Tech Mahindra (TECMAH)

CMP: ₹ 1485 | Target: ₹ 1850 (25%) | Target Period: 12 months | **BUY**

February 3, 2022

Result Update

Margins impacted; recovery strategy in place…

About the stock: Tech Mahindra (TechM) has over 1.2 lakh employees across 90 countries serving 1000+ clients with higher exposure to telecom (40% of revenues).

- Apart from telecom, the company caters to BFSI, manufacturing & retail
- TechM has grown organically & inorganically (dollar revenue CAGR of 5.6% over the past five years)

Q3FY22 Results: TechM reported weak numbers on the margins front.

- Dollar revenues increased 4.1% QoQ to US$1,533 million while revenue grew 4.7% QoQ in CC terms
- EBIT margins dipped 40 bps QoQ at 14.8%
- Order book was at US$704 million in Q3FY22

What should investors do? TechM's share price has grown by ~3.3x over the past five years (from ~₹ 468 in January 2017 to ~₹ 1,570 levels in January 2022).

- We continue to remain positive and retain our BUY rating on the stock

Target Price and Valuation: We value TechM at ₹ 1850 i.e. 23x P/E on FY24E EPS

Key triggers for future price performance:

- Healthy deal wins, traction in communication segment led by legacy modernisation, 5G, customer care, automation, network and cloud to drive revenues
- Pruning of low return geographies, acceleration in Europe and improving demand from lift & shift deals to drive 13.6% CAGR growth in FY21-24E
- Margins in the near term would be impacted due to continued higher employee and subcontractor costs but are expected to recover

Alternate Stock Idea: Apart from TechM, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 2,300

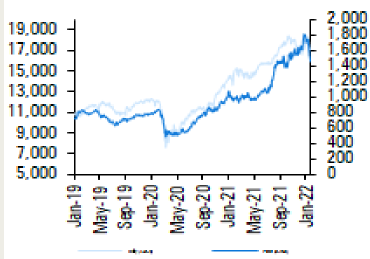
Particulars

Particular	Amount
Market Cap (₹ Crore)	143,496
Total Debt (₹ Crore)	1,662
Cash and Invest (₹ Crore)	12,497
EV (₹ Crore)	132,660
52 week H/L	1837 / 915
Equity capital	437
Face value	₹ 5

Shareholding pattern

	Mar-21	Jun-21	Sep-21	Dec-21
Promoters	36	36	36	36
FII	38	36	36	35
DII	14	17	17	17
Public	12	12	12	12

Price Chart



Recent event & key risks

- Order book remains healthy
- **Key Risk:** (i) Deceleration in deal pipeline, (ii) Inability to sustain cost savings.

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ICICI Securities – Retail Equity Research

Key Financial Summary

Key Financials	FY19	FY20	FY21	5 Year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 years CAGR (FY21-24E)
Net sales	34,742	36,868	37,855	7.4%	43,263	49,833	55,484	13.6%
EBITDA	6,337	5,726	6,847	9.9%	7,744	8,671	9,932	13.2%
EBITDA Margin (%)	18.2	15.5	18.1		17.9	17.4	17.9	
Net Profit	4,298	3,816	4,428	8.1%	5,388	6,035	7,112	17.1%
EPS (₹)	47.7	59.5	50.2		61.1	68.4	80.6	
P/E	31.1	25.0	29.6		24.3	21.7	18.4	
RoNW (%)	21.2	17.5	17.8		19.4	19.4	20.3	
RoCE (%)	23.6	18.3	19.8		21.6	22.1	23.1	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- The company reported 4.1% QoQ growth in revenues at US$1,533.5mn while growth in CC terms was at 4.7% QoQ. In rupee terms, revenue grew 5.2% QoQ to ₹ 11,451 crore

- The revenue growth was aided by CME vertical, which grew 6.2% QoQ, while manufacturing & retail, transport & logistics (RTL) grew 13.5% QoQ. BFSI sector declined 1.6% QoQ due to furlough impact. In terms of geographies, Americas reported growth of 6.5% QoQ while growth in Europe, RoW was relatively muted at 2.5%, 1.4%, respectively

- The company indicated that communication will continue to be the growth driver for TechM, going ahead. The growth in communications would be primarily driven by 5G related spending by operators. The company also said communication vertical growth would be driven by i) infrastructure ii) customer enhancement iii) network modernisation iv) software transformation

- The EBIT margins for the quarter was down 40 bps QoQ. Margin headwinds for the quarter were i) supply side challenges ii) salary revision iii) higher subcontractor costs iv) lower utilisation. Margin tailwinds for the quarter were i) operating efficiency ii) lower SG&A expenses. The company also indicated that SG&A related benefit (70 bps) for the quarter is expected to come back in the next quarter. The company maintained 15% EBIT margin guidance for FY22

