

**BUY**

TP: Rs 1,940 | ▲ 29%

**TECH MAHINDRA**

Technology & Internet

01 February 2022

**Mixed bag – growth outperforms, margin disappoints**

- Q3 revenue growth robust at 4.1% QoQ USD, outperforming our estimate of 3.6%, driven by the CME vertical
- EBIT margin of 14.8% came in below estimates due to higher employee and subcontractor costs
- We cut FY22-FY24 EPS by 3-8% on lower margin forecasts. Maintain BUY with a revised TP of Rs 1,940 (vs. Rs 1,970)

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**Growth beats estimates:** TECHM grew 4.1% QoQ USD, surpassing our 3.6% estimate. CME (communication, media and entertainment) vertical revenue grew 6.2% QoQ USD, outpacing enterprise business growth (of 2.7%). Network services is dominating CME growth. Within enterprise, retail helmed the growth at 13.5% QoQ USD. HLS (health and life sciences) also performed well whereas other verticals were sluggish. Geography-wise, North America was in the lead. Clients moved up the revenue ladder with 6 clients added QoQ in the US\$ 10mn+ bucket, 4 in the US\$ 5mn+ and 14 in the US\$ 1mn+ bucket.

**EBIT margin underperforms:** EBIT margin at 14.8% (-40bps QoQ) was below our estimate of 15.3% as gross margin contracted 160bps QoQ. Subcontracting expense at 16.4% of revenue (+110bps QoQ) was TECHM's highest ever. This was to backfill the attrition rate of 24%, up 300bps QoQ, again TECHM's highest ever. To contain attrition, management intends to hire from tier-II cities and nearshore locations such as Mexico, Costa Rica, Romania, Latvia and Belarus. The company added 3,874 employees QoQ.

**Deal wins stable QoQ:** TCV stood at a decent US\$ 704mn, down 6% QoQ and up 55% YoY, with US\$ 226mn/US\$ 478mn coming from CME/enterprise. This is the fourth straight quarter of US\$ 700mn+ deal wins. The new engagements are spread across cloud, drone technology and automation, product design and engineering programme support.

**5G to gain momentum:** TECHM's 5G positioning is directed towards system integration, design and the digital cloud aspect of 5G, apart from network deployment. Integration of the 5G network with the cloud and driving network management will form some of the company's focus areas.

**Maintain BUY:** The demand outlook is strong and 5G outlook positive. SG&A is expected to remain below 13% of revenue going forward. We cut FY22/FY23/FY24 EPS estimates by 5%/8%/3% as we lower margin estimates. Our TP stands revised to Rs 1,940 (vs. Rs 1,970), set at an unchanged Dec'23E P/E of 22.5x. BUY.

**Key changes**

Target	Rating
▼	◀ ▶

Ticker/Price	TECHM IN/Rs 1,506
Market cap	US\$ 17.6bn
Free float	64%
3M ADV	US\$ 59.5mn
52wk high/low	Rs 1,838/Rs 915
Promoter/FPI/DII	36%/39%/25%

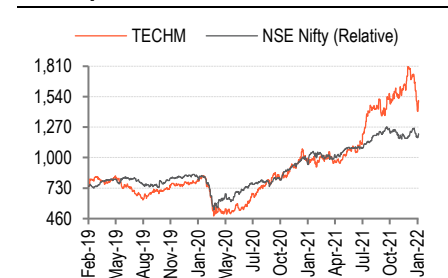
Source: NSE | Price as of 1 Feb 2022

**Key financials**

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	378,551	444,100	524,128
EBITDA (Rs mn)	68,471	80,701	98,655
Adj. net profit (Rs mn)	44,281	55,011	65,693
Adj. EPS (Rs)	50.4	62.6	74.7
Consensus EPS (Rs)	50.4	63.9	72.7
Adj. ROAE (%)	18.7	20.6	21.9
Adj. P/E (x)	29.9	24.1	20.2
EV/EBITDA (x)	19.1	16.2	13.1
Adj. EPS growth (%)	4.2	24.2	19.4

