

Margins continue to improve...

Tech Mahindra's (TechM) revenues increased 2.8% QoQ in constant currency terms (above our estimate of 1.6% QoQ in CC terms) mainly led by 4.5% QoQ growth in communication revenues and 2.7% QoQ growth in Enterprise revenues. The company also reported a healthy expansion in EBITDA margins (up 156 bps QoQ to 19.6%) mainly led by higher utilisation and gross margin expansion. The order book improved 8.1% QoQ to US\$455 million.

5G, digital, large deal wins to drive growth

The company reported healthy growth on the communication and enterprise side. Going forward, TechM expects communication to witness improved IT spends led by 5G, digital, customer experience, AI, cloud and network operations. The company is seeing healthy deal wins in 5G (north of US\$50 million) and is also seeing traction in small & medium size deals. In addition, from the enterprise side, TechM is seeing improving demand from artificial intelligence, machine learning, cybersecurity, customer experience and automation. The company is also seeing traction in 5G related deals on enterprise side across Middle East, Europe & Africa. TechM indicated a deal pipeline of US\$4.5 billion on enterprise side. This, coupled with pruning of low return geographies, acceleration in Europe and improving demand from large lift & shift deals, bodes well for longer term trend in revenues. Hence, although we expect revenues to be under pressure in FY21E, we expect an improved performance in FY22E & FY23E.

Margins to witness gradual improvement

EBIT margins in the quarter improved 173 bps to 15.9%. Going forward, the company expects margins to achieve higher end of 14-15% margin band in FY22E. TechM believes that despite headwinds (like higher variable pay, staggered wage hike lower utilisation & travel cost) it has multiple levers in terms of sustaining and improving margins. Some levers are synergies in portfolio companies (like systems, back-end and process), automation, reduction of sub-contracting cost (from current 13%) higher offshoring, pruning of low return geographies and benefits of large deal won in the previous quarter. Hence, we expect EBIT margins to improve 217 bps YoY to 13.8% in FY21E and another 150 bps in FY21E-23E to 15.3%.

Valuation & Outlook

Increase in large lift & shift deals, digital technologies, improving 5G spend (on communication & enterprise side), large deals and acceleration in Europe bode well for the company's revenue growth. This, coupled with improving margin trajectory and attractive valuation prompt us to be positive on the stock. Hence, we maintain **BUY** with a revised target price of ₹ 1,120 (16 x PE on FY23E EPS) (earlier target price was ₹ 1,105).

Tech Mahindra

Particulars

Particular	Amount
Market Cap (₹ Crore)	92,924.2
Total Debt (₹ Crore)	2,428.2
Cash and Invest (₹ Crore)	8,760.6
EV (₹ Crore)	86,591.8
52 week H/L	1081 / 470
Equity capital	435.9
Face value	₹ 5

Key Risk

- Lower than expected growth in communication vertical will adversely impact financials
- We expect the company to register healthy improvement in margins led cost rationalisation, synergies in portfolio companies, automation and reduction of sub-contracting cost. However, if the company realises lower than expected cost savings it could adversely impact our margin expectation

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Key Financial Summary

Key Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net sales	34,742	36,868	38,155	41,657	46,265	7.9%
EBITDA	6,337	5,726	6,753	7,706	8,883	15.8%
EBITDA Margin (%)	18.2	15.5	17.7	18.5	19.2	
Net Profit	4,298	4,033	4,575	5,208	6,111	14.9%
EPS (₹)	47.7	45.9	52.0	59.2	69.5	
P/E	20.2	21.0	18.5	16.2	13.8	
RoNW (%)	21.2	18.5	19.0	18.9	19.4	
RoCE (%)	23.6	19.1	20.0	20.6	21.6	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q3FY21	Q3FY21E	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Comments
Revenue	9,647.1	9,525.4	9,654.6	-0.1	9,371.8	2.9	Dollar revenues increased 3.4% QoQ mainly led by healthy demand in communication and enterprise verticals
Employee expenses	6,470.8	6,524.9	6,731.2	-3.9	6,424.5	0.7	
Gross Margin	3,176.3	3,000.5	2,923.4	8.7	2,947.3	7.8	
Gross margin (%)	32.9	31.5	30.3	265 bps	31.4	148 bps	
SG&A expenses	1,280.8	1,266.9	1,360.1	-5.8	1,244.3	2.9	
EBITDA	1,895.5	1,733.6	1,563.3	21.2	1,703.0	11.3	
EBITDA Margin (%)	19.6	18.2	16.2	347 bps	18.2	156 bps	The improvement in margins was due to 156 bps led by higher utilisation (80 bps) and operating leverage
Depreciation & amortisation	358.4	371.7	384.8	-6.9	371.7	-3.6	
EBIT	1,537.1	1,361.9	1,178.5	30.4	1,331.3	15.5	
EBIT Margin (%)	15.9	14.3	12.2	373 bps	14.2	173 bps	
Other income (less interest)	178.8	117.5	294.6	-39.3	77.6	130.4	
PBT	1,715.9	1,479.4	1,473.1	16.5	1,408.9	21.8	
Tax paid	426.3	363.9	362.9	17.5	346.2	23.1	
PAT	1,309.8	1,117.4	1,145.9	14.3	1,064.6	23.0	
Adjusted PAT	1,309.8	1,117.4	1,145.9	14.3	1,064.6	23.0	PAT was above our estimate mainly due to higher than expected operating margins and higher other income

