

# Tech Mahindra (TECHM)

## BUY

Consistent deal wins and attractive valuation key positive

### Summary

While Tech Mahindra (TechM) reported healthy revenue growth, EBIT margins (13.2%) were weak mainly led by higher depreciation & amortisation cost. The company has witnessed healthy net new deal wins of US\$3.28 bn (up 48% YoY) in FY22. This coupled with strong hiring (6106) and inorganic acquisition indicates the company could achieve FY22 growth (~17%) in FY23E. However, due to macro-economic issues we have marginally tapered our revenue expectations to 15% in FY23E. In addition, we have lowered our EBIT margins by 92 bps & 69 bps for FY23E & FY24E due to higher depreciation cost, higher facility cost and travel expense. Hence we revise our target price downwards to Rs 1440 (18x FY24E EPS). However, considering the recent fall in price and attractive valuation we maintain our BUY rating on the stock.

### Key Highlights and Investment Rationale

- Communication Deal win & cloud key growth drivers:** The company continues to win 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 (anticipate double digit growth). Further, TechM is witnessing growth in BFSI & Hi Tech within enterprise. This coupled with client mining will lead to 12.4% CAGR growth in revenues over FY22-FY24.
- EBIT margins to improve from H2FY23E onwards:** In the near term we expect margins to be under pressure led by higher depreciation & amortization cost, supply side constraints, visa cost, wage hikes and travel cost. Hence, in H1Y23E we expect EBIT margins to be below 15%. We expect the company to achieve its aspirational 15% margins from H2FY23E onwards mainly led by pricing, higher utilization, lower sub con, offshoring and pyramid rationalization.

TP **Rs1,440**

CMP **Rs1,202**

Potential upside/downside +20%

Previous Rating BUY

### Price Performance (%)

	-1m	-3m	-12m
Absolute	(14.8)	(15.6)	25.0
Rel to Sensex	(5.2)	(6.4)	16.5

### V/s Consensus

EPS (Rs)	FY23E	FY24E
IDBI Capital	71	80
Consensus	72	81
% difference	(0.9)	(1.2)

### Key Stock Data

Bloomberg/Reuters	TECHM IN/TEML.BO
Sector	IT Services
Shares o/s (mn)	972
Market cap. (Rs mn)	1,168,573
3-m daily average value (Rs mn)	265.5
52-week high / low	Rs1,838 / 941
Sensex / Nifty	52,794 / 15,782

### Shareholding Pattern (%)

Promoters	35.3
FII	34.3
DII	18.0
Public	12.4

### Financial snapshot

(Rs mn)

Year	FY20	FY21	FY22	FY23E	FY24E
Revenue	3,68,677	3,78,551	4,46,460	5,22,087	5,76,307
Change (yoy, %)	6	3	18	17	10
EBITDA	57,261	68,471	80,201	95,276	1,05,530
Change (yoy, %)	(10)	20	17	19	11
EBITDA Margin(%)	15.5	18.1	18.0	18.2	18.3
Adj.PAT	42,505	44,788	55,661	61,762	70,099
EPS (Rs)	49	51	64	71	80
Change (yoy, %)	1	5	24	11	13
PE(x)	25	23	19	17	15
Dividend Yield (%)	1	4	4	4	5
EV/EBITDA (x)	17	14	12	10	9
RoE (%)	20.2	19.2	21.7	22.5	23.9
RoCE (%)	17	19	22	24	26

Source: IDBI Capital Research;