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



## Other highlights

- DSO was at 101 days in Q3FY22, up 9 days QoQ, crossing the 100-day mark after five quarters as collections from a few large clients were delayed to Jan'22 (due to furloughs in Dec'21). Management indicated reversion to normal going forward.
- Hiring has been increased in tier-II and III cities such as Bhubaneshwar, Coimbatore and Nagpur where attrition and costs are 15% lower than in metros.
- More fresh graduates will be recruited going forward to flatten the pyramid and reduce costs. Utilisation is expected to remain in the range of 85-88%.
- Offshoring was stable QoQ at 39% of revenues.
- TECHM has partnered with Mahindra Racing to manage its EV racing cars.

**Fig 1 – Quarterly performance**

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenues (US\$ mn)	1,534	1,309	17.2	1,473	4.1	4,390	3,781	16.1
Revenue	114,508	96,471	18.7	108,813	5.2	325,297	281,252	15.7
Operating Expenditure	93,907	77,516	21.1	88,861	5.7	265,980	232,262	14.5
Cost of revenues	80,088	64,708	23.8	74,346	7.7	224,116	194,058	15.5
as % of sales	69.9	67.1	-	68.3	-	68.9	69.0	-
SG&A expenses	13,819	12,808	7.9	14,515	(4.8)	41,864	38,204	9.6
as % of sales	12.1	13.3	-	13.3	-	12.9	13.6	-
<b>EBITDA</b>	<b>20,601</b>	<b>18,955</b>	<b>8.7</b>	<b>19,952</b>	<b>3.3</b>	<b>59,317</b>	<b>48,990</b>	<b>21.1</b>
Depreciation	3,621	3,584	-	3,430	-	10,362	11,133	(6.9)
<b>EBIT</b>	<b>16,980</b>	<b>15,371</b>	<b>10.5</b>	<b>16,522</b>	<b>2.8</b>	<b>48,955</b>	<b>37,857</b>	<b>29.3</b>
Other Income	1,884	1,793	-	2,460	-	6,834	6,232	9.7
Impairment of goodwill and non-current assets	-	-	-	-	-	0	0	
PBT	18,864	17,164	9.9	18,982	(0.6)	55,789	44,089	26.5
Total Tax	5,082	4,263	-	5,572	-	14,940	11,001	-
<b>Adjusted PAT</b>	<b>13,782</b>	<b>12,901</b>	<b>6.8</b>	<b>13,410</b>	<b>2.8</b>	<b>40,849</b>	<b>33,088</b>	<b>23.5</b>
(Profit)/loss from JV's/Ass/MI	(97)	197	-	(22)	-	(244)	379	-
APAT after MI	13,685	13,098	4.5	13,388	2.2	40,605	33,467	21.3
Extra ordinary items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>13,685</b>	<b>13,098</b>	<b>4.5</b>	<b>13,388</b>	<b>2.2</b>	<b>40,605</b>	<b>33,467</b>	<b>21.3</b>
Reported EPS	15.6	14.9	4.5	15.2	2.2	46	38	21.3
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	18.0	19.6	(170)	18.3	(30)	18.2	17.4	80
EBIT	14.8	15.9	(110)	15.2	(40)	15.0	13.5	160
EBT	16.5	17.8	(130)	17.4	(100)	17.2	15.7	150
PAT	12.0	13.6	(160)	12.3	(40)	12.5	11.9	60
Effective Tax Rate	26.9	24.8	210	29.4	(240)	26.8	25.0	180

