

## Margins steady, healthy order book...

Tech Mahindra's (TechM) revenues increased 0.7% QoQ in constant currency terms mainly led by 1.1% QoQ growth in Enterprise revenues. The company also reported EBITDA margins improvement of 45 bps QoQ to 20%. The order book increased from US\$455 million to US\$1043 million, mainly led by robust growth in Enterprise and Communication segment. The company aspires to have double digit revenue growth in FY22E based on deal wins and EBIT margins at 15%.

## Healthy deal wins, traction in cloud to drive revenues

The current quarter revenues were impacted due to a delay in deal closure. However, the company expect deals to ramp up in coming quarter. In addition, TechM has seen healthy deal wins in the current quarter and expects improving deal win in the coming quarter. Hence, the company aspires to achieve double digit revenue growth in FY22E. In addition, we expect communication segment to witness improving growth led by demand from legacy modernisation (Telefonica deal was similar), 5G, customer care, automation, network and cloud. In terms of enterprise, growth is expected to be driven across verticals (BFSI, technology, retail, manufacturing). We believe majority of double digit growth will be led by enterprise segment. 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, we expect dollar revenues to increase at a CAGR of 10.4% over FY21-23E.

## Margins to witness gradual improvement

Despite headwinds like wage hikes (effective April 2021), higher travel cost in H2FY21, retention pay to niche talent, increased hiring (of higher fresher) the company aspires to achieve 15% margins in FY22E. We believe, tailwinds of higher offshoring, synergies in portfolio companies (like systems, back-end and process), automation, reduction of sub-contracting cost (from current 13%), pruning of low return geographies and revenue growth will enable Tech Mahindra to achieve its desired goal. Hence, we expect EBIT margins to improve 50 bps YoY to 14.6% in FY22E and another 70 bps to 15.3% in FY22E.

## Valuation & Outlook

Improving deal pipeline, focus on large deal wins, traction in 5G spend (on communication & enterprise side), revival of growth in manufacturing, acceleration in Europe and cloud is expected to drive revenues. This, coupled with improving margin trajectory and attractive valuation prompt us to be positive on the stock. Hence, we maintain **BUY** with a target price of ₹ 1,120 (16 x PE on FY23E EPS) (earlier target price ₹ 1,120).

# Tech Mahindra

### Particulars

Particular	Amount
Market Cap (₹ Crore)	93,054.7
Total Debt (₹ Crore)	1,661.8
Cash and Invest (₹ Crore)	12,497.1
EV (₹ Crore)	82,219.4
52 week H/L	1081 / 490
Equity capital	437.0
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 TechM realises lower than expected cost savings, it could adversely impact our margin expectation

### Research Analyst

Devang Bhatt  
devang.bhatt@icicisecurities.com

### Key Financial Summary

Key Financials	FY19	FY20	FY21	FY22E	FY23E	CAGR (FY21-23E)
Net sales	34,742	36,868	37,855	42,449	47,370	11.9%
EBITDA	6,337	5,726	6,847	7,895	9,142	15.6%
EBITDA Margin (%)	18.2	15.5	18.1	18.6	19.3	
Net Profit	4,298	3,816	4,428	5,301	6,196	18.3%
EPS (₹)	47.7	59.5	50.2	60.1	70.2	
P/E	20.2	16.2	19.2	16.0	13.7	
RoNW (%)	21.2	17.5	17.8	19.1	19.9	
RoCE (%)	23.6	18.3	19.8	21.2	22.5	

Source: Company, ICICI Direct Research

**Exhibit 1: Variance Analysis**

	Q4FY21	Q4FY21E	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	Comments
Revenue	9,729.9	9,825.3	9,490.2	2.5	9,647.1	0.9	Dollar revenues increased 1.6% QoQ mainly driven by enterprise segment
Employee expenses	6,449.7	6,582.9	6,689.6	-3.6	6,470.8	-0.3	
Gross Margin	3,280.2	3,242.3	2,800.6	17.1	3,176.3	3.3	
Gross margin (%)	33.7	33.0	29.5	420 bps	32.9	79 bps	
SG&A expenses	1,332.1	1,277.3	1,452.8	-8.3	1,280.8	4.0	
EBITDA	1,948.1	1,965.1	1,347.8	44.5	1,895.5	2.8	
EBITDA Margin (%)	20.0	20.0	14.2	583 bps	19.6	45 bps	The improvement in margins was due to operating leverage
Depreciation & amortisation	395.1	358.4	615.7	-35.8	358.4	10.2	
EBIT	1,553.0	1,606.7	732.1	112.1	1,537.1	1.0	
EBIT Margin (%)	16.0	16.4	7.7	825 bps	15.9	3 bps	
Other income (less interest)	-9.1	157.9	232.0	-103.9	178.8	-105.1	The decline in other income QoQ was due to forex loss vs. forex gain in previous quarter
PBT	1,543.9	1,764.6	964.1	60.1	1,715.9	-10.0	
Tax paid	499.8	438.4	239.2	108.9	426.3	17.2	
PAT	1,081.4	1,346.4	586.4	84.4	1,309.8	-17.4	
Adjusted PAT	1,081.4	1,346.4	803.9	34.5	1,309.8	-17.4	Lower other income led to decline in PAT on QoQ basis