### Con-call Highlights

- Revenue in rupee terms for Q4 FY22 grew 4.9% QoQ. Growth was led by Technology (+32% YoY), BFSI (+28% YoY), CME (+21.7% YoY in CC terms). Company expects strong demand to continue going forward on the back of digital transformation driven by 5G technology and adoption of Cloud.
- Company expects verticals like Hi Tech and Manufacturing to enter the \$1 bn league by the end of FY23.
- Amidst strong demand, Company would aim to continue the intake of new deals to be \$1+ bn per quarter.
- Post a rejig in the leadership team in Europe and America, these regions have witnessed healthy growth (+20.3%, +28.5% YoY respectively).
- Price increases, hiring of fresh talent, increased offshoring, better business mix and growth in revenue to act as levers for EBIT margins in FY23.
- H1FY23 EBIT margin might be under pressure on account of wage hikes (in June), visa cost (25-30 bps impact) and seasonality of Comviva. However, the Management aspires to achieve EBIT margins of around 15% by the end of FY23 (v/s. 14.6% for FY22) as price increases and hiring of fresh talent have a lag impact in terms of being margin accretive.
- SG&A expenses are expected to witness an upward movement on the back of increase in facility costs.
- EBIT saw a 5.5% QoQ decline on account of lower utilization, salary hikes, amortization of acquisition costs (80 bps impact) and increased hardware and software depreciation.
- ETR for FY 23 is estimated to be in the range of 25%-26%.
- After investing heavily on acquisitions in FY22, Company would focus on organic growth and integration of acquired assets in FY23.
- Company added 10,000+ freshers during FY 22 and expects to continue the same in FY 23 as a part of its plan to optimize employee costs.
- IT Attrition for the quarter stood at elevated level of 24%. However, was flat on a QoQ basis.
- Board declared final dividend of Rs. 30 per share.

## Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q4FY22	Q3FY22	QoQ (%)	Q4FY21	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>1,608</b>	<b>1,534</b>	<b>4.9</b>	<b>1,330</b>	<b>20.9</b>
<b>Revenues</b>	<b>1,21,163</b>	<b>1,14,508</b>	<b>5.8</b>	<b>97,299</b>	<b>24.5</b>
COGS	85,603	80,088	6.9	64,497	32.7
Gross profit	35,560	34,420	3.3	32,802	8.4
SG&A	14,676	13,819	6.2	13,321	10.2
<b>EBITDA</b>	<b>20,884</b>	<b>20,601</b>	<b>1.4</b>	<b>19,481</b>	<b>7.2</b>
Depreciation & amortization	4,842	3,621	33.7	3,444	40.6
<b>EBIT</b>	<b>16,042</b>	<b>16,980</b>	<b>(5.5)</b>	<b>16,037</b>	<b>0.0</b>
Other income	2,646	1,892	39.9	-91	(3,007.3)
PBT	18,688	18,872	(1.0)	15,946	17.2
Tax	3,280	5,082	(35.5)	4,998	(34.4)
Adjusted net profit	-351	-104	237.5	373	n.m.
Minority interest	15,056	13,685	10.0	11,321	33.0
Exceptional items	0	0	n.m.	-507	n.m.
<b>Reported net profit</b>	<b>15,056</b>	<b>13,685</b>	<b>10.0</b>	<b>10,814</b>	<b>39.2</b>
<b>Diluted EPS (Rs)</b>	<b>17.1</b>	<b>15.6</b>	<b>9.4</b>	<b>13.0</b>	<b>32.0</b>
<b>As % of net revenue</b>					
Gross profit	29.3	30.1		33.7	
SG&A	12.1	12.1		13.7	
EBITDA	17.2	18.0		20.0	
EBIT	13.2	14.8		16.5	
Reported net profit	12.4	12.0		11.1	
Tax rate	17.6	26.9		31.3	

Source: Company; IDBI Capital Research

**Exhibit 2: Actual vs. estimates**

Year to March	Q4FY22	Q4Y22E	Variance (%)
Revenue (US\$ mn)	1,608	1,607	0.1%
Revenue (Rs mn)	1,21,163	1,20,868	0.2%
EBIT (Rs mn)	16,042	17,073	-6.0%
EBIT margin (%)	13.2%	14.1%	(89)bps
Recurring PAT (Rs mn)	15,056	13,740	9.6%
Recurring PAT margin (%)	12.4%	11.4%	106bps
Recurring EPS (Rs)	17.1	15.7	9.0%

