

Tech Mahindra

Estimate change

TP change

Rating change


CMP: INR1,507
TP: INR1,600 (+6%)
Neutral

Margin pressure to drag FY23 growth improvement

Valuations pricing in performance

Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USDb)	1463.3 / 19.6
52-Week Range (INR)	1838 / 894
1, 6, 12 Rel. Per (%)	-17/13/39
12M Avg Val (INR M)	4537

Financials & Valuations (INR b)

Y/E Mar	2021	2022E	2023E
Sales	379	447	533
EBIT Margin (%)	14.2	14.9	14.4
PAT	44	55	64
EPS (INR)	51.7	62.5	71.8
EPS Gr. (%)	6.9	21.0	14.9
BV/Sh. (INR)	284.4	315.2	352.0

Ratios

RoE (%)	19.5	21.1	21.7
RoCE (%)	19.3	21.5	22.2
Payout (%)	87.1	50.0	50.0

Valuations

P/E (x)	28.4	23.5	20.4
P/BV (x)	5.2	4.7	4.2
EV/EBITDA (x)	18.7	15.9	13.6
Div Yield (%)	3.0	2.1	2.4

Shareholding pattern (%)

As On	Dec-21	Sep-21	Dec-20
Promoter	35.7	35.7	35.8
DII	17.4	17.1	13.7
FII	35.4	35.6	39.1
Others	11.6	11.7	11.5

FII Includes depository receipts

- Tech Mahindra (TechM)'s 3QFY22 USD revenue growth at 4.7% QoQ CC (organic growth at 4.0% QoQ CC) was 100bps above our estimates. It was driven by yet another quarter of strong performance from BPO (9.7% QoQ / 35.3% YoY), while IT Services was impacted by furloughs (up 2.0% QoQ, ex-acquisitions). Vertical growth was led by Comm. (+6.9% QoQ CC), while Enterprise (3.2% QoQ CC) was modest. New deal wins at USD704m (down 6% QoQ) have stayed in a narrow range in recent quarters. Although, the management continues to see sustained traction in the deal momentum.
- Excluding one-off gains, the 3Q EBIT margin dipped 120bps QoQ to 14.0% v/s our expectation of 15.1% on higher subcontracting expenses (+12% QoQ), employee-related interventions, and lower utilization (-300bps QoQ to 86%). TechM added a modest 3.9k in 3Q after an all-time high net addition of 15k employees in 2Q.
- We expect the company to deliver good topline performance going forward, driven by continued spending from telcos / equipment makers in preparation for the 5G deployment, along with demand-led strength in the Enterprise vertical. The company should also see meaningful contribution to its FY23E revenues from recent acquisitions (MOFSLE of c400bps). With healthy deal bookings, a robust pipeline, and strong net additions, we expect TechM to deliver an FY22–24E USD revenue CAGR of 16.0% YoY.
- Continued pressure from the supply side, along with sales investments, would result in a dip in the EBIT margin in FY23E (est. -50bps YoY). This would result in a miss on the company guidance of improving margin trajectory going forward. Moreover, while quarterly attrition at the company has now stabilized, the LTM figure of 24% (+300bp QoQ), over and above industry-high sub-con expenses and elevated utilization, would make it difficult to rapidly moderate costs despite elevated fresher onboarding – which is one of the main levers for moderating cost pressures. We further expect the company to see higher amortization on account of the recent spate of acquisitions (nine in FY22, valued at INR65.2b). This would result in TechM delivering a relatively unexciting PAT CAGR of 16% over FY22–24E.
- We continue to stay on the sidelines on TechM as we see stronger business performance as balanced by elevated operational risks in a supply-constrained environment. We reduce our EPS estimates by 3–4% for FY22E/FY23E post the 3Q miss. Our TP implies 19x FY24E EPS. We **remain Neutral** on the stock.

