

HOLD

TP: Rs 1,160 | ▲ 12%

TECH MAHINDRA

Technology & Internet

30 January 2023

Weak performance; expect a muted FY23

- Q3 revenue growth subdued at 0.2% QoQ CC, though marginally above our estimate vs street’s estimate of 0.4%QoQ CC
- EBIT margin robust at 12%, a tad ahead of our forecast; net new deal wins grew 13% YoY to US\$ 795mn
- Maintain HOLD and TP of Rs 1,160, set at 12.5x FY25E EPS

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Communication, technology and retail businesses aid growth: TECHM’s Q3FY23 dollar revenue grew 1.8% QoQ (0.2% QoQ CC) to US\$ 1.7bn. Rupee revenue grew 4.6% QoQ to Rs 137.3bn, driven by the communication (+1.9%), technology (3.3%) and retail (6%) businesses. Exposure to engineering, research & development (ER&D), customer experience (CX) and network services is dampening the performance as large spends in these areas are discretionary in nature and adversely impacted in a recessionary climate.

Delayed decision-making leads to weak deal TCV: TECHM reported net new deal TCV at US\$ 795mn in Q3 (13%/11% YoY/QoQ), its eighth consecutive quarter of wins above US\$ 700mn. Management indicated that it is closely monitoring existing as well as new accounts for weakness. The IT services headcount declined by ~7k QoQ, which indicates a probable muted H2FY23 due to (1) low exposure to relatively resilient geographies, (2) macro headwinds combined with furloughs spilling over to January, (3) further rationalization of low-margin business, (4) account-specific volatility, and (5) restructuring of a couple of large clients in Europe.

Margins to improve in Q4: With incremental pressure from low operating leverage in H2, TECHM indicated that it is unlikely to meet its operating margin guidance of 14% in FY23. The company reported a margin of 12% in Q3, aided by discontinuation of low-margin business, divestment of non-strategic assets, synergy with the newer acquisitions, tailwinds from forex, and operational efficiencies such as higher utilization and lower subcontracting expenses We believe that portfolio rationalization will continue in H2FY23 and provide margin tailwinds but impact revenue in the near term.

Maintain HOLD: The stock is trading at 13.3x/11.2x FY24E/FY25E EPS. Growth hinges on positive pipeline commentary, improvement in the services portfolio (design, engineering and consulting), acquisition synergies, 5G-related spend, and deals in media & entertainment. Given the subdued revenue and margin outlook, we retain HOLD and continue to value the stock at 12.5x FY25E EPS – ~20% discount to WPRO given the overhang from sluggish 5G rollout – for an unchanged TP of Rs 1,160.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	TECHM IN/Rs 1,036
Market cap	US\$ 11.1bn
Free float	64%
3M ADV	US\$ 28.7mn
52wk high/low	Rs 1,575/Rs 944
Promoter/FPI/DII	36%/39%/25%

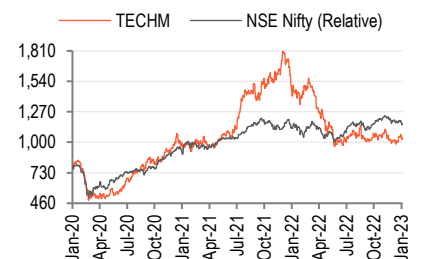
Source: NSE | Price as of 30 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	4,46,460	5,37,442	6,07,222
EBITDA (Rs mn)	80,201	82,605	99,771
Adj. net profit (Rs mn)	55,662	53,171	68,487
Adj. EPS (Rs)	63.9	60.5	77.9
Consensus EPS (Rs)	63.9	71.6	80.9
Adj. ROAE (%)	21.2	18.4	21.4
Adj. P/E (x)	16.2	17.1	13.3
EV/EBITDA (x)	11.2	10.7	8.6
Adj. EPS growth (%)	26.9	(5.4)	28.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