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	37,536	38,155	1.7	40,490	41,657	2.9	44,787.0	46,265	3.3	Traction in 5G and improving deal pipeline prompt us to revise revenue estimates upwards
EBITDA	6,419	6,753	5.2	7,450	7,706	3.4	8,599.1	8,883	3.3	
EBITDA Margin (%)	17.1	17.7	60 bps	18.4	18.5	10 bps	19.2	19.2	0 bps	We expect margins to stabilise at 19.2% in FY23E
PAT	4,402	4,575	3.9	5,169	5,208	0.7	6,097.3	6,111	0.2	
EPS (₹)	50.0	52.0	3.9	58.8	59.2	0.7	69.3	69.5	0.2	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook:** On the communication side, the company expects IT spends to improve led by 5G, digital, customer experience, AI, cloud and network operations. In addition, TechM is seeing healthy funnel in holistic transformation of telecom service providers while the company is in advanced stages with many customers in transformational projects. The company is seeing healthy deal wins in 5G in north of US\$50 million and is also seeing traction in small & medium size deals. In addition, from the enterprise side, TechM is seeing improving demand from artificial intelligence, machine learning, cybersecurity, customer experience and automation. The company is also seeing traction in 5G related deals on enterprise side across Middle East, Europe & Africa. TechM indicated a deal pipeline of US\$4.5 billion on the enterprise side. The company believes demand is from both ends from lift shift kind of deals and digital traction. In addition, this quarter growth was led by BPO and expects growth to continue. Further, in terms of geography, TechM expects Europe to register improving trajectory. The company is investing in Media & Entertainment business to improve its growth trajectory
- **Margin snapshot:** EBIT margins in the quarter improved 173 bps to 15.9%. Going forward, the company expects margins to achieve higher end of 14-15% margin band in FY22E. TechM believes that despite headwinds (like higher variable pay, staggered wage hike lower utilisation & travel cost) it has multiple levers in terms of sustaining and improving margins, going forward. Some levers are synergies in portfolio companies (like systems, back-end and process), automation, reduction of sub-contracting cost (from current 13%) higher offshoring, pruning of low return geographies and benefits of large deal won in the previous quarter
- **Deal wins:** The communication order book declined from US\$208 million to US\$104 million. Enterprise order increased ~64% to US\$352 million. The company is seeing improving funnel in communication across a broad range of holistic transformation of telecom service providers led by better traction in network, 5G stack, digital transformation while it is in advanced stages with many customers in communication segment
- **Employee update:** TechM saw reduction of 2357 employees in Q3FY21 leading to total employees of 1,21,901. The decline was in BPO and software professionals
- **DSO position:** DSO days declined from 97 in Q2FY21 to 95 days in Q3FY21
- **Acquisitions :** The company, pursuant to a share purchase agreement acquired 51% stake in Cerium Systems Pvt Ltd (Cerium) on April 9, 2020 for a total consideration of ₹ 145.4 crore, out of which ₹ 91.6 crore was paid upfront. Further, the company has entered into an agreement to purchase the balance 49% stake over a period of three years, ending March 31, 2023. During the period ended December 31, 2020, the company acquired 6% stake at ₹ 16.4 crore. Further, the company has made earn-out payment for the first tranche amounting to ₹ 41.2 crore