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	41,657	42,449	1.9	46,265.0	47,370	2.4	Traction in 5G and improving deal pipeline prompt us to revise revenue estimates upwards
EBITDA	7,706	7,895	2.5	8,883.0	9,142	2.9	
EBITDA Margin (%)	18.5	18.6	10 bps	19.2	19.3	10 bps	Higher offshoring, synergies in portfolio companies, reduction of sub-contracting cost and revenue growth to drive margins
PAT	5,208	5,301	1.8	6,111.0	6,196	1.4	
EPS (₹)	59.0	60.1	1.8	69.3	70.2	1.4	

Source: Company, ICICI Direct Research

## Conference Call Highlights

- **Revenue outlook:** The current quarter revenues were impacted due to delay in deal closure. However, the company expect deals to ramp up in coming quarter. In addition, TechM has seen healthy deal wins in the current quarter and expects improving deal win in the coming quarter. Hence, the company expects double digit revenue growth in FY22E. TechM is witnessing healthy traction in cloud, cybersecurity and customer experience. In terms of enterprise, growth is expected to be driven across verticals (BFSI, technology, retail and manufacturing). We believe majority of double digit growth will be led by enterprise segment. In enterprise, traction in cloud, revival in manufacturing and absence of seasonality in retail is expected to drive revenue growth. In communication, the company is seeing improving demand from legacy modernisation (Telefonica deal was similar), 5G, customer care, automation, network and cloud. The company has healthy deal funnel while closure of deals will drive growth
- **Margin snapshot:** Despite headwinds like wage hikes (effective April 2021), higher travel cost in H2FY21, retention pay to niche talent, increased hiring (of higher fresher) the company aspires to achieve 15% margins in FY22E. We believe tailwinds of higher offshoring, synergies in portfolio companies (like systems, back-end and process), automation, reduction of sub-contracting cost (from current 13%), pruning of low return geographies and revenue growth will enable Tech Mahindra to achieve its desired goal. Hence, we expect the company register a margin improvement of 120 bps over FY21-23E. Tax rate is expected to be in range of 25-26% in future
- **Deal wins:** The communication order book increased ~4x to US\$518 million. We believe this was mainly led by large deal won by the company (Telephonica deal). Enterprise order increased ~49% to US\$525 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 847 employees in Q4FY21 leading to total employees of 1,21,054. The decline was in BPO and software professionals
- **DSO position & dividend:** DSO days declined from 95 in Q3FY21 to 92 days in Q3FY21. The company expects DSO days to slightly inch up in coming quarters. The company has declared dividend of ₹ 30 per share (including special dividend of ₹ 15/ share). The dividend will be paid by August 11, 2021, if approved
- **Acquisitions :** Tech Mahindra announced the acquisition of Eventus Solutions Group, a consulting and technology service company, headquartered in the US, to bolster consulting capabilities in Customer Experience (CX) and customer management space. The acquisition will enable Tech Mahindra to build an industry leading consulting practice and move up the value chain in the BPS business. The company will pay US\$44 million (~₹ 330 crore) including earnouts valuing the company at EV/sales at 1.3x CY20 sales

## Key Metrics

### Exhibit 3: Geography wise break-up

	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
<b>Revenue by geography (%)</b>					
Americas	47.7	49.3	48.4	46.8	45.5
Europe	26.5	25.8	25.2	26.2	26.5
Rest of World	25.8	24.9	26.4	26.8	28.0
<b>Growth QoQ (%)</b>					
Americas	-5.7	-3.6	2.9	0.0	-1.2
Europe	-6.1	-9.2	2.4	7.5	2.8
Rest of World	0.4	-10.0	11.1	5.0	6.1