- The company has identified nine tier II towns in the country namely Trivandrum, Vizag, Nagpur, Bhubaneshwar, Chandigarh, Kolkata, Indore, Vijayawada and Coimbatore, from where they have been sourcing talent. The company also mentioned that talent availability in these cities is available at 15-20% discounts and dropout rates also lower, which may provide stickiness to employment

- The company also identified and operationalised few onshore delivery centre in Mexico, Canada, Belarus, Latvia, Costa Rica, Romania from where they have been able to procure talent even for niche skills like cloud, SAP4Hana. The company is also looking to elevate fresher hiring. They indicated that they have hired around 10,000 freshers in 9MFY22 and the company is looking to hire 10000-120000 freshers for FY23

- The company indicated that subcontractor costs as percentage of revenue for the quarter (at >16%) increased due to continued travel restrictions due to which they had to deploy subcontractors to fulfil some of incremental demand coming their way. The company is looking to hire permanent employees in the near term to replace these subcontractors, which is expected to lead these costs to taper down

- The company indicated that DSO for the quarter has increased by nine days as payments of some of the clients have been shifted to January due to Christmas holidays. The company indicated that DSO days are expected to be normalised in Q4

- The company called out the following levers for margin improvement, going forward i) Utilisation improvement, in the guided range of 85-88% ii) continued pyramid optimisation iii) reduction in dependence on subcontractor’s iv) portfolio re-alignment wherein they are looking to exit low margin portfolios

Exhibit 1: Variance Analysis

	Q3FY22	Q3FY22E	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	Comments
Revenue	11,451	11,361	9,647	18.7	10,881	5.2	Revenue growth aided by CME vertical while growth in BFSI was impacted due to furlough
Employee expenses	8,009	7,748	6,471	23.8	7,435	7.7	
Gross Margin	3,442	3,613	3,176	8.4	3,447	(0.1)	
Gross margin (%)	30.1	31.8	32.9	-287 bps	31.7	-162 bps	
SG&A expenses	1,382	1,511	1,281	7.9	1,452	(4.8)	
EBITDA	2,060	2,102	1,896	8.7	1,995	3.2	
EBITDA Margin (%)	18	18.5	20	-165 bps	18	-35 bps	
Depreciation & amortisation	362.1	358	358.4	1.0	343.0	5.6	
EBIT	1,698	1,744	1,537	10.5	1,652	2.8	
EBIT Margin (%)	15	15.3	16	-111 bps	15	-36 bps	EBIT margins impacted due to wage hike, higher sub costs and lower utilisation
Other income (less interest)	189	240	179	5.8	247	(23.3)	
PBT	1,887	1,984	1,716	10.0	1,899	(0.6)	
Tax paid	508	575	426	19.2	557	(8.8)	
PAT	1,369	1,406	1,310	4.5	1,339	2.2	
Adjusted PAT	1,369	1,406	1,310	4.5	1,339	2.2	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY22E			FY23E			FY24E			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	43,263	43,263	0.0	49,833	49,833	0.0	53,383	55,484	3.9	
EBITDA	8,177	7,744	-5.3	9,668	8,671	-10.3	10,623	9,932	-6.5	We trim margins on elevated cost pressure amid supply side challenges
EBITDA Margin (%)	18.9	17.9	-100 bps	19.4	17.4	-200 bps	19.9	17.9	-200 bps	
PAT	5,711	5,388	-5.6	6,777	6,035	-11.0	7,601	7,112	-6.4	
EPS (₹)	64.7	61.1	-5.6	76.8	68.4	-11.0	86.2	80.6	-6.5	

Source: Company, ICICI Direct Research

Key Metrics

Exhibit 3: Geography wise break-up

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Revenue by geography (%)					
Americas	46.8	45.5	46.7	47.8	48.9
Europe	26.4	26.5	27.2	25.9	25.5
Rest of World	26.8	28.0	26.1	26.3	25.6
Growth QoQ (%)					
Americas	0.0	-1.2	6.8	8.9	6.5
Europe	8.3	2.0	6.8	1.3	2.5
Rest of World	5.0	6.1	-3.0	7.2	1.4

