

**BUY**

TP: Rs 1,380 | ▲ 22%

**TECH MAHINDRA**

| IT Services

| 29 July 2021

### Positive 5G-led traction in large deals

- Q1 dollar revenue growth beat our estimate at 4.1% QoQ on 4.7% enterprise business growth and 3.2% recovery in communications
- Management’s demand outlook was positive, especially around large 5G deals finally coming through
- We raise our target P/E to 17.2x and roll over to a revised Jun’22 TP of Rs 1,380 (vs. Rs 1,190); reiterate BUY

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**Broad-based growth:** TECHM grew 4.1% QoQ USD in Q1FY22 (with 20bps of cross-currency tailwinds), outperforming our estimate of 3.1%. Growth was spread across verticals, with technology (TME) leading the way at 8.1% QoQ and telecom up a robust 3.2% backed by 5G pickup. Enterprise business grew 4.7% QoQ. TCW was at a first-quarter peak of US\$ 815mn, with US\$ 352mn from the communication vertical and US\$ 463mn from enterprise. The company signed large healthcare and BPO deals in Q1. Its deal pipeline remains strong and is now at an all-time high.

**EBIT margin underperforms:** EBIT margin stood at 15.2% in Q1 (16.7% est.), down 130bps QoQ. Cost of revenue increased 200bps QoQ as a percentage of sales. Lower margins stemmed from salary hikes, visa costs, a seasonal decline in the mobility business and higher subcontracting costs. This was partially offset by operating efficiency, leverage and lower SG&A cost. TECHM has guided for ~15% EBIT margins in FY22 amid a talent supply crunch.

**5G deal activity picks up:** TECHM has developed several 5G use cases and will continue to undertake projects in the areas of network digitisation, product engineering, ecosystem and enterprise. The 5G opportunity extends beyond network modernisation, going into complete core transformation, and is deeply integrated in all large telecom deals. 60-70% of the new communication deals going ahead will be centered around 5G. Management is positive on the demand environment but has decided not to go after low-margin, high-volume deals.

**Supply pressure:** Sluggish hiring over the last six quarters compelled TECHM to hire excessively in Q1. Attrition was at 17%, up 400bps QoQ, closing in on pre-Covid levels of 19-21%. Management sees margin pressure due to the supply-side crunch.

**Maintain BUY:** TECHM has done well in a seasonally weak quarter and its guidance of double-digit organic growth in FY22 remains intact. We expect 5G capex to spur a 15.5% communications revenue CAGR over FY22-FY24 and thus raise our target one-year forward P/E from 15.7x to 17.2x, realigning to the stock’s average during the 4G upcycle of FY14-FY15. On rollover, our Jun’22 TP rises to Rs 1,380 (vs. Rs 1,190).

### Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	TECHM IN/Rs 1,128
Market cap	US\$ 13.3bn
Free float	64%
3M ADV	US\$ 39.5mn
52wk high/low	Rs 1,153/Rs 643
Promoter/FPI/DII	36%/39%/25%

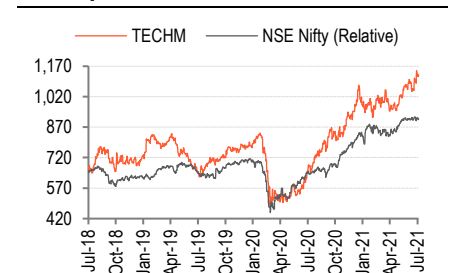
Source: NSE | Price as of 29 Jul 2021

### Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	378,551	441,945	518,834
EBITDA (Rs mn)	68,471	85,355	103,288
Adj. net profit (Rs mn)	44,281	58,587	68,477
Adj. EPS (Rs)	50.4	66.6	77.9
Consensus EPS (Rs)	50.4	59.9	66.2
Adj. ROAE (%)	18.7	21.8	22.7
Adj. P/E (x)	22.4	16.9	14.5
EV/EBITDA (x)	14.3	11.4	9.3
Adj. EPS growth (%)	4.2	32.3	16.9

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

### Stock performance



Source: NSE



## Earnings call highlights

- Among the large telecom deals, TECHM has won engagements with a leading UK telco as well as a tier-I US-based telco.
- Management is apprehensive of the impact of returning travel costs and higher employee costs given industrywide supply pressure, leading to its modest EBIT margin guidance of ~15% for FY22.
- The company plans to hire more fresher as well as lateral employees in coming quarters.
- DSO stood at 93 days in Q1, increasing by 1day QoQ.