Key Metrics

Exhibit 3: Geography wise break-up

	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Revenue by geography (%)					
Americas	48.4	47.7	49.3	48.4	46.8
Europe	27.0	26.5	25.8	25.2	26.2
Rest of World	24.6	25.8	24.9	26.4	26.8
Growth QoQ (%)					
Americas	4.9	-5.7	-3.6	2.9	0.0
Europe	6.3	-6.1	-9.2	2.4	7.5
Rest of World	3.8	0.4	-10.0	11.1	5.0

Source: Company, ICICI Direct Research

Growth in revenues led by Europe and ROW

Exhibit 4: Industry wise break-up

	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Revenue by verticals (%)					
Telecom	42.6	40.8	40.0	39.3	39.7
Manufacturing	17.3	17.7	16.8	16.1	16.3
Technology, media & entertainment	7.6	7.4	9.0	9.8	9.4
Banking, financial services & insurance	13.2	15.3	15.7	16.4	16.0
Retail, transport & logistics	7.2	7.3	7.3	7.5	7.9
Others	12.2	11.5	11.2	10.9	10.8
Growth QoQ (%)					
Telecom	8.9	-8.4	-8.6	3.0	4.5
Manufacturing	1.0	-2.1	-11.5	0.4	4.7
Technology, media & entertainment	-1.4	-6.8	13.4	14.1	-0.8
Banking, financial services & insurance	6.7	10.9	-4.3	9.5	0.9
Retail, transport & logistics	8.1	-3.0	-6.7	7.7	8.9
Others	0.2	-9.8	-9.2	2.0	2.5

Source: Company, ICICI Direct Research

Telecom, Manufacturing and retail segment registered healthy QoQ growth

Exhibit 5: Client & human resource matrix

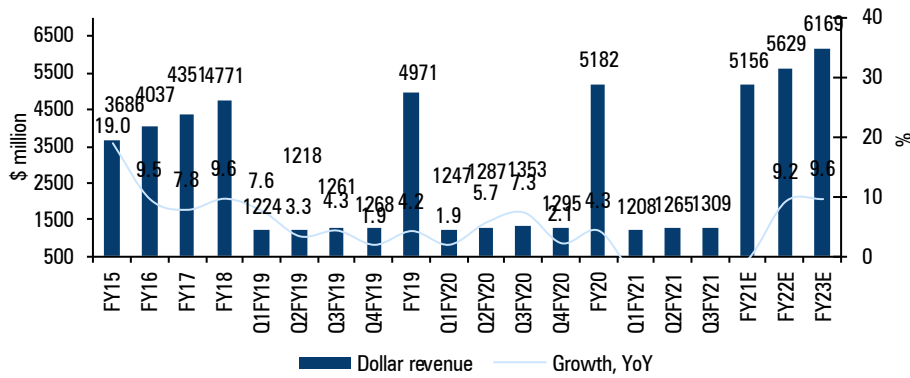
	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Client Metrics					
≥ \$1 million clients	446	446	451	460	454
≥ \$5 million clients	164	160	161	165	162
≥ \$10 million clients	83	85	81	82	83
≥ \$20 million clients	50	49	48	50	50
≥ \$50 million clients	22	22	21	21	21
Headcount, Attrition, Utilization					
Total Employees	130839	125236	123416	124258	121901
IT Attrition (LTM)	20.0	19.0	17.0	14.0	12.0
IT Utilization % (Excluding Trainees)	85.0	84.0	82.0	85.0	87.0

Source: Company, ICICI Direct Research

Utilisation increased 200 bps QoQ while attrition dipped 200 bps QoQ in the quarter