Source: Company, ICICI Direct Research

Growth in revenues led by Americas

Exhibit 4: Industry wise break-up

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Revenue by verticals (%)					
Telecom	39.7	40.4	40.0	40.1	40.9
Manufacturing	16.3	16.4	16.5	16.0	15.8
Technology,media & entertainment	9.4	8.5	8.8	9.0	8.4
Banking,financial services & insurance	16.0	16.4	16.4	16.3	15.4
Retail, transport & logistics	7.9	7.7	7.7	7.8	8.5
Others	10.8	10.6	10.6	10.8	10.9
Growth QoQ (%)					
Telecom	4.5	3.4	3.0	6.7	6.2
Manufacturing	4.7	2.2	4.7	3.2	2.8
Technology	-0.8	-8.1	7.7	8.9	-2.8
Banking,financial services & insurance	0.9	4.1	4.1	5.8	-1.6
Retail, transport & logistics	8.9	-1.0	4.1	7.8	13.5
Others	2.5	-0.3	4.1	8.4	5.1

Source: Company, ICICI Direct Research

Telecom, Manufacturing reported QoQ growth while BFSI was impacted due to furlough

Exhibit 5: Client & human resource matrix

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Client Metrics					
≥ $1 million clients	454	451	466	488	502
≥ $5 million clients	162	169	168	169	173
≥ $10 million clients	83	85	86	90	96
≥ $20 million clients	50	50	51	50	50
≥ $50 million clients	21	21	22	22	22
Headcount, Attrition, Utilization					
Total Employees	121901	121054	126263	141193	145067
IT Attrition (LTM)	12.0	13.0	17.0	21.0	23.5
IT Utilization % (Excluding Trainees)	87.0	87.0	89.0	89.0	86.0

Source: Company, ICICI Direct Research

Utilisation dip by 300bps QoQ

Financial summary

Exhibit 6: Profit and loss statement				₹ crore
(Year-end March)	**FY21**	**FY22E**	**FY23E**	**FY24E**
Net sales	**37,855**	**43,263**	**49,833**	**55,484**
Growth (%)	3	14	15	11
COGS (employee expenses)	25,856	29,852	34,634	38,284
Gross profit	12,000	13,412	15,199	17,200
S,G&A expenses	5,153	5,667	6,528	7,268
Total Operating Expenditure	31,008	35,519	41,162	45,553
EBITDA	**6,847**	**7,744**	**8,671**	**9,932**
Growth (%)	20	13	12	15
Depreciation	1,508	1,384	1,595	1,776
Interest	174	152	152	152
Other Income	787	950	1,101	1,279
PBT	5,952	7,157	8,025	9,284
Total Tax	1,600	1,825	2,046	2,228
Exceptional item	-	-	-	-
PAT	**4,428**	**5,388**	**6,035**	**7,112**
Growth (%)	16	22	12	18
EPS (₹)	50.2	61.1	68.4	80.6

Source: Company, ICICI Direct Research

Exhibit 7: Cash flow statement				₹ crore
(Year-end March)	**FY21**	**FY22E**	**FY23E**	**FY24E**
Profit before Tax	5,953	7,157	8,025	9,284
Add: Depreciation	1,508	1,384	1,595	1,776
(Inc)/dec in Current Assets	1,646	(1,991)	(2,237)	(1,924)
Inc/(dec) in CL and Provisions	(83)	1,255	1,524	1,311
Taxes paid	(1,415)	(1,825)	(2,046)	(2,228)
CF from operating activities	**8,094**	**5,383**	**6,111**	**7,290**
(Inc)/dec in Investments	(5,149)	(1,000)	(1,000)	(1,000)
(Inc)/dec in Fixed Assets	(573)	(1,298)	(1,246)	(1,387)
Others	221	750	901	1,079
CF from investing activities	**(5,450)**	**(1,548)**	**(1,345)**	**(1,308)**
Issue/(Buy back) of Equity	57	-	-	-
Inc/(dec) in loan funds	(795)	-	-	-
Dividend paid & dividend tax	(1,759)	(2,425)	(2,716)	(3,200)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(558)	(152)	(152)	(152)
CF from financing activities	**(2,987)**	**(2,927)**	**(3,218)**	**(3,702)**
Net Cash flow	(343)	908	1,549	2,280
Cash by acquisition	-	-	-	-
Opening Cash	3,017	2,835	3,743	5,291
Cash carried to B/S	**2,835**	**3,743**	**5,291**	**7,572**

