

BUY

TP: Rs 1,890 | ▲ 24%

TECH MAHINDRA

Technology & Internet

12 November 2021

Positive commentary instils confidence; 5G outlook optimistic

- TECHM's analyst meet today focused on the 3Ps – Purpose, People and Performance
- Management aims to raise the revenue run-rate of most verticals to US\$ 1bn in two years. CME will remain the key focus vertical
- We stay positive on TECHM post encouraging commentary on revenue growth, 5G traction, margins and M&A – restate BUY, TP Rs 1,890

Ruchi Burde | Seema Nayak
 researchreport@bobcaps.in

We attended TECHM's analyst day. Key takeaways from the event:

Unlocking M&A synergies: TECHM will continue to undertake more M&A as this is not only a source of revenue and helps to enrich white spaces in its capability, but is also an important part of talent development (for recruiting senior leaders). The company has won US\$ 700mn in large deals led by portfolio company synergies in FY22TD. The synergy-led pipeline is now at US\$ 1.3bn. The large healthcare deal won in Q2FY22 was made possible by combining the capabilities of portfolio assets.

Billion-dollar target for technology & healthcare verticals: TECHM counts on its billion-dollar client club to spur enterprise business growth, where management is targeting US\$ 1bn+ in revenue each from the hi-tech/technology and healthcare (HLS) verticals (vs. respective Q2FY22 annualised run-rates of US\$ 530mn and US\$ 400mn).

In BFSI, it is aiming for a US\$ 1.5bn run-rate over the next one year. CME (communications, media & entertainment) remains the key growth driver for the foreseeable future with HLS and technology as the 'growth gem' verticals (i.e. TECHM will make extraordinary efforts to accelerate their growth). Some of the largest deal wins are in HLS. Hi-tech is also expected to show similar momentum.

5G update: Management expects 5G to contribute US\$ 3.7tn to the global economy by 2030. 5G constituted 20% of TECHM's telecom revenue and 50% of network revenue in Q2FY22, crossing US\$ 500mn. It is expected to fuel growth in the CME vertical which was up 16% YoY in Q2FY22. TECHM's 5G strategy is built around (1) modernising infrastructure, (2) digitising products and platforms, (3) monetising the data and business, and (4) reimagining customer experience. 5G revenue streams will come from enterprises, ecosystems and devices. Please see our Deep Dive report of 14 Sep 2021: [5G juggernaut gains momentum; BUY TECHM](#).

Positive on TECHM: Our positive view is reinforced by management's upbeat outlook on large deals, margins, revenue growth, M&A and deal pricing. We retain BUY with an unchanged Sep'22 TP of Rs 1,890, based on 22.5x one-year forward P/E.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	TECHM IN/Rs 1,522
Market cap	US\$ 17.8bn
Free float	64%
3M ADV	US\$ 69.8mn
52wk high/low	Rs 1,630/Rs 820
Promoter/FPI/DII	36%/39%/25%

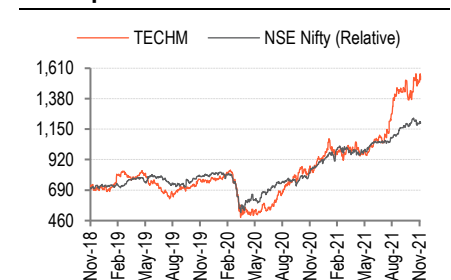
Source: NSE | Price as of 11 Nov 2021

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	63.9	72.7
Adj. ROAE (%)	18.7	21.4	23.3
Adj. P/E (x)	30.2	23.4	19.0
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