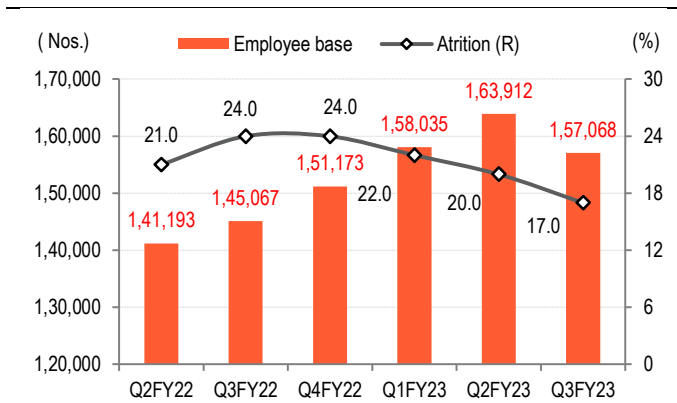


Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q2FY23	Q3FY22	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue	1,668	1,638	1,534	1.8	8.7	1,659	0.5
INR Revenue	1,37,346	1,31,295	1,14,508	4.6	19.9	1,36,704	0.5
EBIT	16,459	14,680	16,962	12.1	(3.0)	16,268	1.2
PAT	12,966	12,854	13,669	0.9	(5.1)	12,987	(0.2)
EBIT Margin (%)	12.0	11.2	14.8	80bps	(283bps)	11.9	8bps
PAT Margin (%)	9.4	9.8	11.9	(35bps)	(250bps)	9.5	(6bps)