Source: BOBCAPS Research, Company

**Fig 2 – Operating metrics**

Operating Metrics at Glance	Q3FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Geography (%)</b>			
North America	48.9	6.5	22.4
Europe	25.5	2.5	13.2
Rest of the World	25.6	1.4	11.9
<b>Top client</b>			
Top 5	23.0	8.9	23.4
Top 10	31.0	4.1	18.7
Top 20	42.0	1.7	15.9
Non Top 10 client revenues	69.0	4.1	16.5
<b>Segment Wise revenue</b>			
Telecom	40.9	6.2	18.0
Manufacturing	15.8	2.8	13.1
Technology, Media and Entertainment	8.4	(2.8)	16.4
BFSI	15.4	(1.6)	13.1
Retail , Transport and Logistics	8.5	13.5	23.6
Others	10.9	5.1	21.0
<b>Revenue by delivery</b>			
Onsite	61.0	4.1	13.4
Offshore	39.0	4.1	23.5
		<b>(bps)</b>	<b>(bps)</b>
Utilization (including trainees)	84	(300)	(300)
Attrition	24	300	1,200
Headcount	145,067	3,874	23,166
	<b>Q3FY22</b>	<b>Q2FY22</b>	<b>Q3FY21</b>
<b>No.of Million \$ Clients</b>			
≥ \$1 million clients	502	488	454
≥ \$5 million clients	173	169	162
≥ \$10 million clients	96	90	83
≥ \$20 million clients	50	50	50
≥ \$50 million clients	22	22	21
DSO	101	92	95

Source: BOBCAPS Research, Company

## Valuation methodology

TECHM's prowess in the communications vertical positions it well to benefit from 5G adoption (see our Deep Dive report of 14 Sep 2021: [5G juggernaut gains momentum; BUY TECHM](#)). We expect 5G capex to spur a 17.3% revenue CAGR in TECHM's communications vertical over FY22-FY24.

Factoring in the Q3FY22 print, we cut FY22/FY23/FY24 EPS estimates by 5%/8%/3% as we lower our margin estimates. Our TP stands revised to Rs 1,940 (vs. Rs 1,970), set at an unchanged Dec'23E P/E multiple of 22.5x. 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). Reiterate BUY.

**Fig 3 – Revised estimates**

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	5,974	6,896	7953	5,966	6,895	7,949	0.1	0.0	0.0
YoY growth (%)	16.9	15.4	15.3	16.7	15.6	15.3	-	-	-
Revenues	444,100	524,128	604,422	443,999	524,039	604,137	0.0	0.0	0.0
EBITDA (Rs mn)	80,701	98,655	118,038	83,048	104,314	120,285	(2.8)	(5.4)	(1.9)
EBITDA margins (%)	18.2	18.8	19.5	18.7	19.9	19.9	-	-	-
EBIT Margin (%)	15.0	15.6	16.3	15.5	16.7	16.7	-	-	-
Net Profits	55012	65693	77092	57639	71317	79687	(4.6)	(7.9)	(3.3)
EPS (Rs)	62.6	74.7	87.7	65.5	81.1	90.6	(4.6)	(7.9)	(3.3)

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	5,111	5,974	6,896	7,953
YoY growth (%)	(1.4)	16.9	15.4	15.3
EBIT margin (%)	14.2	15.0	15.6	16.3

Source: Company, BOBCAPS Research

**Fig 5 – Peer comparison**

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		RoE (%)		P/E (x)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	BUY	4,770	14.1	104.0	120.3	39.6	37.5	36.5	31.6
INFO IN	BUY	2,250	17.1	54.4	62.3	29.8	32.0	32.6	28.4
WPRO IN	BUY	850	18.2	22.6	26.9	20.5	21.6	25.5	21.4
HCLT IN	BUY	1,610	12.6	49.0	56.2	20.3	20.9	23.1	20.1
TECHM IN	BUY	1,940	16.2	62.6	74.7	20.6	21.9	24.1	20.2
LTI IN	BUY	8,490	23.2	131.1	166.8	28.9	30.9	48.0	37.8
MPHL IN	HOLD	3,470	19.1	75.7	90.1	20.9	23.1	41.6	34.9
MTCL IN	BUY	5,610	23.9	97.9	105.3	34.2	31.0	40.9	38.1
PSYS IN	HOLD	4,580	27.9	82.3	98.3	22.0	22.7	54.6	45.7
COFORGE IN	BUY	7,080	27.8	125.1	174.2	28.3	33.2	38.3	27.5
ECLX IN	BUY	3,690	22.9	125.8	143.6	27.0	28.4	19.5	17.1