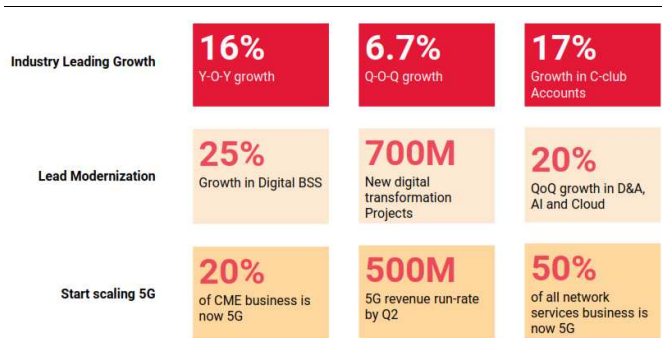
Source: NSE



Other highlights

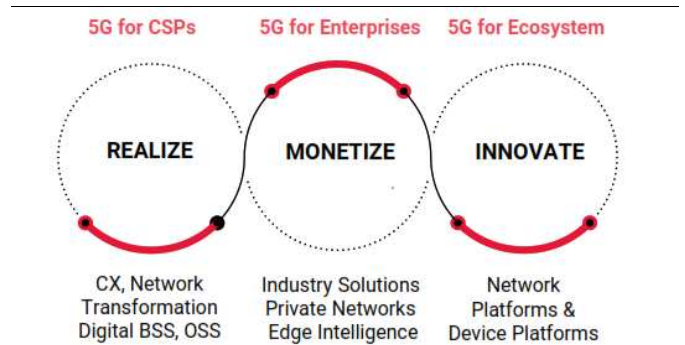
- **Emphasis on margin improvement:** TECHM has expanded its EBIT margin by 100bps YoY in Q2FY22. It will continue to use levers such as synergies from portfolio companies, control on subcontracting costs, offshore mix optimisation (onsite:offshore mix currently at 1:3) and yield management.
- **Focus on top accounts and large deal wins:** Management aims to drive growth through the top-50 accounts out of its 1,200-strong client base. TECHM has a dedicated team focused on winning large deals. Net new deal wins over the last 12 months stood at US\$ 3bn.
- **Targeting select HLS sub-segments:** In the HLS vertical, where management expects high growth, TECHM will focus on the provider and life sciences management system sub-segments.
- **Efforts to boost talent retention:** Amid supply constraints, the company is feeling the pressure. It has tripled its fresher hiring and about 30% of new hiring has been through buddy referrals. Management is working to provide a holistic work environment to employees where they have flexibility, in order to increase retention. Utilisation will be maintained at 87%.
- **Free cash flow increasing:** Consistent reduction of DSOs has helped increase free cash flow. TECHM will continue to return 64% of FCF to shareholders via buybacks and dividends.

Fig 1 – 5G traction driving stellar CME vertical performance



Source: Company

Fig 2 – TECHM’s 5G playbook



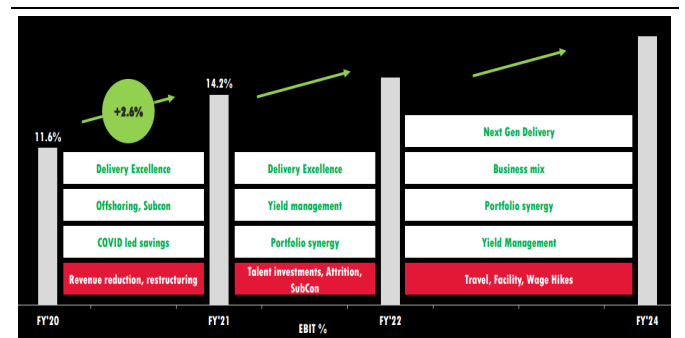
Source: Company

Fig 3 – Holistic focus on business integration



Source: Company

Fig 4 – Margin improvement focus



Source: Company

Valuation methodology

TECHM's prowess in the communications vertical positions it well to benefit from growing 5G adoption. We expect 5G capex to spur a ~15% revenue CAGR in TECHM's communications vertical over FY22-FY24, and value the company at an unchanged one-year forward P/E multiple of 22.5x considering the upbeat growth outlook. Reiterate BUY for a Sep'22 TP of Rs 1,890. During the 4G upcycle, TECHM traded at an average 15% discount to TCS. We have valued the company at a 30-40% discount to our target multiples for TCS and Infosys (INFO).