**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>1,384</b>	<b>1,207</b>	<b>14.7</b>	<b>1,330</b>	<b>4.1</b>	<b>5,186</b>	<b>5,094</b>	<b>1.8</b>
Revenue	101,976	91,063	12.0	97,299	4.8	384,056	364,838	5.3
Operating Expenditure	83,212	78,058	6.6	77,818	6.9	315,776	308,050	2.5
Cost of revenues	69,682	65,105	7.0	64,497	8.0	263,529	257,952	2.2
as % of sales	68.3	71.5	-	66.3	-	68.6	70.7	-
SG&A expenses	13,530	12,953	4.5	13,321	1.6	52,247	50,098	4.3
as % of sales	13.3	14.2	-	13.7	-	13.6	13.7	-
<b>EBITDA</b>	<b>18,764</b>	<b>13,005</b>	<b>44.3</b>	<b>19,481</b>	<b>(3.7)</b>	<b>68,280</b>	<b>56,788</b>	<b>20.2</b>
Depreciation	3,311	3,832	-	3,444	-	14,304	14,308	(0.0)
<b>EBIT</b>	<b>15,453</b>	<b>9,173</b>	<b>68.5</b>	<b>16,037</b>	<b>(3.6)</b>	<b>53,976</b>	<b>42,480</b>	<b>27.1</b>
Other Income	2,490	3,659	-	(89)	-	5,636	11,270	(50.0)
Impairment of goodwill and non-current assets	-	-	-	507	-	-	-	-
PBT	17,943	12,832	39.8	15,441	16.2	59,612	53,750	10.9
Total Tax	4,286	3,276	-	4,998	-	16,022	12,488	-
<b>Adjusted PAT</b>	<b>13,657</b>	<b>9,556</b>	<b>42.9</b>	<b>10,443</b>	<b>30.8</b>	<b>43,590</b>	<b>41,262</b>	<b>5.6</b>
(Profit)/loss from JV's/Ass/MI	(125)	167	-	371	-	428	748	-
APAT after MI	13,532	9,723	39.2	10,814	25.1	44,018	42,010	4.8
Extra ordinary items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>13,532</b>	<b>9,723</b>	<b>39.2</b>	<b>10,814</b>	<b>25.1</b>	<b>44,018</b>	<b>42,010</b>	<b>4.8</b>
Reported EPS	15.4	11.1	39.2	12.3	25.1	51	48	6.5
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	18.4	14.3	410	20.0	(160)	17.8	15.6	220
EBIT	15.2	10.1	510	16.5	(130)	14.1	11.6	240
EBT	17.6	14.1	350	15.9	170	15.5	14.7	80
PAT	13.3	10.7	260	11.1	220	11.5	11.5	(10)
Effective Tax rate	23.9	25.5	(160)	32.4	(850)	26.9	23.2	360

Source: Company, BOBCAPS Research

**Fig 2 – Operating metrics**

(in US\$ terms)	Q1FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Geography</b>			
North America	46.7	6.8	8.6
Europe	27.2	6.8	20.9
Rest of the World	26.1	(3.0)	20.2
<b>Client Concentration</b>			
Top 5	22.1	3.6	16.6
Top 10	31.0	4.0	14.4
Top 20	43.2	4.1	14.0
Non-Top 10	69.0	4.1	14.8
<b>Revenue by Vertical</b>			
Telecom	40.0	3.2	12.6
Manufacturing	16.5	4.5	12.2
Technology, Media and Entertainment	8.8	8.1	22.8
BFSI	16.4	3.7	19.8
Retail, Transport and Logistics	7.7	3.2	16.4
Others	10.6	4.3	11.2
<b>Revenue by Delivery</b>			
Onsite	62.0	2.4	11.1
Offshore	38.0	6.9	21.0
	<b>Q1FY22</b>	<b>QoQ chg</b>	<b>YoY chg</b>
Utilisation (including trainees) (%)	88	100bps	600bps
Attrition (%)	17	400bps	-
Headcount	126,263	5,209	2,847
	<b>Q1FY22</b>	<b>Q4FY21</b>	<b>Q1FY21</b>
<b>No. of Million Dollar Clients</b>			
≥ US\$ 1mn clients	466	451	451
≥ US\$ 5mn clients	168	169	161
≥ US\$ 10mn clients	86	85	81
≥ US\$ 20mn clients	51	50	48
≥ US\$ 50mn clients	22	21	21
DSO	93	92	107