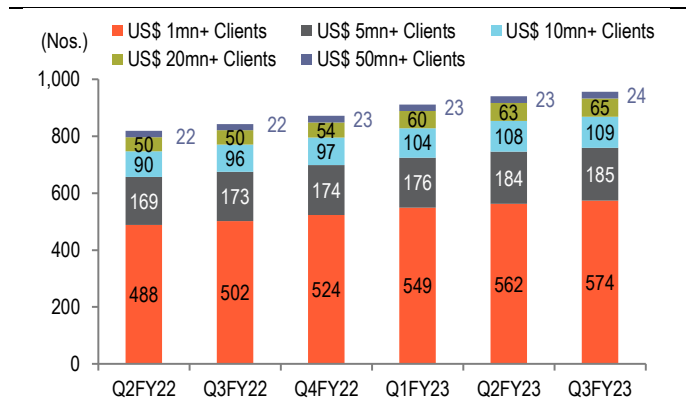
Source: Company, BOBCAPS Research

Fig 2 – Employee base and Attrition



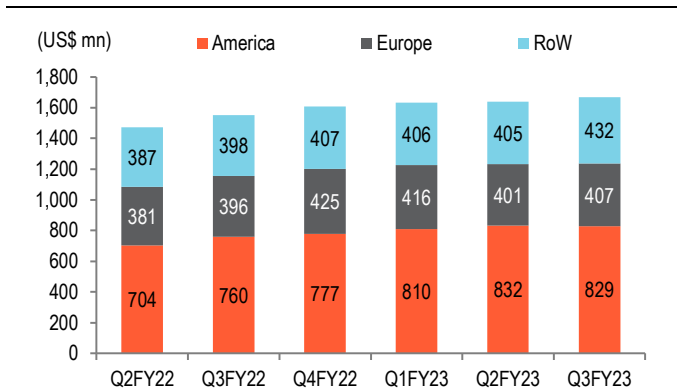
Source: Company, BOBCAPS Research

Fig 3 – Client concentration



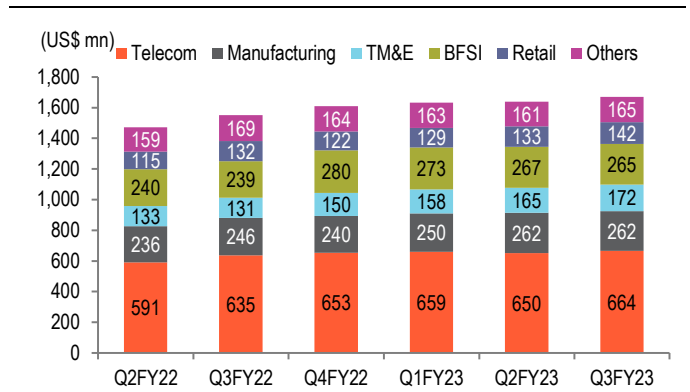
Source: Company, BOBCAPS Research

Fig 4 – Revenue by geography



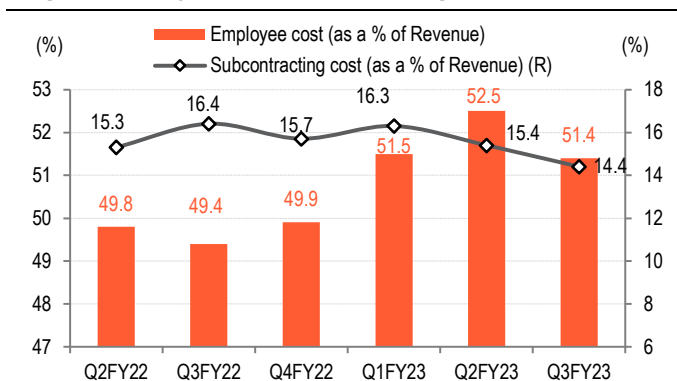
Source: Company, BOBCAPS Research

Fig 5 – Vertical-wise revenue contribution



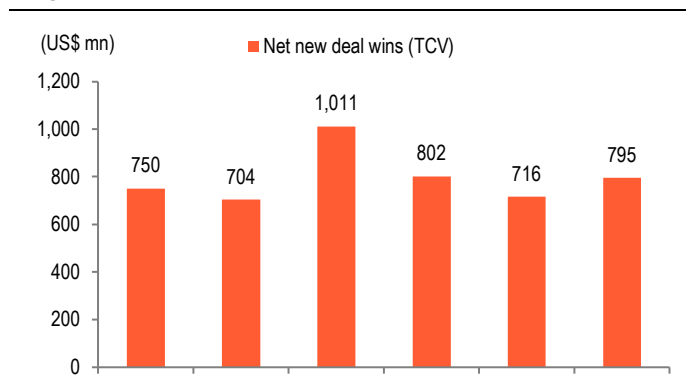
Source: Company, BOBCAPS Research

Fig 6 – Employee and Subcontracting costs



Source: Company, BOBCAPS Research

Fig 7 – Net new deal TCV



Source: Company, BOBCAPS Research

Earnings call highlights

- TECHM reported net new deal wins of US\$ 795mn in Q3FY23 against US\$ 716bn in Q2FY23 and US\$ 704mn in Q3FY22, within the guided range of US\$ 700mn-1,000mn. Deal size hasn't changed over the last four quarters.
- 5G spends remain robust and the focus on capacity building and carrier additions continues. Management sees no near-term impact from macro-related concerns.
- Restructuring by a couple of large clients led to softness in Europe. TECHM expects traction from these two accounts in Q1FY24.
- Per management, deal size per client depends on the macro environment. India deal wins are mainly margin-focused while the Middle East is showing strong demand traction.
- BPO business along with software services is seeing a headcount reduction due to a focus on improving utilization.
- Management indicated uncertainty over margins in H2FY23 on account of slower growth, furloughs and currency-related movements. The company is working to improve subcontracting cost, automation/delivery excellence, and synergies with newer acquisitions.
- Favourable movement in the pound and euro led to an improvement in dollar growth for TECHM in Q3.

Valuation methodology

The stock is trading at 13.3x/11.2x FY24E/FY25E EPS. Growth hinges on positive pipeline commentary, improvement in the services portfolio (design, engineering and consulting), acquisition synergies, 5G-related spend, and deals in media & entertainment. Given the subdued revenue and margin outlook, we retain HOLD and continue to value the stock at 12.5x FY25E EPS – ~20% discount to WPRO given the overhang from sluggish 5G rollout – for an unchanged TP of Rs 1,160.

