FIRST LIGHT

26 October 2021

RESEARCH

[#2 Watch Out] India Strategy | Climate Action

Climate colonialism

Tech Mahindra | Target: Rs 1,890 | +24% | BUY

Growth outperforms; 5G demand outlook robust

Coforge | Target: Rs 6,680 | +24% | BUY

Strong Q2 performance coupled with large deals

SUMMARY

India Strategy: Climate Action

- Historical emissions responsible for global warming – US, EU, China and Russia account for two-thirds of greenhouse gas dump
- Climate plans that don't address past emissions unfair to developing nations such as India whose carbon space was unfairly appropriated
- Earnings of emitting industries in India may remain intact but valuations will suffer due to waning investor interest

Click here **for the full report.**

Tech Mahindra

- Q2 revenue growth beat estimates at 6.4% QoQ USD on 6.3%/6.7% enterprise/communications business growth
- Management maintained upbeat commentary on demand and 5G-led deal activity
- We raise our target P/E to 22.5x and revise our Sep'22 TP to Rs 1,890 (vs. Rs 1,660) on a buoyant outlook; reiterate BUY

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Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.63	(7bps)	31bps	78bps
India 10Y yield (%)	6.36	3bps	24bps	45bps
USD/INR	74.90	0.0	(1.7)	(1.8)
Brent Crude (US$/bbl)	85.53	1.1	15.0	101.4
Dow	35,677	0.2	5.2	25.8
Shanghai	3,583	(0.3)	(0.9)	8.2
Sensex	60,822	(0.2)	3.1	50.0
India FII (US$ mn)	**21-Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	(45.5)	(423.1)	(348.0)	1,679.2
FII-E	(323.1)	(41.8)	8,488.2	1,161.8

Source: Bloomberg

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Coforge

- Robust Q2 revenue growth of 6.6% QoQ USD led by BFSI; EBIT margin in line at 14.8% (+230bps QoQ)
- Organic revenue growth guidance for FY22 raised to 22%+ YoY CC backed by highest-ever executable order book of US$ 688mn
- We cut FY22/FY23 EPS 4%/3% on lower exchange rate estimates, and revise our Sep'22 TP to Rs 6,680 (from Rs 6,930) – retain BUY

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CLIMATE ACTION | #2 Watch Out | 25 October 2021

Climate colonialism

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Disproportionate emission dump by developed countries: The US, EU and Russia have dumped ~50% of global cumulative greenhouse gases, as per our estimate, despite housing a mere 12% of the world's population. China accounts for another 15% of cumulative emissions, with ~18% of the world's population. India has a staggering 17% population share but has contributed just 4% of global greenhouse gases.

Past emissions matter as much as current emissions: Per the Intergovernmental Panel on Climate Change's (IPCC) report, the world needs to limit its future cumulative carbon dump to 600-800Gt CO_2 (~20x CY19) to prevent temperatures rising 1.5°C above the pre-industrial era. This limit is due to the past dump that lingers on.

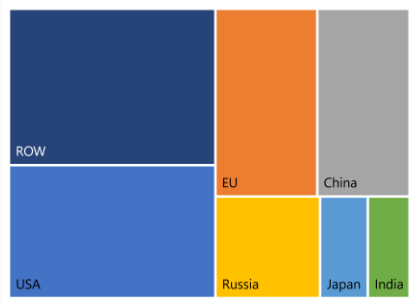
Demands for sharp cuts unfair to countries like India: Western countries have been able to improve the living standards of their citizens thanks to early industrialisation. However, in the process, they have used a disproportionately higher amount of carbon space. Now countries such as India, which are yet to bring the living standards of their population on par with those of the West, find that they have to curb carbon emissions due to the past excesses of developed nations.

India is thus being pushed to invest in expensive renewable and energy efficiency solutions. The COP26 President has already publicly demanded a sharp emission cut by India (Source: Hindustan Times, 16 Aug 2021), which would require an early closure of coal-based power plants that currently generate 70% of India's electricity.

Implications for India: We believe western countries do not have the moral high ground to force a sharp emission cut on India. However, we expect pressure on Indian companies via indirect routes like financial flows and border adjustment taxes.