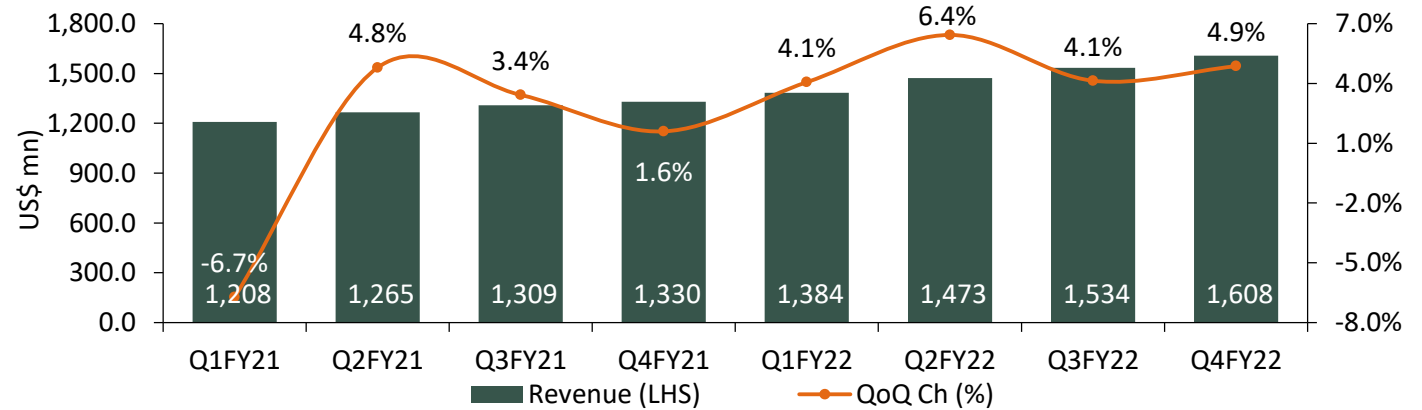
Source: Company, IDBI Capital Research

**Exhibit 3: Earnings Revision**

Year-end: March	FY23E			FY24E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	6,915	6,923	-0.1%	7,583	7,623	-0.5%
Revenue (Rs bn)	522.1	519.2	0.6%	576.3	571.7	0.8%
EBIT margin (%)	14.5%	15.5%	(92) bps	15.0%	15.6%	(69) bps
EPS (Rs/sh)	70.4	73.6	-4.4%	79.9	82.0	-2.6%