Source: Company, ICICI Direct Research

Exhibit 8: Balance sheet				₹ crore
(Year-end March)	**FY21**	**FY22E**	**FY23E**	**FY24E**
Liabilities				
Equity Capital	437	437	437	437
Share application money	-	-	-	-
Reserve and Surplus	24,428	27,392	30,711	34,622
Total Shareholders funds	24,865	27,829	31,148	35,059
Minority Interest	380	325	270	215
Total Debt	1,662	1,662	1,662	1,662
Other long term liabilities	3,990	3,990	3,990	3,990
Total Liabilities	**30,897**	**33,805**	**37,069**	**40,926**
Assets				
Net Block	3,470	3,734	3,735	3,697
Capital WIP	118	118	118	118
Investments	10,238	11,239	12,240	13,241
Deferred tax assets	913	913	913	913
Goodwill on consolidation	4,008	4,008	4,008	4,008
Debtors	6,475	7,571	8,721	9,710
Loans and Advances (short)	-	-	-	-
Other non-current assets	3,794	3,795	3,796	3,796
Cash	2,835	3,743	5,291	7,572
Other current assets	6,261	7,156	8,242	9,177
Total Current Assets	25,258	29,156	33,941	39,145
Trade payables	2,785	3,183	3,666	4,082
Current liabilities	5,465	6,246	7,195	8,011
Provisions	531	607	699	778
Total Current Liabilities	8,782	10,036	11,560	12,871
Application of Funds	**30,897**	**33,805**	**37,069**	**40,926**

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios				₹ crore
(Year-end March)	**FY21**	**FY22E**	**FY23E**	**FY24E**
Per share data (₹)				
EPS	50.2	61.1	68.4	80.6
Cash EPS	67.3	76.8	86.5	100.7
BV	281.8	315.4	353.0	397.4
DPS	45.0	27.5	30.8	27.5
Cash Per Share	32.1	42.4	60.0	85.8
Operating Ratios (%)				
EBITDA Margin	18.1	17.9	17.4	17.9
PAT Margin	11.7	12.5	12.1	12.8
Return Ratios (%)				
RoE	17.8	19.4	19.4	20.3
RoCE	19.8	21.6	22.1	23.1
RoIC	29.2	33.0	35.4	39.6
Valuation Ratios (x)				
P/E	29.6	24.3	21.7	18.4
EV / EBITDA	19.4	16.9	14.8	12.6
EV / Net Sales	3.5	3.0	2.6	2.3
Market Cap / Sales	3.8	3.3	2.9	2.6
Price to Book Value	5.3	4.7	4.2	3.7
Solvency Ratios				
Debt/EBITDA	0.2	0.2	0.2	0.2
Debt/Equity	0.1	0.1	0.1	0.0
Current Ratio	1.5	1.5	1.5	1.5
Quick Ratio	1.5	1.5	1.5	1.5

Source: Company, ICICI Direct Research

Exhibit 10: ICICI Direct coverage universe (IT)

					EPS (₹)			P/E			RoCE (x)			RoE(x)		
Company Name	**CMP**	**TP (₹)**	**Rating**	**Mcap (₹)**	**FY21**	**FY22E**	**FY23E**	**FY21**	**FY22E**	**FY23E**	**FY21**	**FY22E**	**FY23E**	**FY21**	**FY22E**	**FY23E**
HCL Tech (HCLTEC)	1,110	1,430	HOLD	301,217	45.8	48.0	54.9	24.2	23.1	20.2	23.5	23.0	25.1	20.8	19.5	21.1
Infosys (INFTEC)	1,764	2,300	BUY	749,894	45.5	55.9	63.2	38.8	31.6	27.9	31.7	34.5	36.4	25.2	28.2	29.8
TCS (TCS)	3,697	4,600	BUY	1,367,890	87.6	104.0	120.9	42.2	35.6	30.6	45.9	49.0	51.7	37.5	41.4	43.4
Tech M (TECMAH)	1,485	1,850	BUY	143,496	50.2	61.1	68.4	29.6	24.3	21.7	19.8	21.6	22.1	17.8	19.4	19.4
Wipro (WIPRO)	573	750	BUY	313,832	19.1	21.8	25.6	30.0	26.3	22.4	21.3	22.5	26.2	19.5	21.6	25.4
LTI (LTINFC)	6,276	8,050	BUY	110,180	111.0	137.3	169.9	56.6	45.7	36.9	31.9	33.0	34.0	26.5	27.6	28.5
Mindtree (MINCON)	3,986	5,055	HOLD	61,547	67.4	89.8	109.2	59.1	44.4	36.5	32.5	36.0	36.3	25.7	28.2	28.2
Coforge (NIITEC)	4,849	5,300	HOLD	30,143	73.3	115.2	146.7	66.2	42.1	33.0	23.3	28.6	30.9	18.5	25.0	27.1
TeamLease (TEASER)	4,374	4,500	BUY	7,506	46.5	63.8	93.0	94.1	68.5	47.0	14.2	15.7	18.7	11.6	15.1	17.6
Infoedge (INFEDG)	4,900	5,800	BUY	63,486	20.9	37.1	45.1	234.3	132.1	108.6	7.7	13.1	14.9	6.0	9.9	11.2

Source: Company, ICICI Direct Research

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