Source: Company, ICICI Direct Research

Growth in revenues led by Europe and ROW

### Exhibit 4: Industry wise break-up

	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
<b>Revenue by verticals (%)</b>					
Telecom	40.8	40.0	39.3	39.7	39.6
Manufacturing	17.7	16.8	16.1	16.3	16.3
Technology, media & entertainment	7.4	9.0	9.8	9.4	9.3
Banking, financial services & insurance	15.3	15.7	16.4	16.0	16.5
Retail, transport & logistics	7.3	7.3	7.5	7.9	7.5
Others	11.5	11.2	10.9	10.8	10.8
<b>Growth QoQ (%)</b>					
Telecom	-8.4	-8.6	3.0	4.5	1.3
Manufacturing	-2.1	-11.5	0.4	4.7	1.6
Technology, media & entertainment	-6.8	13.4	14.1	-0.8	0.5
Banking, financial services & insurance	10.9	-4.3	9.5	0.9	4.8
Retail, transport & logistics	-3.0	-6.7	7.7	8.9	-3.5
Others	-9.8	-9.2	2.0	2.5	1.6

Source: Company, ICICI Direct Research

Manufacturing and BFSI segment registered healthy QoQ growth

### Exhibit 5: Client & human resource matrix

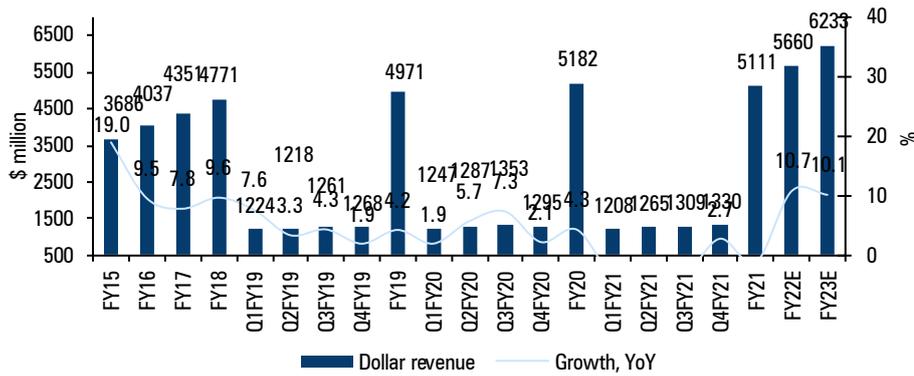
	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
<b>Client Metrics</b>					
≥ \$1 million clients	446	451	460	454	451
≥ \$5 million clients	160	161	165	162	169
≥ \$10 million clients	85	81	82	83	85
≥ \$20 million clients	49	48	50	50	50
≥ \$50 million clients	22	21	21	21	21
<b>Headcount, Attrition, Utilization</b>					
Total Employees	125236	123416	124258	121901	121054
IT Attrition (LTM)	19.0	17.0	14.0	12.0	13.0
IT Utilization % (Excluding Trainees)	84.0	82.0	85.0	87.0	87.0