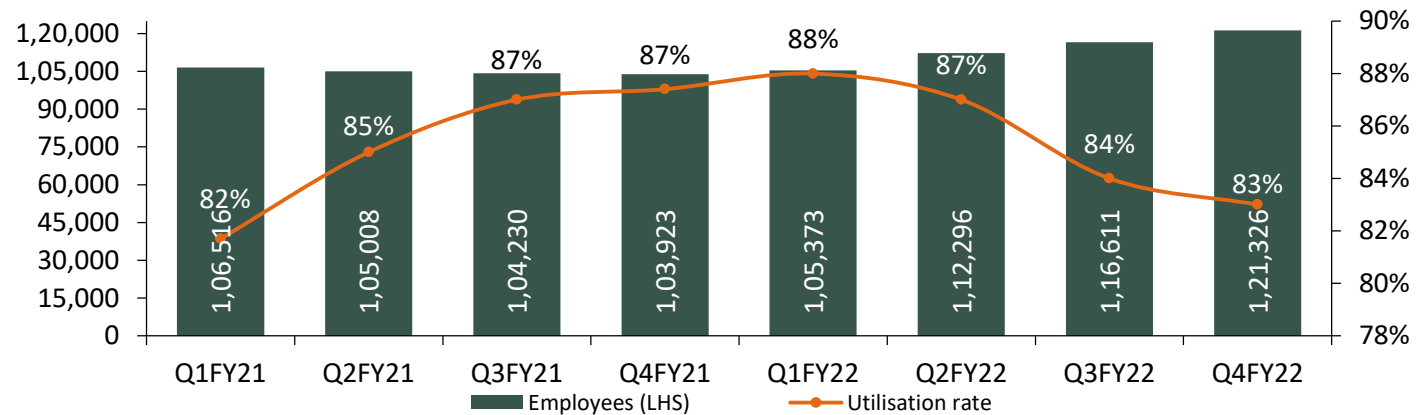
Source: Company; IDBI Capital Research

**Exhibit 4: Q4FY22 revenue was in line with our expectation**



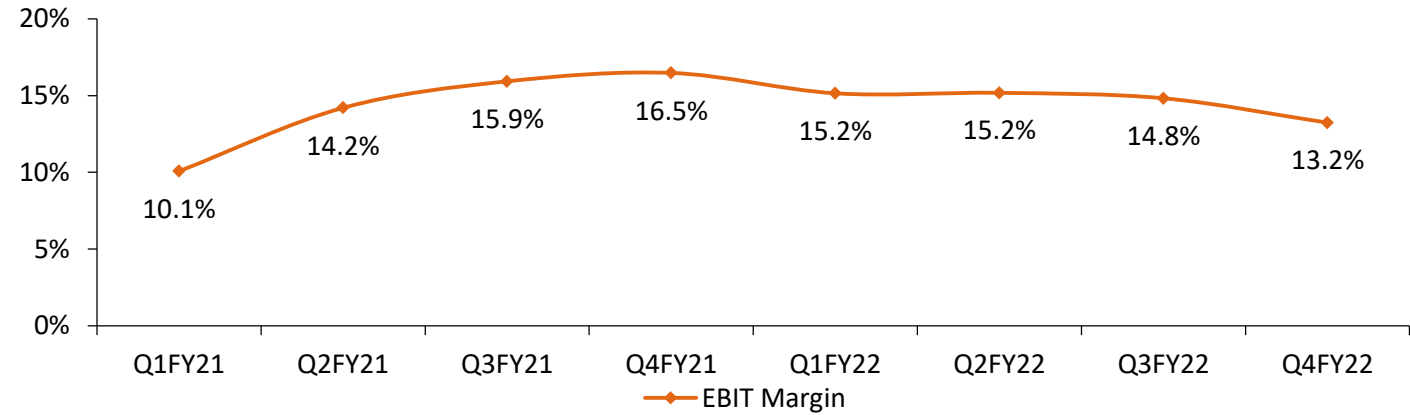
Source: Company; IDBI Capital Research

**Exhibit 5: Utilisation declined QoQ**



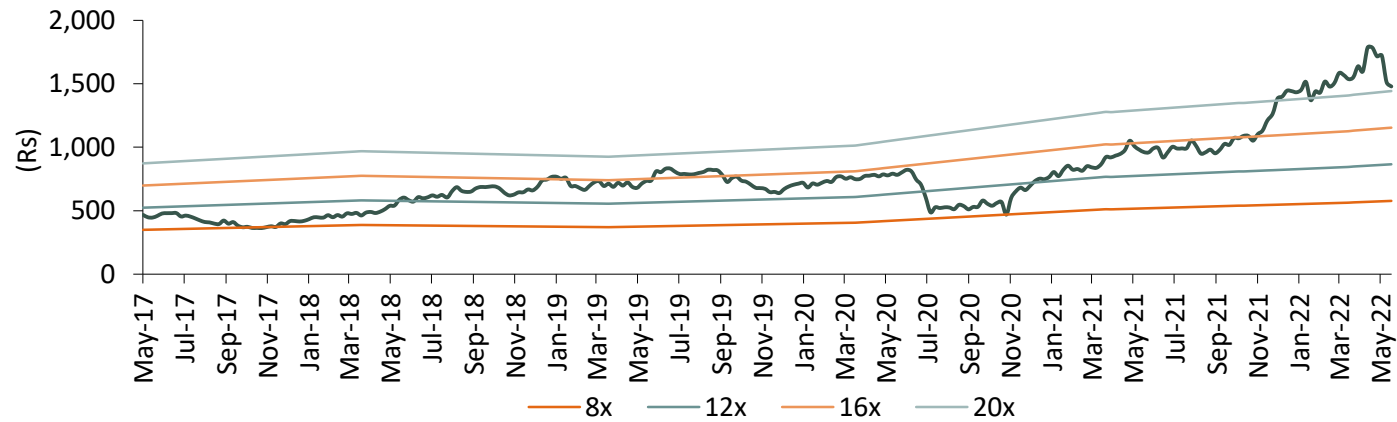
Source: Company; IDBI Capital Research

**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	FY22	FY23E	FY24E
<b>Net sales</b>	<b>3,47,421</b>	<b>3,68,677</b>	<b>3,78,551</b>	<b>4,46,460</b>	<b>5,22,087</b>	<b>5,76,307</b>
<i>Change (yoy, %)</i>	13	6	3	18	17	10
Operating expenses	(2,84,053)	(3,11,416)	(3,10,080)	(3,66,260)	(4,26,811)	(4,70,777)
<b>EBITDA</b>	<b>63,368</b>	<b>57,261</b>	<b>68,471</b>	<b>80,201</b>	<b>95,276</b>	<b>1,05,530</b>
<i>Change (yoy, %)</i>	34	-10	20	17	19	11
<i>Margin (%)</i>	18.2	15.5	18.1	18.0	18.2	18.3