Key risks

Key downside risks to our estimates are:

- delayed 5G pickup,
- lack of synergy among portfolio companies, and
- high attrition impacting margins.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,145	1,240	BUY
Coforge	COFORGE IN	4.5	5,376	6,680	BUY
eClerx Services	ECLX IN	1.2	2,373	2,880	BUY
HCL Technologies	HCLT IN	42.3	1,161	1,440	BUY
IndiaMart InterMesh	INMART IN	3.1	7,512	8,430	BUY
Info Edge	INFOE IN	10.6	6,148	6,530	BUY
Infosys	INFO IN	99.2	1,733	2,000	BUY
Just Dial	JUST IN	0.6	767	1,190	BUY
L&T Infotech	LTI IN	16.4	6,949	7,980	BUY
Mindtree	MTCL IN	10.8	4,888	3,390	SELL
Mphasis	MPHL IN	8.4	3,348	3,510	HOLD
Persistent Systems	PSYS IN	4.4	4,131	4,170	HOLD
Tata Consultancy Services	TCS IN	175.9	3,488	4,630	BUY
Tech Mahindra	TECHM IN	17.8	1,522	1,890	BUY
Wipro	WPRO IN	47.6	642	840	BUY

Source: BOBCAPS Research, NSE | Price as of 11 Nov 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	368,677	378,551	441,203	516,470	595,287
EBITDA	57,261	68,471	82,513	102,807	118,522
Depreciation	14,458	14,577	14,114	16,527	19,049
EBIT	42,803	53,894	68,399	86,280	99,473
Net interest inc./(exp.)	(1,919)	(1,740)	(1,510)	(1,650)	(1,650)
Other inc./(exp.)	11,924	7,871	9,207	6,401	3,517
Exceptional items	0	0	0	0	0
EBT	52,753	59,530	76,107	91,071	101,400
Income taxes	11,604	15,999	19,458	22,313	24,843
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	1,301	762	663	1,640	2,060
Reported net profit	42,505	44,281	57,302	70,359	78,557
Adjustments	0	0	0	0	0
Adjusted net profit	42,505	44,281	57,302	70,359	78,557

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	103,830	102,292	114,834	134,424	154,938
Provisions	11,055	13,121	12,088	14,150	16,309
Debt funds	24,282	16,618	16,618	16,618	16,618
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,359	4,370	4,370	4,370	4,370
Reserves & surplus	217,705	248,075	279,197	316,613	358,174
Shareholders' fund	222,064	252,445	283,567	320,983	362,544
Total liab. and equities	373,535	396,780	439,411	498,478	562,713
Cash and cash eq.	30,167	26,904	47,252	88,901	135,277
Accounts receivables	75,772	64,728	87,032	101,879	117,427
Inventories	358	242	242	242	242
Other current assets	121,702	110,932	113,995	120,182	126,660
Investments	61,046	104,436	104,436	104,436	104,436
Net fixed assets	76,047	80,405	77,321	73,706	69,539
CWIP	501	1,183	1,183	1,183	1,183
Intangible assets	33,877	40,082	40,082	40,082	40,082
Deferred tax assets, net	8,443	9,133	9,133	9,133	9,133
Other assets	0	0	0	0	0
Total assets	373,535	396,780	439,411	498,478	562,713

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	46,075	64,824	46,187	77,853	91,087
Capital expenditures	(15,386)	(12,048)	(11,030)	(12,912)	(14,882)
Change in investments	(16,880)	43,390	0	0	0
Other investing cash flows	13,843	(64,787)	10,717	8,051	5,167
Cash flow from investing	(18,423)	(33,445)	(313)	(4,861)	(9,716)
Equities issued/Others	0	(569)	0	0	0
Debt raised/repaid	0	(13,624)	0	0	0
Interest expenses	0	(1,789)	0	0	0
Dividends paid	(17,912)	(18,660)	(25,527)	(31,344)	(34,996)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(17,912)	(34,642)	(25,527)	(31,344)	(34,996)
Chg in cash & cash eq.	9,740	(3,263)	20,348	41,649	46,376
Closing cash & cash eq.	30,167	26,904	47,252	88,901	135,277

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	48.3	50.4	65.2	80.0	89.3
Adjusted EPS	48.3	50.4	65.2	80.0	89.3
Dividend per share	16.9	17.6	24.1	29.6	33.1
Book value per share	252.5	287.1	322.4	365.0	412.2