3Q topline beat driven by BPO, slight margin miss

- 3QFY22 revenue increased 17.2% YoY (v/s estimated increase of 15.9% YoY), EBITDA grew 8.7% YoY (v/s estimate of 11.3% YoY), and PAT was up 4.5% YoY (v/s estimated increase of 13.2%).
- 9MFY22 USD revenue / INR EBIT / INR PAT grew 16%/29%/21% YoY.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

- TechM's 3QFY22 revenue grew 4.1% QoQ to USD1,534m, above our estimate of USD1,516m (+3% QoQ). This implies CC revenue growth of 4.7% QoQ.
- Communications and Enterprise revenue grew 6.9% QoQ CC and 3.2% QoQ CC, respectively.
- Growth in Enterprise was driven by Retail (+13.5% QoQ) and Manufacturing (+2.8% QoQ), while BFSI (-1.6% QoQ) and Technology (-2.8% QoQ) were softer due to furloughs.
- The EBIT margin at 14.8% was down 40bps QoQ and came in 30bps below our estimates.
- Net employee additions were modest at ~3.9k employees. Utilization fell to 86% (v/s 89% in 2Q).
- However, at the same time, attrition inched up 300bps QoQ to 24%.
- PAT at INR13.7b (+2% QoQ) came in 8% below our estimates on lower margins and other income.
- Total net new TCV stood at USD704m, of which USD478m was in Enterprise and USD226m in Communications. Deal wins have been higher than the average run-rate of USD400–500m.
- FCF for the quarter stood at USD123m, implying FCF/PAT of 67%.
- DSO at 101 days was up from 92 days in 2Q.

Key highlights from management commentary

- TechM reported net new deal wins of USD704m (TCV) in 3QFY22, marking the fourth straight quarter of USD700m+ in deal wins. The company's momentum in deal wins has accelerated v/s the historical average of USD450–500m. The management sees sustained and broad-based acceleration in the deal pipeline. It expects the deal win momentum to continue.
- Within Communications, the strong growth of 6.9% QoQ CC was led by traction from 5G engagements and legacy-to-digital modernization. A ramp-up in large deals contributed to the strong growth in Communications. The 5G contribution in the deal pipeline, deal bookings, and revenues is improving; the management expects this trend to continue. The overall growth momentum in Communications is expected to continue.
- Traction is seen in broad-based growth across sectors. Strong deal wins and a robust pipeline would aid the continuing growth momentum.
- Margins for the quarter were down 40bps QoQ due to increased wages, lower utilization, higher sub-contractor expenses, and deployment costs for freshers. This decline was partially offset by one-time gains on SG&A (70–80bps) and operating leverage.
- Revenue growth, offshoring, sub-con costs (in FY23E), and higher pricing are key margin levers. Headwinds include higher attrition, wage inflation, travel costs, and investments in pyramid rationalization.

Valuation and view

- TechM's high exposure to the Communications vertical remains a potential opportunity as a broader 5G rollout could lead to a new spending cycle in this space. The company is seeing traction in 5G investments.
- We expect margins to remain stable in FY22 and decline 40bps in FY23.
- We expect TechM to deliver growth in the high teens in FY22. We value the stock at 19x FY24E EPS. **Maintain Neutral.**

Quarterly Performance

(INR b)