Key risks

- Multiple digital deal wins, including in the domestic market, represent an upside risk to our estimates.
- A further decline in interest rate would be a key downside risk.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	37.8	1,135	1,240	BUY
Infosys	INFO IN	79.4	1,539	1,760	BUY
Tata Consultancy Services	TCS IN	154.1	3,434	3,580	HOLD
Tech Mahindra	TECHM IN	11.1	1,036	1,160	HOLD
Wipro	WPRO IN	27.1	402	440	HOLD

Source: BOBCAPS Research, NSE | Price as of 30 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	3,78,551	4,46,460	5,37,442	6,07,222	6,79,583
EBITDA	68,471	80,201	82,605	99,771	1,18,617
Depreciation	14,577	15,204	19,730	20,184	22,078
EBIT	53,894	64,997	62,875	79,587	96,539
Net interest inc./(exp.)	(1,740)	(1,626)	(1,853)	(1,320)	(1,320)
Other inc./(exp.)	7,871	11,123	7,153	8,585	9,510
Exceptional items	0	0	0	0	0
EBT	59,530	74,522	68,045	86,913	1,04,788
Income taxes	15,999	18,220	15,377	20,426	25,150
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	762	(612)	373	2,060	2,060
Reported net profit	44,281	55,662	53,171	68,487	81,638
Adjustments	0	0	0	0	0
Adjusted net profit	44,281	55,662	53,171	68,487	81,638

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	1,02,292	1,45,645	1,44,299	1,49,726	1,58,259
Provisions	13,121	15,527	14,724	16,636	18,619
Debt funds	16,618	1,420	1,420	1,420	1,420
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,370	4,388	4,388	4,388	4,388
Reserves & surplus	2,48,075	2,69,423	2,98,405	3,34,382	3,77,652
Shareholders' fund	2,52,445	2,73,811	3,02,793	3,38,770	3,82,040
Total liab. and equities	3,96,780	4,48,707	4,75,541	5,18,856	5,72,642
Cash and cash eq.	26,904	37,889	51,456	83,599	1,23,322
Accounts receivables	64,728	74,676	80,984	83,181	83,784
Inventories	242	405	405	405	405
Other current assets	1,10,932	1,38,706	1,41,210	1,43,045	1,48,001
Investments	1,04,436	49,522	49,522	49,522	49,522
Net fixed assets	80,405	1,39,318	1,43,772	1,50,914	1,59,417
CWIP	1,183	1,651	1,651	1,651	1,651
Intangible assets	40,082	74,258	74,258	74,258	74,258
Deferred tax assets, net	9,133	8,191	8,191	8,191	8,191
Other assets	0	0	0	0	0
Total assets	3,96,780	4,48,707	4,75,541	5,18,856	5,72,642

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	64,824	52,836	52,432	80,072	95,843
Capital expenditures	(12,048)	(8,353)	(24,185)	(27,325)	(30,581)
Change in investments	43,390	57,765	0	0	0
Other investing cash flows	(64,787)	(44,597)	9,006	9,905	10,830
Cash flow from investing	(33,445)	4,815	(15,179)	(17,420)	(19,752)
Equities issued/Others	(569)	(1,238)	0	0	0
Debt raised/repaid	(13,624)	(1,625)	0	0	0
Interest expenses	(1,789)	(3,995)	0	0	0
Dividends paid	(18,660)	(39,808)	(23,687)	(30,510)	(36,368)
Other financing cash flows	0	0	0	0	1
Cash flow from financing	(34,642)	(46,666)	(23,687)	(30,510)	(36,367)
Chg in cash & cash eq.	(3,263)	10,985	13,567	32,143	39,724
Closing cash & cash eq.	26,904	37,889	51,456	83,599	1,23,322

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	50.4	63.9	60.5	77.9	92.8
Adjusted EPS	50.4	63.9	60.5	77.9	92.8
Dividend per share	17.6	23.4	22.4	28.8	34.3
Book value per share	287.1	311.3	344.3	385.2	434.4