Source: Company, ICICI Direct Research

Utilisation was flat and attrition increased by 1% QoQ

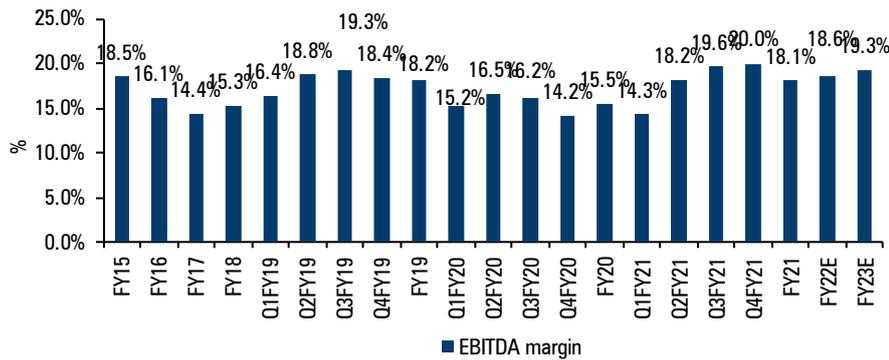
## Financial story in charts

Exhibit 6: Dollar revenues trend



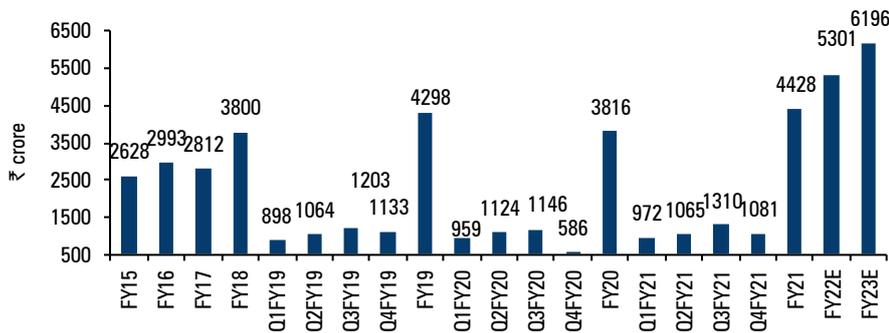
Source: Company, ICICI Direct Research

Exhibit 7: Revise our margin estimates for FY22E and FY23E



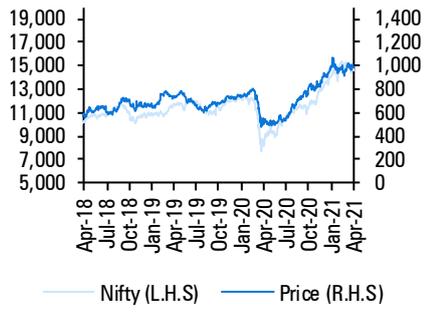
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

**Exhibit 9: Price Performance**



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 10: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Net sales</b>	<b>36,868</b>	<b>37,855</b>	<b>42,449</b>	<b>47,370</b>
Growth (%)	6	3	12	12
COGS (employee expenses)	25,974	25,856	28,865	31,975
Gross profit	10,893	12,000	13,584	15,395
S,G&A expenses	5,167	5,153	5,688	6,253
Total Operating Expenditure	31,142	31,008	34,553	38,227
<b>EBITDA</b>	<b>5,726</b>	<b>6,847</b>	<b>7,895</b>	<b>9,142</b>
Growth (%)	(10)	20	15	16
Depreciation	1,663	1,508	1,691	1,888
Interest	192	174	141	141
Other Income	1,192	787	950	1,101
PBT	5,063	5,952	7,013	8,214
Total Tax	1,160	1,600	1,788	2,095
Exceptional item	-	-	-	-
<b>PAT</b>	<b>3,816</b>	<b>4,428</b>	<b>5,301</b>	<b>6,196</b>
Growth (%)	(11)	16	20	17
EPS (₹)	59.5	50.2	60.1	70.2

Source: Company, ICICI Direct Research

Exhibit 12: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Liabilities</b>				
Equity Capital	436	437	437	437
Share application money	-	-	-	-
Reserve and Surplus	21,377	24,428	27,343	30,751
Total Shareholders funds	21,813	24,865	27,780	31,188
Minority Interest	393	380	305	230
Total Debt	2,428	1,662	1,662	1,662
Other long term liabilities	4,043	3,990	3,990	3,990
<b>Total Liabilities</b>	<b>28,677</b>	<b>30,897</b>	<b>33,737</b>	<b>37,070</b>
<b>Assets</b>				
Net Block	3,834	3,470	3,402	3,049
Capital WIP	50	118	118	118
Investments	5,848	10,238	11,239	12,240
Deferred tax assets	844	913	913	913
Goodwill on consolidation	3,388	4,008	4,008	4,008
Debtors	7,581	6,475	7,429	8,290
Loans and Advances (short)	-	-	-	-
Other non-current assets	4,175	3,794	3,795	3,795
Cash	3,148	2,835	4,094	6,245
Other current assets	6,799	6,261	7,021	7,835
Total Current Assets	23,176	25,258	29,230	34,056
Trade payables	3,257	2,785	3,123	3,485
Current liabilities	4,983	5,465	6,129	6,839
Provisions	436	531	596	665
Total Current Liabilities	8,676	8,782	9,847	10,989
<b>Application of Funds</b>	<b>28,677</b>	<b>30,897</b>	<b>33,737</b>	<b>37,070</b>

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Profit before Tax	5,058	5,953	7,013	8,214
Add: Depreciation	1,663	1,508	1,691	1,888
(Inc)/dec in Current Assets	(2,335)	1,646	(1,714)	(1,676)
Inc/(dec) in CL and Provisions	1,813	(83)	1,066	1,142
Taxes paid	(1,513)	(1,415)	(1,788)	(2,095)
<b>CF from operating activities</b>	<b>4,358</b>	<b>8,094</b>	<b>5,659</b>	<b>6,714</b>
(Inc)/dec in Investments	1,298	(5,149)	(1,000)	(1,000)
(Inc)/dec in Fixed Assets	(829)	(573)	(1,273)	(1,184)
Others	253	221	750	901
<b>CF from investing activities</b>	<b>1,029</b>	<b>(5,450)</b>	<b>(1,524)</b>	<b>(1,284)</b>
Issue/(Buy back) of Equity	47	57	-	-
Inc/(dec) in loan funds	193	(795)	-	-
Dividend paid & dividend tax	(2,492)	(1,759)	(2,385)	(2,788)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(426)	(558)	(141)	(141)
<b>CF from financing activities</b>	<b>(4,466)</b>	<b>(2,987)</b>	<b>(2,876)</b>	<b>(3,279)</b>
Net Cash flow	921	(343)	1,259	2,151
Cash by acquisition	-	-	-	-
Opening Cash	2,043	3,017	2,835	4,094
<b>Cash carried to B/S</b>	<b>3,148</b>	<b>2,835</b>	<b>4,094</b>	<b>6,245</b>