Y/E March	FY21				FY22E				FY21	FY22E	Est. 3QE	Var. (% / bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE				
Revenue (USD m)	1,208	1,265	1,309	1,330	1,384	1,473	1,534	1,621	5,111	6,011	1,517	1.1
QoQ (%)	-6.7	4.8	3.4	1.6	4.1	6.4	4.1	5.7	-1.4	17.6	3.0	114bp
Revenue (INR b)	91	94	96	97	102	109	115	122	379	447	115	-0.1
YoY (%)	5.2	3.3	-0.1	2.5	12.0	16.1	18.7	25.0	2.7	18.1	18.9	-16bp
GPM (%)	28.5	31.4	32.9	33.7	31.7	31.7	30.1	30.9	31.7	31.0	31.9	-184bp
SGA (%)	14.2	13.3	13.3	13.7	13.3	13.3	12.1	12.9	13.6	12.9	13.5	-143bp
EBITDA	13	17	19	19	19	20	21	22	68	81	21	-2.4
EBITDA Margin (%)	14.3	18.2	19.6	20.0	18.4	18.3	18.0	18.0	18.1	18.2	18.4	-41bp
EBIT	9	13	15	16	15	17	17	18	54	67	17	-1.9
EBIT Margin (%)	10.1	14.2	15.9	16.5	15.2	15.2	14.8	14.7	14.2	14.9	15.1	-27bp
Other income	4	1	2	0	2	2	2	2	6	9	3	-25.3
ETR (%)	25.5	24.6	24.8	26.4	23.9	29.4	26.9	26.5	25.3	26.7	26.0	94bp
Adj. PAT	10	11	13	12	14	13	14	15	46	55	15	-7.7
QoQ (%)	-4.8	9.5	23.0	-7.5	11.7	-1.1	2.2	7.7			10.8	-855bp
YoY (%)	1.3	-5.3	14.3	18.6	39.2	25.7	4.5	21.7	7.2	21.4	13.2	-874bp
Extra-Ordinary Item	0.0	0.0	0.0	-1.3	0.0	0.0	0.0	0.0	-1.3	0.0	0.0	0.0
Reported PAT	10	11	13	11	14	13	14	15	44	55	15	-7.7
EPS (INR)	11.1	12.1	14.9	12.3	15.3	15.1	15.5	16.7	51.7	62.5	16.8	-7.8

E: MOFSL Estimates

Key Performance Indicators

Y/E March	FY21				FY22E				FY21	FY22E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Revenue (QoQ CC %)	-6.3	2.9	2.8	0.7	3.9	7.2	4.7			
Margins (%)										
Gross Margin	28.5	31.4	32.9	33.7	31.7	31.7	30.1	30.9	31.7	31.0
EBITDA margin	14.3	18.2	19.6	20.0	18.4	18.3	18.0	18.0	18.1	18.2
EBIT Margin	10.1	14.2	15.9	16.5	15.2	15.2	14.8	14.7	14.2	14.9
Net Margin	10.7	11.4	13.6	12.4	13.3	12.3	12.0	12.1	12.0	12.4
Operating Metrics										
Headcount (k)	123	124	122	121	126	141	145		121	
Util excl. trainees (%)	82.0	85.0	87.0	87.0	89.0	89.0	86.0		85.3	
Attrition (%)	17.0	14.0	12.0	13.0	17.0	21.0	24.0		13.0	
Offshore rev. (%)	36.0	37.0	37.0	37.0	38.0	39.0	39.0		36.8	
Deal TCV (USD m)	290	421	455	1043	815	750	704		2,209	
Key Verticals (QoQ %)										
Communication	-8.6	3.0	4.5	1.3	0.0	0.0	0.0		-6.1	
Enterprise	-6.6	5.8	2.7	2.0	4.7	6.3	2.7		0.6	
Key Geographies (QoQ%)										
North America	-3.6	2.9	0.0	-1.2	6.8	8.9	6.5		-2.6	
Europe	-9.2	2.4	8.3	2.0	6.8	1.3	2.5		-4.9	

Key highlights from management commentary

Demand and industry outlook

- TechM posted robust revenue growth of 4.7% QoQ CC. The CME business grew 6.9% QoQ CC and Enterprise 3.2% QoQ CC.
- Among the verticals, CME registered strong growth, while Hi-Tech and BFSI were softer due to the impact of furloughs – however, demand remains strong for BFSI and is expected to rebound next quarter.
- TechM reported net new deal wins of USD704m (TCV) in 3QFY22, marking the fourth straight quarter of USD700m+ in deal wins. The company's momentum in deal wins has accelerated v/s the historical average of USD450–500m. The management sees sustained and broad-based acceleration in the deal pipeline. It expects the deal win momentum to continue.

- Within Communications, the strong growth of 6.9% QoQ CC was led by traction from 5G engagements and legacy-to-digital modernization. A ramp-up in large deals contributed to the strong growth in Communications. The 5G contribution in the deal pipeline, deal bookings, and revenues is improving; the management expects this trend to continue. The overall growth momentum in Communications is expected to continue.
- In addition to the 5G network deployment, the management has increased its focus on cloud integration, design, and software and services related to network maintenance.
- TechM announced a split in the BFSI vertical by introducing a dedicated sub-vertical for Insurance, with improved focus given the CTC acquisition.
- Traction is seen in broad-based growth across sectors. Strong deal wins and a robust pipeline would aid the continuing growth momentum. The management hinted at a strong rebound in the next quarter.