Depreciation	(11,292)	(14,458)	(14,577)	(15,204)	(19,364)	(19,335)
<b>EBIT</b>	<b>52,076</b>	<b>42,803</b>	<b>53,894</b>	<b>64,997</b>	<b>75,912</b>	<b>86,195</b>
Interest paid	(1,332)	(1,919)	(1,740)	(1,626)	(1,316)	(1,136)
Other income	5,342	11,924	7,871	11,123	8,823	9,626
<b>Pre-tax profit</b>	<b>56,086</b>	<b>52,808</b>	<b>60,025</b>	<b>74,494</b>	<b>83,419</b>	<b>94,685</b>
Tax	(12,544)	(11,604)	(15,999)	(18,221)	(21,689)	(24,618)
<i>Effective tax rate (%)</i>	22.4	22.0	26.7	24.5	26.0	26.0
Minority Interest	(567.0)	(874.0)	255.0	(612.0)	32.0	32.0
<b>Net profit</b>	<b>42,975</b>	<b>40,330</b>	<b>44,281</b>	<b>55,661</b>	<b>61,762</b>	<b>70,099</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>61,762</b>	<b>70,099</b>
<i>Change (yoy, %)</i>	13	(1)	5	24	11	13
EPS	48	49	51	64	71	80
Dividend per sh	14.0	15.0	45.0	45.0	50.0	57.0
<i>Dividend Payout %</i>	35	37	88	71	71	71