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	3.6	3.5	3.0	2.5	2.1
EV/EBITDA	23.1	19.3	16.0	12.7	10.8
Adjusted P/E	31.5	30.2	23.4	19.0	17.0
P/BV	6.0	5.3	4.7	4.2	3.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	80.6	74.4	75.3	77.3	77.5
Interest burden (PBT/EBIT)	123.2	110.5	111.3	105.6	101.9
EBIT margin (EBIT/Revenue)	11.6	14.2	15.5	16.7	16.7
Asset turnover (Rev./Avg TA)	104.1	98.3	105.5	110.1	112.2
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
Adjusted ROAE	19.8	18.7	21.4	23.3	23.0

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	6.1	2.7	16.6	17.1	15.3
EBITDA	(9.6)	19.6	20.5	24.6	15.3
Adjusted EPS	1.2	4.2	29.4	22.8	11.7
Profitability & Return ratios (%)					
EBITDA margin	15.5	18.1	18.7	19.9	19.9
EBIT margin	11.6	14.2	15.5	16.7	16.7
Adjusted profit margin	11.5	11.7	13.0	13.6	13.2
Adjusted ROAE	19.8	18.7	21.4	23.3	23.0
ROCE	15.1	16.3	19.6	24.8	29.0
Working capital days (days)					
Receivables	72	68	63	67	67
Inventory	1	0	0	0	0
Payables	114	121	110	110	111
Ratios (x)					
Gross asset turnover	5.0	4.8	5.6	6.8	8.3
Current ratio	2.0	1.8	2.0	2.1	2.2
Net interest coverage ratio	(22.3)	(31.0)	(45.3)	(52.3)	(60.3)
Adjusted debt/equity	0.0	0.0	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

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

BUY – Expected return >+15%

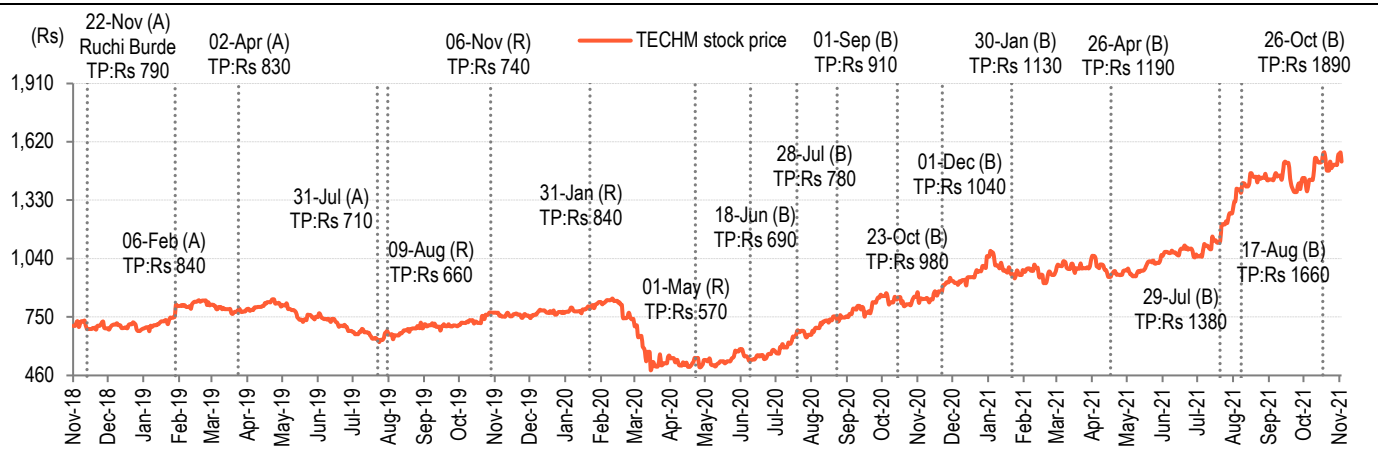
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): TECH MAHINDRA (TECHM IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

Rating distribution

As of 31 October 2021, out of 105 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 52 have BUY ratings, 25 have HOLD ratings, 6 are rated ADD*, 2 are rated REDUCE* and 20 are rated SELL. None of these companies have been investment banking clients in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.