Source: Company, BOBCAPS Research

## Valuation methodology

We believe that telecom is a relatively resilient industry in the current environment (see our report [Deep Dive 2: Telecom tech spends resilient – upgrade TECHM](#)). 5G-driven traction and digitisation of telcos will boost the communications vertical, which forms nearly 40% of TECHM's revenues. With the onset of Covid-19, 5G adoption timelines have shifted to FY22 onward, but demand is coming from adjacent areas such as supply chain transformation, app modernisation, open network on cloud, intelligent and cognitive managed operations, digital OSS, and enterprise network modernisation.

We expect 5G capex to spur a 15.5% revenue CAGR in TECHM's communications vertical over FY22-FY24, similar to the high growth seen during the 4G capex cycle in FY14 and FY15. We thus value the company at its average FY14-FY15 P/E multiple of 17.2x vs. 15.7x earlier. On rollover, our Jun'22 TP rises to Rs 1,380 (vs. Rs 1,190). During the 4G upcycle, TECHM traded at an average 15% discount to TCS. We have valued the company at a 42% discount to our multiple of 29.6x for TCS. Reiterate BUY.

**Fig 3 – Revised estimates**

(Rs mn)	New			Old		Change (%)	
	FY22E	FY23E	FY24E	FY22E	FY23E	FY22E	FY23E
Revenues (US\$ mn)	5,818	6,630	7641	5,814	6,722	(0.1)	1.4
YoY growth (%)	13.8	14.0	15.3	13.7	15.6	-	-
Revenues	441,945	518,834	597,979	442,650	526,036	0.2	1.4
EBITDA (Rs mn)	85,355	103,288	119,070	84,577	101,572	(0.9)	(1.7)
EBITDA margins (%)	19.3	19.9	19.9	19.1	19.3	-	-
EBIT Margin (%)	16.1	16.7	16.7	15.0	15.1	-	-
Net Profits	58587	68477	78895	55755	66570	(4.8)	(2.8)
EPS (Rs)	66.6	77.9	89.7	63.4	75.7	(4.8)	(2.8)

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Parameter	FY21	FY22E	FY23E	FY24E
USD growth YoY	(1.4)	13.8	14.0	15.3
EBITDA Margin (%)	18.1	19.3	19.9	19.9
EBIT Margin (%)	14.2	16.1	16.7	16.7

Source: Company, BOBCAPS Research

**Fig 5 – Peer comparison**

Ticker	CMP (Rs)	Mkt Cap (US\$ bn)	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		P/E (x)		ROE (%)	
						FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	3,196	160.5	BUY	3,890	15.1	109.8	127.0	29.1	25.2	41.4	43.1
INFO IN	1,617	92.1	BUY	1,860	14.3	54.1	61.1	29.9	26.5	33.8	33.8
WPRO IN	589	43.6	HOLD	590	18.4	23.5	27.1	25.1	21.8	7.1	7.5
HCLT IN	1,009	36.6	BUY	1,260	11.3	52.2	59.0	19.3	17.1	31.9	38.4
TECHM IN	1,128	13.2	BUY	1,380	13.9	77.9	89.7	14.5	12.6	21.8	22.7
LTI IN	4,634	10.9	BUY	4,990	18.7	134.1	158.4	34.6	29.3	37.1	42.6
MPHL IN	2,670	6.7	HOLD	2,500	14.0	82.0	95.7	32.6	27.9	22.3	25.5
MTCL IN	2,809	6.2	SELL	2,270	15.8	87.7	93.9	32.0	29.9	50.5	55.7
PSYS IN	3,125	3.3	HOLD	2,920	21.0	74.0	91.4	42.3	34.2	19.6	22.5
COFORGE IN	5,188	4.2	BUY	5,530	26.8	131.8	174.3	39.4	29.8	25.3	28.8

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- low growth in the communication business,
- lack of synergy among portfolio companies, and
- prolonged delay in 5G timelines.

## Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Coforge	COFORGE IN	4	5,172	5,530	BUY
HCL Technologies	HCLT IN	37	1,008	1,260	BUY
Info Edge	INFOE IN	9	5,209	2,880	SELL
Infosys	INFO IN	93	1,617	1,860	BUY
L&T Infotech	LTI IN	11	4,640	4,990	BUY
Mindtree	MTCL IN	6	2,796	2,270	SELL
Mphasis	MPHL IN	7	2,670	2,500	HOLD
Persistent Systems	PSYS IN	3	3,123	2,920	HOLD
Tata Consultancy Services	TCS IN	161	3,196	3,890	BUY
Tech Mahindra	TECHM IN	13	1,128	1,380	BUY
Wipro	WPRO IN	44	590	590	HOLD

Source: BOBCAPS Research, NSE | Price as of 29 Jul 2021

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>368,677</b>	<b>378,551</b>	<b>441,945</b>	<b>518,834</b>	<b>597,979</b>
EBITDA	57,261	68,471	85,355	103,288	119,070
Depreciation	14,458	14,577	14,190	16,603	19,135
EBIT	42,803	53,894	71,165	86,686	99,935
Net interest inc./(exp.)	(1,919)	(1,740)	(1,544)	(1,650)	(1,650)
Other inc./(exp.)	11,924	7,871	6,380	3,503	3,503
Exceptional items	0	0	0	0	0
EBT	52,753	59,530	76,029	88,578	101,848
Income taxes	11,604	15,999	18,517	21,702	24,953
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	1,301	762	1,103	1,640	2,060
<b>Reported net profit</b>	<b>42,505</b>	<b>44,281</b>	<b>58,587</b>	<b>68,477</b>	<b>78,895</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>42,505</b>	<b>44,281</b>	<b>58,587</b>	<b>68,477</b>	<b>78,895</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	103,830	102,292	115,027	135,039	155,638
Provisions	11,055	13,121	12,108	14,215	16,383
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	279,488	315,860	357,609
Shareholders' fund	222,064	252,445	283,858	320,230	361,979
<b>Total liab. and equities</b>	<b>373,535</b>	<b>396,780</b>	<b>439,915</b>	<b>498,406</b>	<b>562,922</b>
Cash and cash eq.	30,167	26,904	47,606	88,241	134,827
Accounts receivables	75,772	64,728	87,178	102,345	117,958
Inventories	358	242	242	242	242
Other current assets	121,702	110,932	114,056	120,376	126,881
Investments	61,046	104,436	104,436	104,436	104,436
Net fixed assets	76,047	80,405	77,264	73,632	69,446
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
<b>Total assets</b>	<b>373,535</b>	<b>396,780</b>	<b>439,915</b>	<b>498,406</b>	<b>562,922</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>46,075</b>	<b>64,824</b>	<b>49,926</b>	<b>78,959</b>	<b>91,528</b>
Capital expenditures	(15,386)	(12,048)	(11,049)	(12,971)	(14,949)
Change in investments	(16,880)	43,390	0	0	0
Other investing cash flows	13,843	(64,787)	7,924	5,153	5,153
<b>Cash flow from investing</b>	<b>(18,423)</b>	<b>(33,445)</b>	<b>(3,125)</b>	<b>(7,818)</b>	<b>(9,796)</b>
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)	(26,099)	(30,505)	(35,146)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(17,912)</b>	<b>(34,642)</b>	<b>(26,099)</b>	<b>(30,505)</b>	<b>(35,146)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>9,740</b>	<b>(3,263)</b>	<b>20,702</b>	<b>40,635</b>	<b>46,585</b>
<b>Closing cash &amp; cash eq.</b>	<b>30,167</b>	<b>26,904</b>	<b>47,606</b>	<b>88,241</b>	<b>134,827</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21P	FY22E	FY23E	FY24E
Reported EPS	48.3	50.4	66.6	77.9	89.7
Adjusted EPS	48.3	50.4	66.6	77.9	89.7
Dividend per share	16.9	17.6	24.6	28.8	33.2
Book value per share	252.5	287.1	322.8	364.1	411.6