Margin performance

- Margins for the quarter were down 40bps QoQ due to increased wages, lower utilization, higher sub-contractor expenses, and deployment costs for freshers. This decline was partially offset by one-time gains on SG&A (70–80bps) and operating leverage.
- Revenue growth, offshoring, sub-con costs (in FY23E), and higher pricing are key margin levers. Headwinds include higher attrition, wage inflation, travel costs, and investments in pyramid rationalization.
- The management indicated SG&A expenses would be marginally below 13% going forward.

Other highlights

- The management stated its intention to hire freshers in significant numbers.
- The strategy to hire from Tier-2 towns is going well for the company; it is seeing lower costs (10-15%) and lower drop-out rates (15% lower).
- TechM has expanded to nine towns within India, with several near-shore locations overseas.
- The increase in DSO to 101 days in 3Q (from 92 in 2Q) was due to lower collections in December (collections happened in the first week of January). This metric is expected to improve over the next quarter.

Exhibit 1: BFSI and Technology verticals affected by furloughs

Verticals	Contribution to rev (%)	Growth (QoQ %)
Comm., Media & Ent.	40.9	6.2
Manufacturing	15.8	2.8
Technology	8.4	-2.8
BFSI	15.4	-1.6
Retail, Transport & Logistics	8.5	13.5
Others	11.0	6.1

Exhibit 2: Broad-based growth across geographies

Geographies	Contribution to revenue (%)	Growth (QoQ %)
Americas	48.9	6.5
Europe	25.5	2.5
Rest of World	25.6	1.4

Valuation and view

- TechM's high exposure to the Communications vertical remains a potential opportunity as a broader 5G rollout could lead to a new spending cycle in this space. The company is seeing traction in 5G investments.
- We expect margins to remain stable in FY22 and decline 40bps in FY23.
- We expect TechM to deliver growth in the high teens in FY22. We value the stock at 19x FY24E EPS. **Maintain Neutral.**

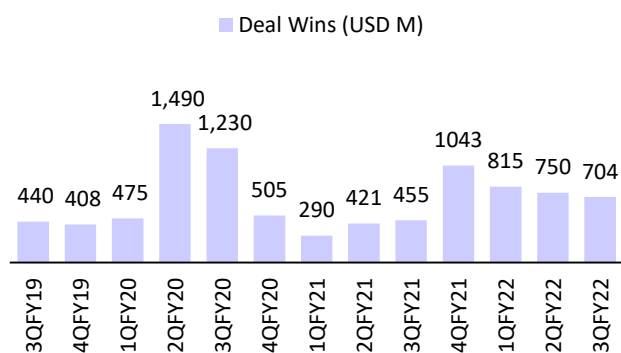
Exhibit 3: Revisions to our estimates

	Revised			Earlier			Change		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
INR/USD	74.3	75.0	75.0	74.5	75.0	75.0	-0.3%	0.0%	0.0%
USD Revenue – m	6,011	7,101	8,087	5,949	6,807	7,718	1.0%	4.3%	4.8%
Growth (%)	17.6	18.1	13.9	16.4	14.4	13.4	120bps	370bps	50bps
EBIT margin(%)	14.9	14.4	14.9	15.2	15.2	15.5	-30bps	-80bps	-60bps
PAT (INR B)	55	64	75	57	66	77	-3.4%	-4.2%	-2.6%
EPS	62.5	71.8	84.3	64.8	75.1	86.7	-3.5%	-4.3%	-2.7%