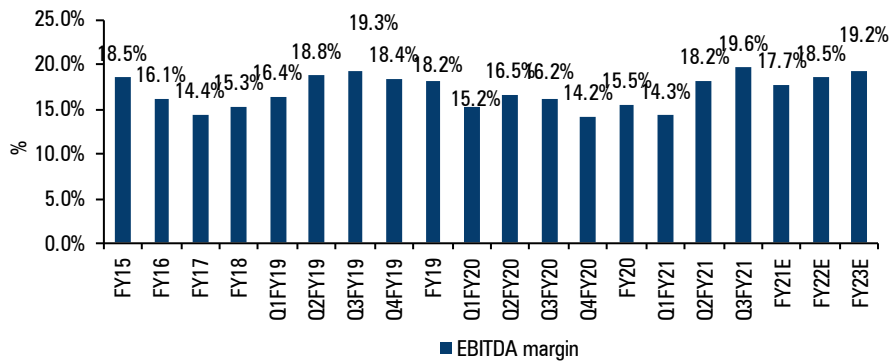
Financial story in charts

Exhibit 6: Dollar revenues trend



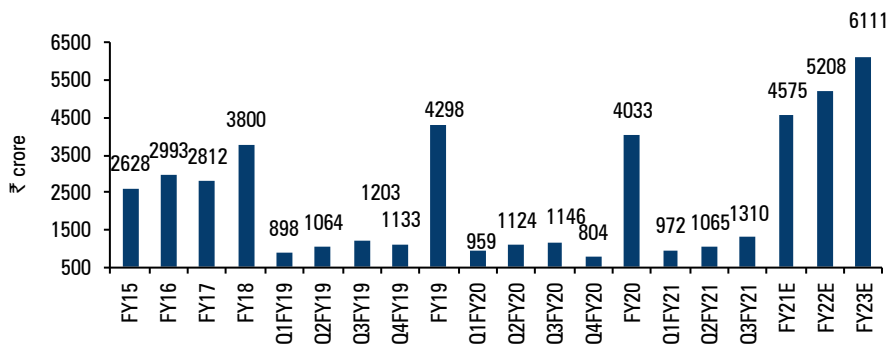
Source: Company, ICICI Direct Research

Exhibit 7: Revise our margin estimates for FY21E, FY22E and FY23E



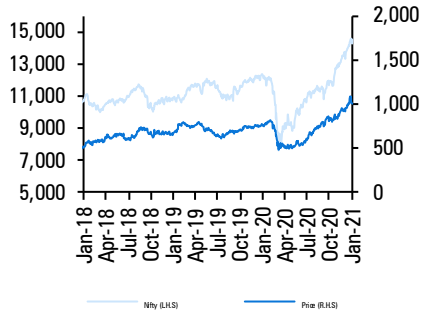
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

Exhibit 9: Three year chart



Source: Company, ICICI Direct Research

Financial summary

Exhibit 10: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Net sales	36,868	38,155	41,657	46,265
Growth (%)	6	3	9	11
COGS (employee expenses)	25,974	26,251	28,327	31,229
Gross profit	10,893	11,904	13,330	15,036
S,G&A expenses	5,167	5,151	5,624	6,153
Total Operating Expenditure	31,142	31,402	33,950	37,382
EBITDA	5,726	6,753	7,706	8,883
Growth (%)	(10)	18	14	15
Depreciation	1,446	1,496	1,634	1,814
Interest	192	175	175	175
Other Income	1,192	927	964	1,172
PBT	5,281	6,010	6,862	8,066
Total Tax	1,160	1,496	1,715	2,016
Exceptional item	-	-	-	-
PAT	4,033	4,575	5,208	6,111
Growth (%)	(6)	13	14	17
EPS (₹)	45.9	52.0	59.2	69.5

Source: Company, ICICI Direct Research

Exhibit 12: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity Capital	436	436	436	436
Share application money	-	-	-	-
Reserve and Surplus	21,377	23,665	27,050	31,022
Total Shareholders funds	21,813	24,100	27,486	31,458
Minority Interest	393	333	273	213
Total Debt	2,428	2,428	2,428	2,428
Other long term liabilities	4,043	4,043	4,043	4,043
Total Liabilities	28,677	30,905	34,230	38,142
Assets				
Net Block	3,834	3,641	3,399	3,092
Capital WIP	50	50	50	50
Investments	5,848	6,850	7,851	8,853
Deferred tax assets	844	844	844	844
Goodwill on consolidation	3,388	3,388	3,388	3,388
Debtors	7,581	8,013	8,331	9,253
Loans and Advances (short)	-	-	-	-
Other non-current assets	4,175	4,175	4,176	4,176
Cash	3,148	4,400	6,844	9,399
Other current assets	6,799	7,021	7,665	8,513
Total Current Assets	23,176	26,082	30,488	35,812
Trade payables	3,257	3,370	3,680	4,087
Current liabilities	4,983	5,342	5,832	6,477
Provisions	436	452	493	548
Total Current Liabilities	8,676	9,164	10,005	11,111
Application of Funds	28,677	30,905	34,230	38,142