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Per share data (₹)</b>				
EPS	59.5	50.2	60.1	70.2
Cash EPS	85.4	67.3	79.3	91.6
BV	340.0	281.8	314.9	353.5
DPS	15.0	45.0	27.0	31.6
Cash Per Share	49.1	32.1	46.4	70.8
<b>Operating Ratios (%)</b>				
EBITDA Margin	15.5	18.1	18.6	19.3
PAT Margin	10.3	11.7	12.5	13.1
<b>Return Ratios (%)</b>				
RoE	17.5	17.8	19.1	19.9
RoCE	18.3	19.8	21.2	22.5
RoIC	20.5	29.2	32.9	38.1
<b>Valuation Ratios (x)</b>				
P/E	16.2	19.2	16.0	13.7
EV / EBITDA	15.1	12.0	10.1	8.4
EV / Net Sales	2.4	2.2	1.9	1.6
Market Cap / Sales	2.5	2.5	2.2	2.0
Price to Book Value	2.8	3.4	3.1	2.7
<b>Solvency Ratios</b>				
Debt/EBITDA	0.4	0.2	0.2	0.2
Debt/Equity	0.1	0.1	0.1	0.1
Current Ratio	1.7	1.5	1.5	1.5
Quick Ratio	1.7	1.5	1.5	1.5

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	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
HCL Tech (HCLTEC)	928	1,110	Buy	2,51,741	40.8	45.8	52.3	60.9	23	20	18	15	23.0	23.5	24.7	25.5	21.6	20.8	21.0	21.2
Infosys (INFTEC)	1,343	1,650	Buy	5,72,062	38.9	45.5	55.0	64.1	35	30	24	21	30.8	31.7	34.1	36.9	25.2	25.2	27.9	30.2
TCS (TCS)	3,101	3,800	Buy	11,47,370	86.2	86.7	109.3	128.7	36	36	28	24	44.4	45.9	51.2	54.4	38.4	37.5	43.3	45.7
Tech M (TECMAH)	963	1,120	Buy	93,055	59.5	50.2	60.1	70.2	16	19	16	14	18.3	19.8	21.2	22.5	17.5	17.8	19.1	19.9
Wipro (WIPRO)	480	530	Hold	2,63,138	16.6	19.1	20.5	24.8	29	25	23	19	19.3	21.3	21.6	25.7	17.4	19.5	21.0	25.4
Mindtree (MINCON)	2,064	2,390	Buy	34,018	38.3	67.4	79.8	94.0	54	31	26	22	23.0	32.5	32.6	32.6	20.0	25.7	25.5	25.3
LTI (LTINFC)	3,935	4,580	Hold	68,753	86.6	107.7	125.5	149.1	45	37	31	26	30.7	32.4	31.7	31.6	28.1	28.7	28.0	27.9
Coforge (NIITEC)	2,807	3,300	Hold	17,011	71.4	72.3	102.9	121.2	39	39	27	23	23.0	23.5	26.4	27.1	18.5	19.4	23.9	24.4
Infoedge (INFEDG)	4,890	5,725	Hold	62,877	26.8	21.8	38.9	49.0	183	224	126	100	18.0	8.3	14.0	16.3	13.5	6.3	10.5	12.3
Teamlease (TEASER)	3,076	3,290	Buy	5,259	20.5	53.1	68.8	85.6	150	58	45	36	15.0	13.5	15.7	16.5	6.5	14.4	15.5	16.3

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

[pankaj.pandey@icicisecurities.com](mailto:pankaj.pandey@icicisecurities.com)

ICICI Direct Research Desk,  
ICICI Securities Limited,  
1st Floor, Akruiti Trade Centre,  
Road No 7, MIDC,  
Andheri (East)  
Mumbai – 400 093  
[research@icicidirect.com](mailto:research@icicidirect.com)

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