29.3		24.8	

Source: Company; IDBI Capital Research

Exhibit 2: Actual vs. estimates

Year to March	Q3FY22	Q3Y22E	Variance (%)
Revenue (US\$ mn)	1,534	1,524	0.6%
Revenue (Rs mn)	1,14,508	1,14,311	0.2%
EBIT (Rs mn)	16,980	17,170	-1.1%
EBIT margin (%)	14.8%	15.0%	(19)bps
Recurring PAT (Rs mn)	13,685	14,569	-6.1%
Recurring PAT margin (%)	12.0%	12.7%	(79)bps
Recurring EPS (Rs)	15.6	16.6	-6.0%

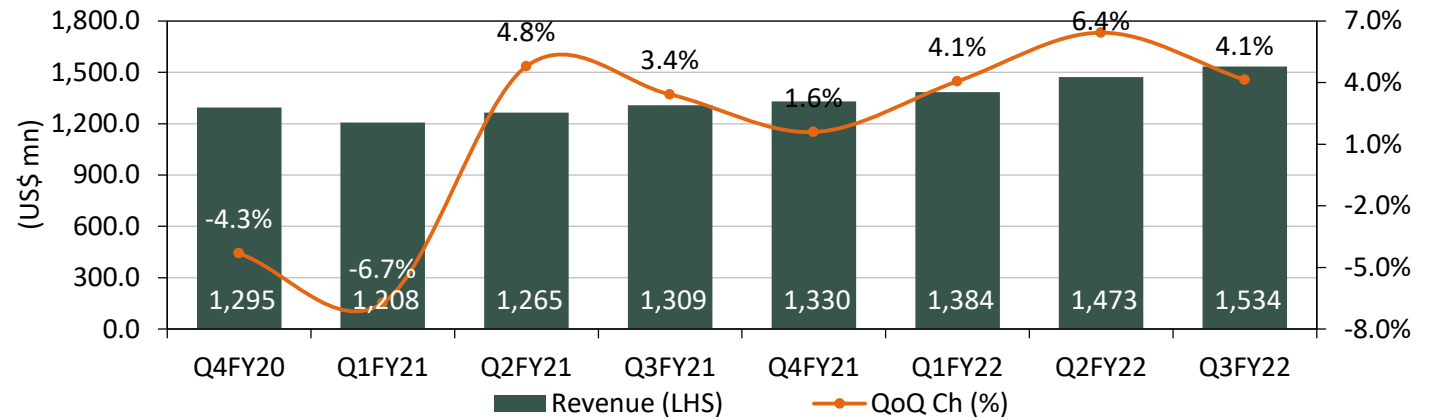
Source: Company, IDBI Capital Research

Exhibit 3: Earnings Revision

Year-end: March	FY22E			FY23E			FY24E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	6,009	5,958	0.9%	6,923	6,778	2.1%	7,623	7,660	-0.5%
Revenue (Rs bn)	446.8	443.4	0.8%	519.2	508.3	2.2%	571.7	574.5	-0.5%
EBIT margin (%)	15.4%	15.4%	0 bps	15.5%	15.3%	16 bps	15.6%	14.9%	75 bps
EPS (Rs/sh)	64.4	65.6	-1.9%	73.6	73.3	0.5%	82.0	80.6	1.8%