Source: MOFSL, Company

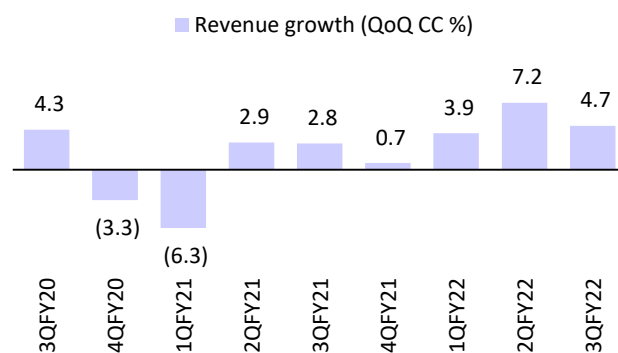
Story in charts

Exhibit 4: Deal wins continue to be robust in 3QFY22



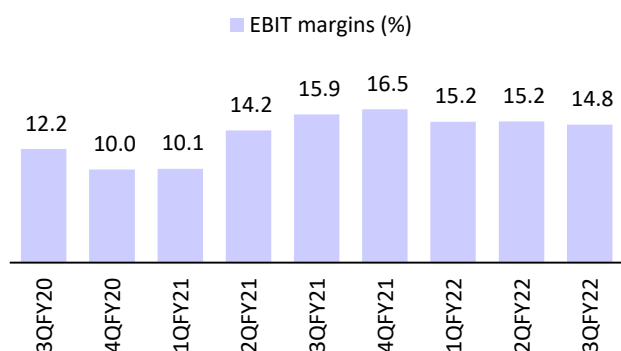
Source: Company, MOFSL

Exhibit 5: TechM reports robust sequential growth



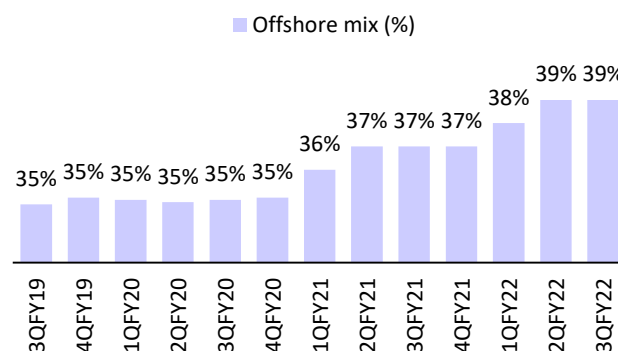
Source: Company, MOFSL

Exhibit 6: EBIT margin drops 40bps



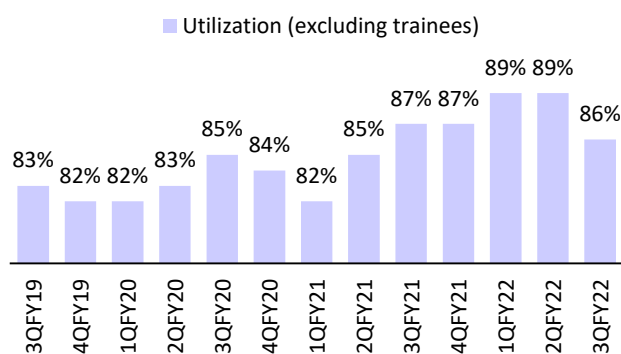
Source: Company, MOFSL

Exhibit 7: Offshoring mix remains strong



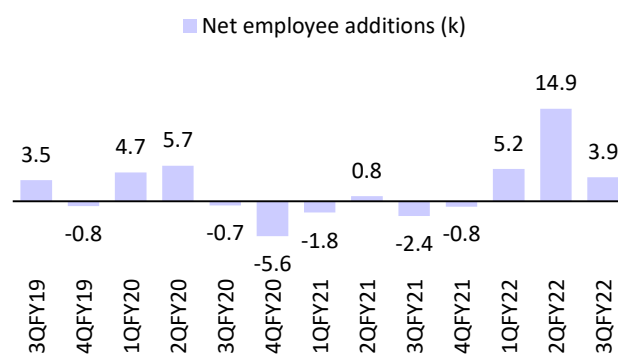
Source: Company, MOFSL

Exhibit 8: Utilization, excluding trainees, moderates in 3Q



Source: Company, MOFSL

Exhibit 9: Decent headcount additions in 3Q



Source: Company, MOFSL

Exhibit 10: Operating metrics

	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22
Revenue by Geography (%)									
Americas	48.4	47.7	49.3	48.4	46.8	45.5	46.7	47.8	48.9
Europe	27.0	26.5	25.8	25.2	26.4	26.5	27.2	25.9	25.5
Rest of World	24.6	25.8	24.9	26.4	26.8	28.0	26.1	26.3	25.6
Onsite-Offshore Mix (%)									
Onsite	65.3	65.2	64.0	63.0	63.0	63.0	62.0	61.0	61.0
Offshore	34.7	34.8	36.0	37.0	37.0	37.0	38.0	39.0	39.0
Client Metrics									
No. of active clients	964	973	981	988	997	1,007	1,058	1,123	1,191
% of repeat business	91.2	86.1	97.0	95.0	94.0	92.0	96.0	93.0	92.0
No. of Million \$ clients									
USD1m+	446	446	451	460	454	451	466	488	502
USD5m+	164	160	161	165	162	169	168	169	173
USD10m+	83	85	81	82	83	85	86	90	96
USD20m+	50	49	48	50	50	50	51	50	50
USD50m+	22	22	21	21	21	21	22	22	22
Client concentration (%)									
Top 5 Clients	22.3	21.4	22.0	22.0	22.0	22.0	22.0	22.0	23.0
Top 6-10	8.7	9.6	9.0	8.0	9.0	9.0	9.0	9.0	8.0
Top 11-20	11.1	12.6	12.0	13.0	11.0	12.0	12.0	12.0	11.0