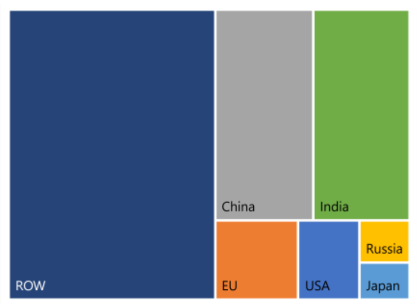
This will likely mean that (a) Indian companies exporting products and services to the West will have to invest in greening up production processes, and players geared to providing green services (renewables, hydrogen, energy efficiency) will likely benefit from the new capex; and (b) listed large emitters such as coal, refiners, steel and cement will find valuation multiples coming under pressure (for details, see our note of 9 June 2021: **Clean your way up**).

Relative share of cumulative carbon dump



Source: BOBCAPS Research

Population distribution



Source: BOBCAPS Research

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BUY
TP: Rs 1,890 | ⮝ 24%

TECH MAHINDRA | Technology & Internet | 26 October 2021

Growth outperforms; 5G demand outlook robust

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Growth ahead, margin in line: TECHM reported broad-based Q2FY22 revenue growth of 6.4% QoQ USD/7.2% CC, exceeding our (4.1% USD/4.8% CC) and street expectations. This was due to traction in TME (+8.9% QoQ USD), retail, transport & logistics (8.1%), and other (+8.3%) verticals. Enterprise/communications business grew 6.3%/6.7% USD. EBIT margin at 15.2% was stable QoQ, in line with estimates. Employee costs and SG&A expense as a percentage of revenue were flat QoQ.

TCV slightly muted: TCV stood at US$ 750mn, down 8% QoQ but up 78% YoY. The CME and enterprise segments contributed US$ 255mn and US$ 495mn respectively. Contract wins were in the areas of core digitisation, business process reengineering, cloud migration and transformation of legacy systems. Deals were from verticals such as telecom, energy and utility, manufacturing and transportation.

Abundant 5G opportunity: 5G rollout has expanded TECHM's addressable market. Demand is coming from the areas of (1) legacy OSS transformation, (2) network capability and 5G infrastructure buildup, and (3) R&D and product development.

Record hiring: TECHM hired its highest-ever quarterly tally of 14,930 employees in Q2, equally distributed between information technology and BPS. This was to backfill for elevated attrition of 21% (+400bps QoQ) amid intense talent supply pressure in the sector and inadequate hiring during Q3FY20-Q4FY21.

Robust outlook: Management expects deal win and growth momentum to continue. Communications business growth is likely to come from sustained 5G investments as well as digital and legacy modernisation, with H2FY22 to see the usual tailwind from Comviva revenues.

Maintain BUY: We adjust FY22/FY23 EPS estimates by -2% to +3% to factor in new USDINR estimates and retain BUY on revenue outperformance with margin resilience. During the 4G upcycle, TECHM traded at an average 15% discount to TCS. Baking in the upbeat 5G growth outlook, we raise our target one-year forward P/E from 20x to 22.5x – a 30-40% discount to Infosys/TCS – to arrive at a new Sep'22 TP of Rs 1,890.

Key changes

Target	Rating
▲	◄►

Ticker/Price	TECHM IN/Rs 1,524
Market cap	US$ 17.7bn
Free float	64%
3M ADV	US$ 69.8mn
52wk high/low	Rs 1,577/Rs 782
Promoter/FPI/DII	36%/39%/25%

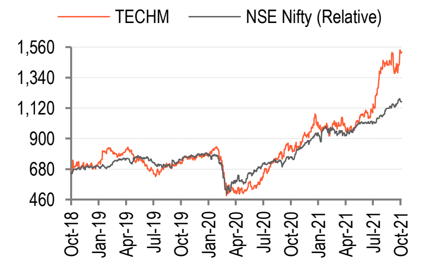
Source: NSE | Price as of 25 Oct 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	378,551	441,203	516,470
EBITDA (Rs mn)	68,471	82,513	102,807
Adj. net profit (Rs mn)	44,281	57,302	70,359
Adj. EPS (Rs)	50.4	65.2	80.0
Consensus EPS (Rs)	50.4	59.9	66.2
Adj. ROAE (%)	18.7	21.4	23.3
Adj. P/E (x)	30.3	23.4	19.1
EV/EBITDA (x)	19.3	16.0	12.7
Adj. EPS growth (%)	4.2	29.4	22.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