**Balance Sheet**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E*	FY23E	FY24E
<b>Shareholders' funds</b>	<b>2,02,844</b>	<b>2,18,131</b>	<b>2,48,650</b>	<b>2,64,981</b>	<b>2,83,043</b>	<b>3,03,325</b>
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	2,60,611	2,78,673	2,98,955
<b>Total Debt</b>	<b>14,047</b>	<b>24,282</b>	<b>16,618</b>	<b>15,618</b>	<b>13,618</b>	<b>11,618</b>
Other liabilities	3,334	21,076	19,027	19,027	19,027	19,027
<b>Curr Liab &amp; prov</b>	<b>1,09,456</b>	<b>1,05,757</b>	<b>1,07,929</b>	<b>1,25,098</b>	<b>1,45,610</b>	<b>1,60,316</b>
Current liabilities	77,224	72,193	71,361	82,286	95,547	1,05,054
Provisions	32,232	33,564	36,568	42,811	50,063	55,262
<b>Total liabilities</b>	<b>1,26,837</b>	<b>1,51,115</b>	<b>1,43,574</b>	<b>1,59,743</b>	<b>1,78,255</b>	<b>1,90,961</b>
<b>Total equity &amp; liabilities</b>	<b>3,34,458</b>	<b>3,73,179</b>	<b>3,96,019</b>	<b>4,29,131</b>	<b>4,65,673</b>	<b>4,98,629</b>
Net fixed assets	71,667	76,047	80,405	1,05,126	97,762	90,427
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
<b>Current assets</b>	<b>2,15,658</b>	<b>2,31,723</b>	<b>2,52,553</b>	<b>2,60,944</b>	<b>3,04,850</b>	<b>3,45,141</b>
Inventories	752	358	242	285	334	368
Sundry Debtors	69,586	75,772	64,728	85,622	1,00,126	1,10,525
Cash and Bank	1,18,550	87,606	1,24,971	1,01,535	1,18,439	1,39,371
Loans and advances	26,770	30,632	29,331	34,249	40,051	44,210
<b>Total assets</b>	<b>3,34,458</b>	<b>3,73,179</b>	<b>3,96,019</b>	<b>4,29,131</b>	<b>4,65,673</b>	<b>4,98,629</b>

\*Note; Awaiting Annual Report



**Cash Flow Statement**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E*	FY23E	FY24E
Pre-tax profit	56,086	52,808	60,025	74,494	83,419	94,685
Depreciation	25,946	9,343	14,577	15,204	19,364	19,335
Tax paid	(12,916)	(13,611)	(16,284)	(18,221)	(21,689)	(24,618)
Chg in working capital	17,187	(13,353)	14,633	(8,687)	159	114
Other operating activities	(27,320)	(50,579)	33,059	(5,997)	(6,371)	(4,613)
<b>Cash flow from operations (a)</b>	<b>58,983</b>	<b>(15,392)</b>	<b>1,06,010</b>	<b>56,793</b>	<b>74,882</b>	<b>84,903</b>
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	-	-	-	-	-	-
<b>Cash flow from investing (b)</b>	<b>(15,760)</b>	<b>(8,299)</b>	<b>(21,779)</b>	<b>(39,925)</b>	<b>(12,000)</b>	<b>(12,000)</b>
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)	(39,330)	(43,700)	(49,818)
Chg in minorities	(881)	(1,718)	117	-	-	-
Other financing activities	-	-	-	-	-	-
<b>Cash flow from financing (c)</b>	<b>(18,982)</b>	<b>(7,253)</b>	<b>(46,866)</b>	<b>(40,330)</b>	<b>(45,700)</b>	<b>(51,818)</b>
<b>Net chg in cash (a+b+c)</b>	<b>24,241</b>	<b>(30,944)</b>	<b>37,365</b>	<b>(23,462)</b>	<b>17,182</b>	<b>21,085</b>

\*Note; Awaiting Annual Report

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Book Value (Rs)	229	250	284	303	324	347
Adj EPS (Rs)	48	49	51	64	71	80
Adj EPS growth (%)	13	1	5	24	11	13
EBITDA margin (%)	18	16	18	18	18	18
Pre-tax margin (%)	16	14	16	17	16	16
Net Debt/Equity (x)	-1	0	0	0	0	0
ROCE (%)	23	17	19	22	24	26
ROE (%)	22.0	20.2	19.2	21.7	22.5	23.9
<b>DuPont Analysis</b>						
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	1.6
Net margin (%)	12.4	11.5	11.8	12.5	11.8	12.2
<b>Working Capital &amp; Liquidity ratio</b>						
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)	24.8	24.7	23.5	18.9	17.0	15.0
Price/Book value (x)	5.3	4.8	4.2	4.0	3.7	3.5
EV/Net sales (x)	2.8	2.7	2.5	2.2	1.8	1.6
EV/EBITDA (x)	15	17	14	12	10	9
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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