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	2.4	2.0	1.6	1.4	1.2
EV/EBITDA	13.1	11.2	10.7	8.6	7.1
Adjusted P/E	20.6	16.2	17.1	13.3	11.2
P/BV	3.6	3.3	3.0	2.7	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	74.4	74.7	78.1	78.8	77.9
Interest burden (PBT/EBIT)	110.5	114.7	108.2	109.2	108.5
EBIT margin (EBIT/Revenue)	14.2	14.6	11.7	13.1	14.2
Asset turnover (Rev./Avg TA)	98.3	105.6	116.3	122.1	124.5
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.5	1.5
Adjusted ROAE	18.7	21.2	18.4	21.4	22.7

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	2.7	17.9	20.4	13.0	11.9
EBITDA	19.6	17.1	3.0	20.8	18.9
Adjusted EPS	4.2	26.9	(5.4)	28.8	19.2
Profitability & Return ratios (%)					
EBITDA margin	18.1	18.0	15.4	16.4	17.5
EBIT margin	14.2	14.6	11.7	13.1	14.2
Adjusted profit margin	11.7	12.5	9.9	11.3	12.0
Adjusted ROAE	18.7	21.2	18.4	21.4	22.7
ROCE	16.3	19.5	18.9	22.8	27.1
Working capital days (days)					
Receivables	68	57	53	49	45
Inventory	0	0	0	0	0
Payables	121	124	116	106	100
Ratios (x)					
Gross asset turnover	4.8	4.1	3.8	4.1	4.4
Current ratio	1.8	1.6	1.7	1.9	2.0
Net interest coverage ratio	(31.0)	(40.0)	(33.9)	(60.3)	(73.1)
Adjusted debt/equity	0.0	(0.1)	(0.2)	(0.2)	(0.3)

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

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

BUY – Expected return >+15%

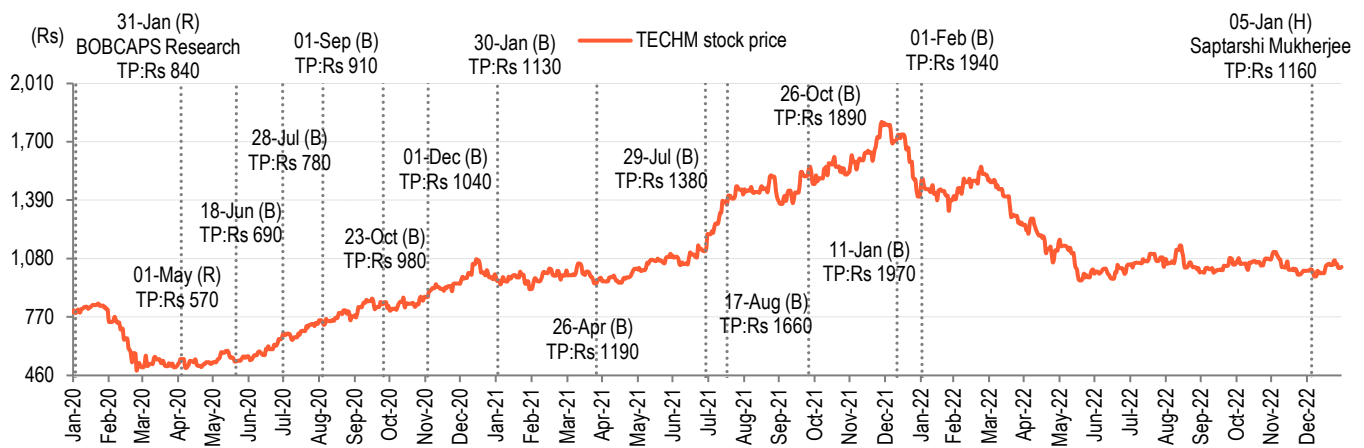
HOLD – Expected return from -6% to +15%

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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