BUY
TP: Rs 6,680 | ⮝ 24%

COFORGE | Technology & Internet | 25 October 2021

Strong Q2 performance coupled with large deals

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- **Organic revenue growth guidance for FY22 raised to 22%+ YoY CC backed by highest-ever executable order book of US$ 688mn**
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In-line performance: Coforge's Q2FY22 revenue grew 6.6% QoQ USD/7.5% QoQ CC, in line with our estimate of 6.8%/7.4%. Excluding SLK Global, revenue was up 3.9% QoQ CC. BFS spearheaded growth at 22.6% QoQ in rupee terms aided by inorganic revenue, continuing the stellar performance from last quarter. Recovery in the transportation vertical was a bit subdued at 5.7% QoQ. Insurance failed to recover with flattish growth of 1.8% due to delays in 'Advantage Go' license revenue. This will flow through in Q3, per management.

EBIT margin expands: EBIT margin stood at 14.8% (+230bps QoQ), in line with our estimate of 15%. Cost of revenue and SGA declined 220bps and 20bps QoQ respectively. Margin expansion was aided by (1) higher utilisation (+150bps QoQ to 78.5%), (2) ramp-up of deals in offshore locations, and (3) offshore pyramid optimisation.

Record executable order book: Coforge's executable orders for the next 12 months stood at a record US$ 688mn, up 41% YoY and 7% QoQ. The company bagged three large deals, of which two were over US$ 50mn TCV each. Order intake was robust with 11 new logos and totaled US$ 285mn, comprising US$ 123mn from the US, US$ 114mn from EMEA and US$ 48mn from RoW.

FY22 guidance raised: On the basis of a robust pipeline comprising large deals, ~40% YoY revenue growth in H1FY22 and good operating margins, management has raised organic revenue growth guidance to 'at least' 22% CC for FY22. This comes after back-to-back guidance upgrades over the last two quarters. SLK Global business is also expected to grow 22% YoY CC. EBITDA margin growth is guided at 40% USD YoY at 19% (vs. 18% in FY21). Management expects Insuretech to recover well in H2 as license revenues from 'Advantage Go' come through.

Maintain BUY: We cut FY22/FY23/FY24 EPS estimates by 4%/3%/6% as we reduce USDINR exchange rates and normalise FY24 revenue growth assumptions. Our Sep'22 TP thus reduces to Rs 6,680 (vs. Rs 6,930), based on an unchanged one-year forward P/E multiple of 35x which is 3SD above the stock's five-year mean. Maintain BUY given the strong all-round Q2 performance and sturdy deal pipeline.

Key changes

Target	Rating
▼	◄►

Ticker/Price	COFORGE IN/Rs 5,398
Market cap	US$ 4.5bn
Free float	43%
3M ADV	US$ 38.9mn
52wk high/low	Rs 6,030/Rs 2,078
Promoter/FPI/DII	70%/13%/17%

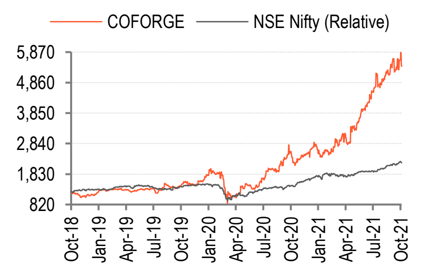
Source: NSE | Price as of 22 Oct 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	46,628	63,876	77,035
EBITDA (Rs mn)	8,035	11,913	14,943
Adj. net profit (Rs mn)	4,556	7,631	10,445
Adj. EPS (Rs)	75.0	125.6	172.0
Consensus EPS (Rs)	75.0	112.9	143.0
Adj. ROAE (%)	18.6	28.4	32.8
Adj. P/E (x)	72.0	43.0	31.4
EV/EBITDA (x)	41.0	27.5	21.8
Adj. EPS growth (%)	2.9	67.5	36.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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