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

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

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Coforge	COFORGE IN	4.0	4,791	7,080	BUY
eClerx Services	ECLX IN	1.2	2,450	3,690	BUY
HCL Technologies	HCLT IN	41.1	1,133	1,610	BUY
Infosys	INFO IN	100.8	1,772	2,250	BUY
L&T Infotech	LTI IN	14.8	6,295	8,490	BUY
Mindtree	MTCL IN	8.8	3,984	5,610	BUY
Mphasis	MPHL IN	7.9	3,147	3,470	HOLD
Persistent Systems	PSYS IN	4.8	4,497	4,580	HOLD
Tata Consultancy Services	TCS IN	190.7	3,801	4,770	BUY
Tech Mahindra	TECHM IN	17.6	1,506	1,940	BUY
Wipro	WPRO IN	42.6	577	850	BUY

Source: BOBCAPS Research, NSE | Price as of 1 Feb 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>368,677</b>	<b>378,551</b>	<b>444,100</b>	<b>524,128</b>	<b>604,422</b>
EBITDA	57,261	68,471	80,701	98,655	118,038
Depreciation	14,458	14,577	14,164	16,772	19,342
EBIT	42,803	53,894	66,538	81,883	98,697
Net interest inc./(exp.)	(1,919)	(1,740)	(1,462)	(1,650)	(1,650)
Other inc./(exp.)	11,924	7,871	9,647	6,339	4,369
Exceptional items	0	0	0	0	0
EBT	52,753	59,530	74,717	86,612	101,476
Income taxes	11,604	15,999	19,861	22,519	26,384
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	1,301	762	149	1,640	2,060
<b>Reported net profit</b>	<b>42,505</b>	<b>44,281</b>	<b>55,011</b>	<b>65,693</b>	<b>77,092</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>42,505</b>	<b>44,281</b>	<b>55,011</b>	<b>65,693</b>	<b>77,092</b>

### 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	115,588	136,417	157,315
Provisions	11,055	13,121	12,167	14,360	16,560
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	278,424	313,252	354,001
Shareholders' fund	222,064	252,445	282,794	317,622	358,371
<b>Total liab. and equities</b>	<b>373,535</b>	<b>396,780</b>	<b>439,471</b>	<b>497,321</b>	<b>561,168</b>
Cash and cash eq.	30,167	26,904	46,480	85,634	131,274
Accounts receivables	75,772	64,728	87,603	103,390	119,228
Inventories	358	242	242	242	242
Other current assets	121,702	110,932	114,233	120,811	127,411
Investments	61,046	104,436	104,436	104,436	104,436
Net fixed assets	76,047	80,405	77,344	73,675	69,444
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>439,471</b>	<b>497,321</b>	<b>561,168</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>46,075</b>	<b>64,824</b>	<b>44,075</b>	<b>73,534</b>	<b>89,074</b>
Capital expenditures	(15,386)	(12,048)	(11,102)	(13,103)	(15,111)
Change in investments	(16,880)	43,390	0	0	0
Other investing cash flows	13,843	(64,787)	11,109	7,989	6,019
<b>Cash flow from investing</b>	<b>(18,423)</b>	<b>(33,445)</b>	<b>6</b>	<b>(5,114)</b>	<b>(9,092)</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)	(24,506)	(29,265)	(34,343)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(17,912)</b>	<b>(34,642)</b>	<b>(24,506)</b>	<b>(29,265)</b>	<b>(34,343)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>9,740</b>	<b>(3,263)</b>	<b>19,575</b>	<b>39,155</b>	<b>45,640</b>
<b>Closing cash &amp; cash eq.</b>	<b>30,167</b>	<b>26,904</b>	<b>46,480</b>	<b>85,634</b>	<b>131,274</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	48.3	50.4	62.6	74.7	87.7
Adjusted EPS	48.3	50.4	62.6	74.7	87.7
Dividend per share	16.9	17.6	23.1	27.6	32.4
Book value per share	252.5	287.1	321.6	361.2	407.5