Headcount									
Software professionals	73,079	71,515	71,020	69,512	68,734	68,427	69,877	76,800	81,115
BPO	51,096	46,816	45,554	48,462	46,832	46,125	49,668	57,058	56,297
Sales and support	6,664	6,905	6,842	6,284	6,335	6,502	6,718	7,335	7,655
Total	1,30,839	1,25,236	1,23,416	1,24,258	1,21,901	1,21,054	1,26,263	1,41,193	1,45,067
IT Attrition (LTM %)	20	19	17	14	12	13	17	21	24
IT Utilization (%)	84	83	82	85	87	87	88	87	84
IT Utilization (excl. trainees)	85	84	82	85	87	87	89	89	86
DSO - incl. unbilled	112	112	107	97	95	92	93	92	101
Borrowings (USD m)	288.9	326.7	280.0	230.0	262.0	232.0	218.0	206.0	210.0
Cash and Cash Equivalent (USD m)	1,154.0	1,164.3	1,378.0	1,564.0	1,625.0	1,781.0	1,818.0	1,626.0	1,346.0
Capital Expenditure (USD m)	31.8	26.9	26.0	34.0	16.0	20.0	22.0	23.0	26.0

Source: Company, MOFSL

Financials and valuations

Income Statement

(INR b)

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
Sales	291	308	347	369	379	447	533	607
Change (%)	10.0	5.6	12.9	6.1	2.7	18.1	19.2	13.9
COGS	206	215	234	260	259	308	368	417
SGA expenses	44	45	50	52	52	58	69	79
Total Expenses	250	261	284	311	310	366	438	495
EBITDA	42	47	63	57	68	81	95	111
% of Net Sales	14.4	15.3	18.2	15.5	18.1	18.2	17.8	18.3
Depreciation	10	11	11	14	15	14	18	21
Other Income	6	12	3	10	6	9	10	12
PBT	39	49	55	53	60	76	87	102
Tax	10	11	13	12	15	20	23	27
Rate (%)	25.4	22.4	22.6	22.0	25.3	26.7	26.5	26.5
PAT	29	38	43	41	45	56	64	75
Minority interest	0	0	0	-1	-1	0	0	0
Share from associates	0	0	0	0	0	0	0	0
PAT before EO	28	38	43	43	46	55	64	75
Change (%)	-7.4	33.9	13.1	-1.1	7.2	21.4	14.9	17.4
Extraordinary Items (EO)	0	0	0	-2	-1	0	0	0
Reported PAT	28	38	43	40	44	55	64	75
Change (%)	-7.4	33.9	13.1	-6.2	9.8	25.0	14.9	17.4