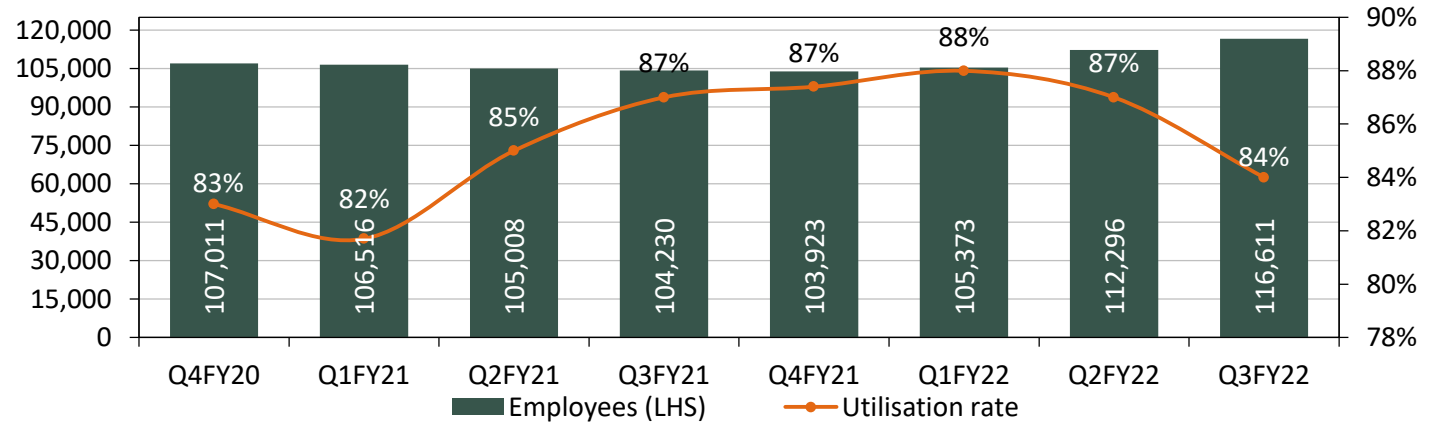
Source: Company; IDBI Capital Research

Exhibit 4: Q3FY22 revenue was better than our forecast



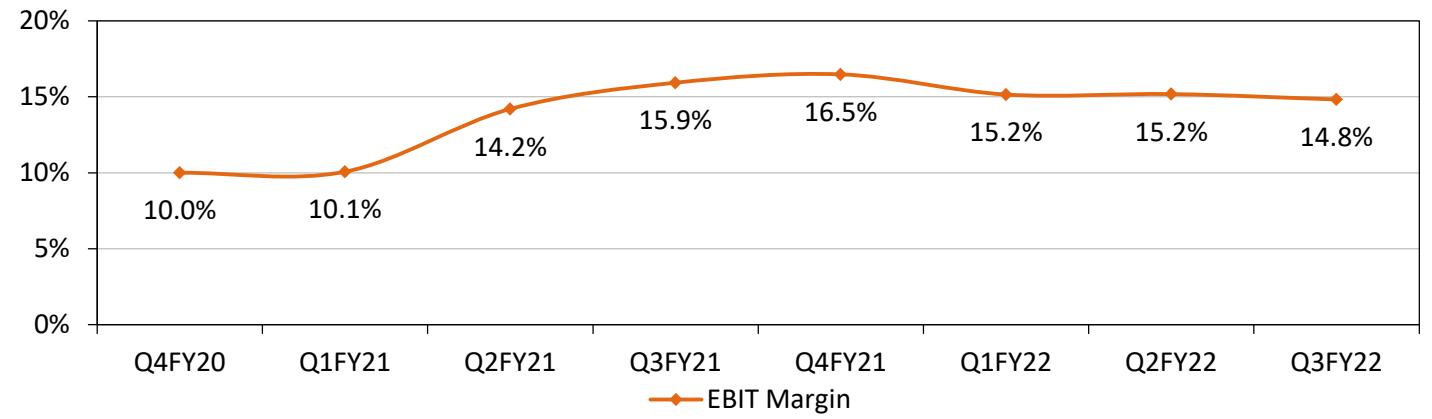
Source: Company; IDBI Capital Research

Exhibit 5: Utilisation was declined QoQ



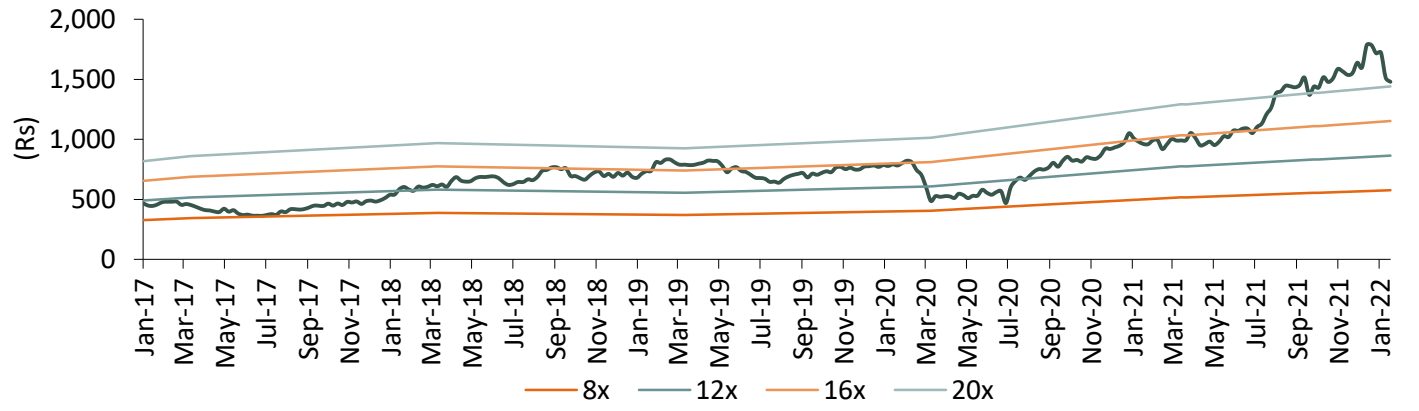
Source: Company; IDBI Capital Research

Exhibit 6: EBIT Margin dipped due to supply side pressure



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	FY22E	FY23E	FY24E
Net sales	3,47,421	3,68,677	3,78,551	4,46,760	5,19,229	5,71,694
<i>Change (yoy, %)</i>	13	6	3	18	16	10
Operating expenses	(2,84,053)	(3,11,416)	(3,10,080)	(3,63,524)	(4,20,785)	(4,62,489)
EBITDA	63,368	57,261	68,471	83,235	98,443	1,09,205
<i>Change (yoy, %)</i>	34	-10	20	22	18	11
<i>Margin (%)</i>	18.2	15.5	18.1	18.6	19.0	19.1
Depreciation	(11,292)	(14,458)	(14,577)	(14,563)	(18,195)	(19,742)
EBIT	52,076	42,803	53,894	68,673	80,248	89,463
Interest paid	(1,332)	(1,919)	(1,740)	(1,414)	(1,316)	(1,136)
Other income	5,342	11,924	7,871	10,112	8,600	9,172
Pre-tax profit	56,086	52,808	60,025	77,371	87,532	97,499
Tax	(12,544)	(11,604)	(15,999)	(20,763)	(23,196)	(25,837)
<i>Effective tax rate (%)</i>	22.4	22.0	26.7	26.8	26.5	26.5
Minority Interest	(567.0)	(874.0)	255.0	(365.0)	32.0	32.0
Net profit	42,975	40,330	44,281	56,243	64,368	71,694
Exceptional items	-	(2,175)	(507)	-	-	-
Adjusted net profit	42,975	42,505	44,788	56,243	64,368	71,694
<i>Change (yoy, %)</i>	13	(1)	5	26	14	11
EPS	48	49	51	64	74	82
Dividend per sh	14.0	15.0	45.0	50.0	57.5	64.0
<i>Dividend Payout %</i>	35	37	88	78	78	78