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	3.6	3.5	2.9	2.5	2.1
EV/EBITDA	22.9	19.1	16.2	13.1	10.7
Adjusted P/E	31.2	29.9	24.1	20.2	17.2
P/BV	6.0	5.2	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	73.6	75.8	76.0
Interest burden (PBT/EBIT)	123.2	110.5	112.3	105.8	102.8
EBIT margin (EBIT/Revenue)	11.6	14.2	15.0	15.6	16.3
Asset turnover (Rev./Avg TA)	104.1	98.3	106.2	111.9	114.2
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>20.6</b>	<b>21.9</b>	<b>22.8</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	6.1	2.7	17.3	18.0	15.3
EBITDA	(9.6)	19.6	17.9	22.2	19.6
Adjusted EPS	1.2	4.2	24.2	19.4	17.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.5	18.1	18.2	18.8	19.5
EBIT margin	11.6	14.2	15.0	15.6	16.3
Adjusted profit margin	11.5	11.7	12.4	12.5	12.8
Adjusted ROAE	19.8	18.7	20.6	21.9	22.8
ROCE	15.1	16.3	18.8	23.0	28.3
<b>Working capital days (days)</b>					
Receivables	72	68	63	67	67
Inventory	1	0	0	0	0
Payables	114	121	109	108	110
<b>Ratios (x)</b>					
Gross asset turnover	5.0	4.8	5.6	6.9	8.4
Current ratio	2.0	1.8	1.9	2.1	2.2
Net interest coverage ratio	(22.3)	(31.0)	(45.5)	(49.6)	(59.8)
<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%

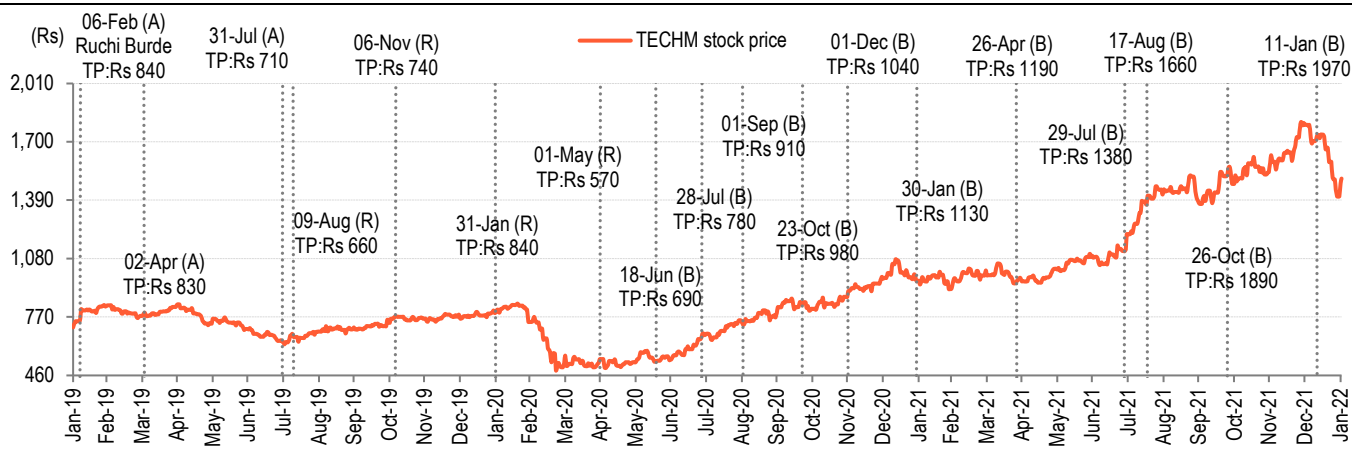
**HOLD** – Expected return from -6% to +15%

**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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