Balance Sheet

(INR b)

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
Share Capital	4	4	4	4	4	4	4	4
Reserves	160	184	198	214	244	272	305	343
Net Worth	164	188	203	218	249	277	309	347
Minority Interest	5	5	5	4	4	4	4	4
Loans	12	17	14	24	17	17	17	17
Other LT liabilities	12	12	9	28	28	32	38	42
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	205	235	243	287	309	342	380	422
Applications								
Assets	68	79	73	89	91	115	105	94
Investments	7	15	12	2	6	26	26	26
Other non-current assets	22	30	33	50	47	56	66	75
Curr. Assets	163	181	216	232	253	248	302	361
Debtors	53	65	70	76	65	77	92	106
Cash & Bank Balance	20	20	20	30	27	29	29	37
Investments	63	75	98	57	98	68	93	118
Other Current Assets	27	22	28	68	63	74	88	101
Current Liab. & Prov	56	70	91	87	88	102	120	134
Net Current Assets	108	111	124	145	165	146	183	227
Application of Funds	205	235	243	287	309	342	380	422

Financials and valuations

Ratios

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	024E
Basic (INR)								
EPS	32.4	43.0	48.5	48.7	52.1	63.0	72.4	85.0
Diluted EPS	31.9	42.7	47.7	48.3	51.7	62.5	71.8	84.3
Cash EPS	42.9	54.8	60.3	62.3	66.7	78.8	92.3	107.6
Book Value	187.9	213.4	228.7	249.9	284.4	315.2	352.0	395.1
DPS	9.0	14.0	14.0	15.0	45.0	31.3	35.9	42.2
Payout %	28.2	32.8	29.3	31.0	87.1	50.0	50.0	50.0
Valuation (x)								
P/E	45.6	34.4	30.5	30.4	28.4	23.5	20.4	17.4
Cash P/E	34.5	27.0	24.5	23.7	22.2	18.8	16.0	13.7
EV/EBITDA	30.7	27.6	20.6	22.4	18.7	15.9	13.6	11.5
EV/Sales	4.4	4.2	3.8	3.5	3.4	2.9	2.4	2.1
Price/Book Value	7.9	6.9	6.5	5.9	5.2	4.7	4.2	3.7
Dividend Yield (%)	0.6	0.9	0.9	1.0	3.0	2.1	2.4	2.9
Profitability Ratios (%)								
RoE	18.4	21.5	22.0	20.2	19.5	21.1	21.7	22.7
RoCE	17.7	17.2	22.8	17.3	19.3	21.5	22.2	23.4
Turnover Ratios								
Debtors (Days)	67	77	73	75	62	63	63	64
Fixed Asset Turnover (x)	4.3	3.9	4.7	4.1	4.1	3.9	5.1	6.4
Leverage Ratio								
Debt/Equity Ratio(x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0

Cash Flow Statement

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
(INR b)								
CF from Operations	35	43	55	49	65	70	82	96
Change in Working Capital	6	-8	-11	-5	16	-13	-17	-16
Net Operating CF	41	36	44	44	81	57	65	80
Net Purchase of FA	-8	-8	-8	-8	-6	-8	-9	-10
Free Cash Flow	33	28	37	35	75	49	57	70
Net Purchase of Invest.	-21	-26	-13	19	-49	-20	-25	-25
Net Cash from Invest.	-29	-34	-21	10	-55	-28	-34	-35
Inc./Dec in Equity	0	0	0	0	1	0	0	0
Proceeds from LTB/STB	-4	6	-6	-20	-13	0	0	0
Dividend Payments	-12	-9	-17	-25	-18	-27	-32	-37
Cash Flow from Fin.	-16	-3	-23	-45	-30	-27	-32	-37
Other adjustments	0	0	0	1	0	0	0	0
Net Cash Flow	-4	0	1	10	-3	2	0	8
Opening Cash Balance	24	20	20	20	30	27	29	29
Add: Net Cash	-4	0	1	10	-3	2	0	8
Closing Cash Balance	20	20	20	30	27	29	29	37

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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