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit before Tax	5,058	6,010	6,862	8,066
Add: Depreciation	1,446	1,496	1,634	1,814
(Inc)/dec in Current Assets	(2,335)	(654)	(964)	(1,770)
Inc/(dec) in CL and Provisions	1,813	487	841	1,107
Taxes paid	(1,513)	(1,496)	(1,715)	(2,016)
CF from operating activities	4,358	5,291	6,068	6,403
(Inc)/dec in Investments	1,298	(1,000)	(1,000)	(1,000)
(Inc)/dec in Fixed Assets	(829)	(954)	(1,041)	(1,157)
Others	253	727	764	972
CF from investing activities	1,029	(1,226)	(1,277)	(1,184)
Issue/(Buy back) of Equity	47	-	-	-
Inc/(dec) in loan funds	193	-	-	-
Dividend paid & dividend tax	(2,492)	(2,287)	(1,823)	(2,139)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(426)	(175)	(175)	(175)
CF from financing activities	(4,466)	(2,812)	(2,348)	(2,664)
Net Cash flow	921	1,252	2,443	2,555
Cash by acquisition	-	-	-	-
Opening Cash	2,043	3,148	4,400	6,844
Cash carried to B/S	3,148	4,400	6,844	9,399

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	45.9	52.0	59.2	69.5
Cash EPS	62.3	69.0	77.8	90.1
BV	248.0	274.0	312.5	357.7
DPS	15.0	26.0	20.7	24.3
Cash Per Share	35.8	50.0	77.8	106.9
Operating Ratios (%)				
EBITDA Margin	15.5	17.7	18.5	19.2
PAT Margin	10.9	12.0	12.5	13.2
Return Ratios (%)				
RoE	18.5	19.0	18.9	19.4
RoCE	19.1	20.0	20.6	21.6
RoIC	21.5	26.5	30.8	35.2
Valuation Ratios (x)				
P/E	21.0	18.5	16.2	13.8
EV / EBITDA	15.1	12.5	10.5	8.7
EV / Net Sales	2.3	2.2	1.9	1.7
Market Cap / Sales	2.5	2.4	2.2	2.0
Price to Book Value	3.9	3.5	3.1	2.7
Solvency Ratios				
Debt/EBITDA	0.4	0.4	0.3	0.3
Debt/Equity	0.1	0.1	0.1	0.1
Current Ratio	1.7	1.6	1.6	1.6
Quick Ratio	1.7	1.6	1.6	1.6

Source: Company, ICICI Direct Research

Exhibit 14: ICICI Direct coverage universe (IT)

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	EPS (₹)				P/E (x)				RoCE (%)				RoE (%)			
					FY20	FY21E	FY22E	FY23E	FY20E	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
HCL Tech (HCLTEC)	915	1,150	Buy	2,48,215	40.8	49.4	54.3	63	22	19	17	15	23.0	24.0	24.3	24.7	21.6	21.9	20.8	20.6
Infosys (INFTEC)	1,239	1,610	Buy	5,27,763	38.9	47.6	54.5	63	32	26	23	20	30.8	34.9	36.1	38.2	25.2	28.0	29.2	30.9
TCS (TCS)	3,112	3,600	Buy	11,67,723	86.2	89.0	107.7	124	36	35	29	25	43.5	44.0	46.9	49.2	37.5	35.7	39.3	40.9
Tech M (TECMAH)	962	1,120	Buy	92,924	45.9	52.0	59.2	69	21	18	16	14	19.1	20.0	20.6	21.6	18.5	19.0	18.9	19.4
Wipro (WIPRO)	418	490	Hold	2,44,863	16.6	19.8	21.8	24	25	21	19	17	19.3	22.4	24.6	27.2	17.4	19.9	22.0	24.5
Mindtree (MINCON)	1,640	1,970	Buy	27,030	38.3	66.9	75.3	88	43	25	22	19	23.0	33.4	32.5	32.7	20.0	28.4	27.2	26.9
LTI (LTINFC)	3,996	4,580	Hold	69,818	86.6	108.3	126.8	151	46	37	32	27	30.7	32.5	32.0	31.8	28.1	28.8	28.3	28.1
Coforge (NIITEC)	2,398	2,875	Buy	14,435	71.4	73.5	94.0	111	34	33	26	22	23.0	24.4	26.7	27.5	18.5	19.7	22.1	22.7
Infoedge (INFEDG)	4,367	4,090	Buy	56,153	26.8	23.8	33.1	39	163	184	132	111	18.0	9.1	11.9	13.3	13.5	6.8	9.0	10.0
Teamlease (TEASER)	2,856	3,290	Buy	4,883	20.5	50.2	72.8	93	140	57	39	31	15.0	12.9	16.4	17.5	6.5	13.8	16.3	17.4

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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