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21P	FY22E	FY23E	FY24E
EV/Sales	2.7	2.6	2.2	1.9	1.6
EV/EBITDA	17.1	14.3	11.4	9.3	7.8
Adjusted P/E	23.3	22.4	16.9	14.5	12.6
P/BV	4.5	3.9	3.5	3.1	2.7

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21P	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	80.6	74.4	77.1	77.3	77.5
Interest burden (PBT/EBIT)	123.2	110.5	106.8	102.2	101.9
EBIT margin (EBIT/Revenue)	11.6	14.2	16.1	16.7	16.7
Asset turnover (Rev./Avg TA)	104.1	98.3	105.6	110.6	112.7
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
<b>Adjusted ROAE</b>	<b>19.8</b>	<b>18.7</b>	<b>21.8</b>	<b>22.7</b>	<b>23.1</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21P	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	6.1	2.7	16.7	17.4	15.3
EBITDA	(9.6)	19.6	24.7	21.0	15.3
Adjusted EPS	1.2	4.2	32.3	16.9	15.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.5	18.1	19.3	19.9	19.9
EBIT margin	11.6	14.2	16.1	16.7	16.7
Adjusted profit margin	11.5	11.7	13.3	13.2	13.2
Adjusted ROAE	19.8	18.7	21.8	22.7	23.1
ROCE	15.1	16.3	20.7	24.9	29.2
<b>Working capital days (days)</b>					
Receivables	72	68	63	67	67
Inventory	1	0	0	0	0
Payables	114	121	111	110	111
<b>Ratios (x)</b>					
Gross asset turnover	5.0	4.8	5.6	6.9	8.4
Current ratio	2.0	1.8	2.0	2.1	2.2
Net interest coverage ratio	(22.3)	(31.0)	(46.1)	(52.5)	(60.6)
<b>Adjusted debt/equity</b>	<b>0.0</b>	<b>0.0</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(0.3)</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

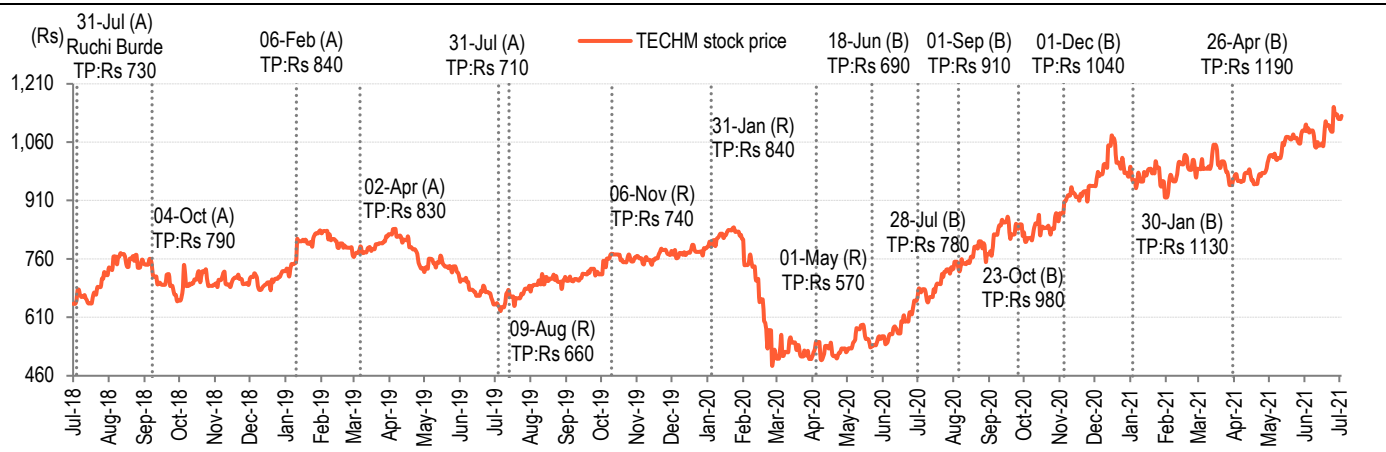
**HOLD** – Expected return from -6% to +15%

**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

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