Balance Sheet

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Shareholders' funds	2,02,844	2,18,131	2,48,650	2,61,193	2,75,306	2,91,064
Share capital	4,437	4,359	4,370	4,370	4,370	4,370
Reserves & surplus	1,98,407	2,13,772	2,44,280	2,56,823	2,70,936	2,86,694
Total Debt	14,047	24,282	16,618	15,618	13,618	11,618
Other liabilities	3,334	21,076	19,027	19,027	19,027	19,027
Curr Liab & prov	1,09,456	1,05,757	1,07,929	1,25,179	1,44,835	1,59,065
Current liabilities	77,224	72,193	71,361	82,339	95,046	1,04,245
Provisions	32,232	33,564	36,568	42,840	49,789	54,820
Total liabilities	1,26,837	1,51,115	1,43,574	1,59,824	1,77,480	1,89,710
Total equity & liabilities	3,34,458	3,73,179	3,96,019	4,25,177	4,56,914	4,84,870
Net fixed assets	71,667	76,047	80,405	1,05,767	99,572	91,829
Investments	9,228	3,804	6,648	6,648	6,648	6,648
Other non-curr assets	37,905	61,605	56,413	56,413	56,413	56,413
Current assets	2,15,658	2,31,723	2,52,553	2,56,349	2,94,281	3,29,980
Inventories	752	358	242	286	332	365
Sundry Debtors	69,586	75,772	64,728	85,680	99,578	1,09,640
Cash and Bank	1,18,550	87,606	1,24,971	96,833	1,08,891	1,25,857
Loans and advances	26,770	30,632	29,331	34,272	39,831	43,856
Total assets	3,34,458	3,73,179	3,96,019	4,25,177	4,56,914	4,84,870

Cash Flow Statement

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Pre-tax profit	56,086	52,808	60,025	77,371	87,532	97,499
Depreciation	25,946	9,343	14,577	14,563	18,195	19,742
Tax paid	(12,916)	(13,611)	(16,284)	(20,763)	(23,196)	(25,837)
Chg in working capital	17,187	(13,353)	14,633	(8,687)	152	110
Other operating activities	(27,320)	(50,579)	33,059	(5,997)	(6,371)	(4,613)
Cash flow from operations (a)	58,983	(15,392)	1,06,010	56,487	76,313	86,902
Capital expenditure	(20,896)	(13,723)	(18,935)	(39,925)	(12,000)	(12,000)
Chg in investments	5,136	5,424	(2,844)	-	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(15,760)	(8,299)	(21,779)	(39,925)	(12,000)	(12,000)
Equity raised/(repaid)	20	(78)	11	-	-	-
Debt raised/(repaid)	(3,213)	10,235	(7,664)	(1,000)	(2,000)	(2,000)
Dividend (incl. tax)	(14,908)	(15,692)	(39,330)	(43,700)	(50,255)	(55,936)
Chg in minorities	(881)	(1,718)	117	-	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(18,982)	(7,253)	(46,866)	(44,700)	(52,255)	(57,936)
Net chg in cash (a+b+c)	24,241	(30,944)	37,365	(28,138)	12,058	16,966

Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Book Value (Rs)	229	250	284	299	315	333
Adj EPS (Rs)	48	49	51	64	74	82
Adj EPS growth (%)	13	1	5	26	14	11
EBITDA margin (%)	18	16	18	19	19	19
Pre-tax margin (%)	16	14	16	17	17	17
Net Debt/Equity (x)	-1	0	0	0	0	0
ROCE (%)	23	17	19	23	26	28
ROE (%)	22.0	20.2	19.2	22.1	24.0	25.3
DuPont Analysis						
Asset turnover (x)	1.1	1.0	1.0	1.1	1.2	1.2
Leverage factor (x)	1.6	1.7	1.6	1.6	1.6	1.7
Net margin (%)	12.4	11.5	11.8	12.6	12.4	12.5
Working Capital & Liquidity ratio						
Inventory days	1	0	0	0	0	0
Receivable days	73	75	62	70	70	70
Payable days	32	38	33	32	32	32

Valuations

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
PER (x)	31.1	30.9	29.4	23.4	20.5	18.4
Price/Book value (x)	6.6	6.0	5.3	5.0	4.8	4.5
EV/Net sales (x)	3.5	3.4	3.2	2.8	2.4	2.1
EV/EBITDA (x)	19	22	18	15	12	11
Dividend Yield (%)	1	1	3	3	4	4

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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