Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Tech Mahindra Ltd

Decent Q3, Maintain Buy

IT & ITeS		Sharekhan code: TECHM	
Reco/View: Buy	↔	CMP: Rs. 1,036	Price Target: Rs. 1,220 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↓	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 11.65
Updated Dec 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 1,00,898 cr
52-week high/low:	Rs. 1,575 / 944
NSE volume: (No of shares)	25 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	63.11 cr

Shareholding (%)

Promoters	35.2
FII	28.0
DII	23.7
Others	13.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	-1.1	-1.2	-26.5
Relative to Sensex	4.1	-0.4	-4.6	-30.6

Sharekhan Research, Bloomberg

Summary

- For Q3FY23, Tech Mahindra reported revenues at $1668 million up 1.8% q-o-q/8.8% y-o-y. However, revenue growth in CC terms stood at 0.2% q-o-q, missed our cc growth estimates of 0.7% q-o-q. EBIT margin at 12% for Q3FY23 was up ~60 bps q-o-q owing to currency tailwinds, lower employee benefit expenses and lower subcontracting costs which was partially offset by higher SG&A expenses.
- Deal wins picked up with net new deal TCVs at $795 million versus $716 million in Q2FY23. The company's utilisation rate improved by 100 bps sequentially to 85% while LTM attrition moderated by 300 bps to 17% in Q3FY23 from 20% in Q2FY2023.
- The management said that, while demand drivers are strong, they are anticipating a slowdown in H1CY23. The company cited that they are witnessing decision making being more spread out. However, they expect a lot more cost take out opportunities fructifying and while they are optimistic on retail and manufacturing, they are seeing tepidness in the Hi-tech vertical.
- We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. While the company has reflected some concerns of delays in decision making, the consistent deal wins and healthy deal pipeline provides decent revenue visibility. Hence, we maintain a Buy rating on Tech Mahindra with unchanged PT of Rs 1220. We advise investors to adopt a staggered approach to invest from long term perspective.

For Q3FY23, Tech Mahindra reported revenues at $1668 mn up 1.8% q-o-q/8.8% y-o-y led by growth in Retail, Technology, CME verticals. However, the reported CC revenue growth of 0.2% q-o-q, missed our cc growth estimates of 0.7% q-o-q. Retail/ Technology/CME verticals grew 6.9%/ 3.8%/2.1% q-o-q respectively, while BFSI and Manufacturing contracted 0.7% and 0.1% q-o-q. RoW and Europe grew 6.8% and 1.4% q-o-q, while America reported a decline of 0.4% q-o-q. In rupee terms Revenue stood at Rs 13,735 crore: up 4.6% 000 and up 19.9% YoY. EBIT margin at 12% for Q3FY23 was up ~60 bps q-o-q owing to currency tailwinds, lower employee benefit expenses and lower subcontracting costs which was partially offset by higher SG&A expenses. Deals wins picked up with net new deal TCV at $ 795 million versus $716 million in Q2FY23. For Q3FY23, there was a sharp decline in net additions by 6844 employees, taking total headcount to 1,57,068 .The company's utilisation rate improved by 100 bps sequentially to 86%. LTM attrition rate moderated to 17% in Q3FY23 from 20% in Q2FY2023. The management said that while demand drivers are strong, they are anticipating a slowdown in H1CY23. The company cited that they are witnessing decision making being more spread out. However, they expect a lot more cost take out opportunities fructifying and while they are optimistic on Retail and Manufacturing, they are seeing tepidness in the hi-tech vertical. We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. While the company has reflected some concerns of delays in decision making, the consistent deal wins and healthy deal pipeline provides decent revenue visibility. Hence, we maintain a Buy rating on Tech Mahindra with unchanged PT of Rs 1220. We advise investors to adopt a staggered approach to invest from long term perspective.

Key positives

- Deal wins picked up with net new deal TCV at $ 795 million versus $716 million in Q2FY23.
- Company added 1-2 clients sequentially in $50 million, $20 million + revenue brackets respectively.
- LTM attrition moderated to 17% in Q3FY23 from 20% in Q2FY23.

Key negatives

- Revenue from top-5 and top-10 declined by 3.0% q-o-q, and 1.8% q-o-q respectively while revenue.
- Sharp decline in net additions by 6844 employees taking total headcount to 1,57,068.

Management Commentary

- The management said that while demand drivers are strong, they are anticipating a slowdown in H1CY23. The company cited that they are witnessing decision making being more spread out. However, they expect a lot more cost take out opportunities fructifying and while they are optimistic on Retail and Manufacturing, they are seeing tepidness in the Hi-tech vertical.
- Management stated that margin improvement for FY24 would be based on levers of normalization of subcontracting expenses, focus on driving offshore, divesting of non-strategic low margin portfolios companies and delivery excellence.

Revision in estimates – We have fine-tuned our estimates for FY23/24/25 owing to macro-overhang and INR-USD reset

Our Call

Valuation – Decent Q3, Maintain Buy: We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. While the company has reflected some concerns of delays in decision making, the consistent deal wins, and healthy deal pipeline provides decent revenue visibility. Hence, we maintain a Buy rating on Tech Mahindra with unchanged PT of Rs 1220. We advise investors to adopt a staggered approach to invest from long term perspective.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	44,646.0	53,254.4	56,165.6	62,271.1
OPM (%)	18.0	15.6	16.7	17.3
Adjusted PAT	5,566.1	5,382.9	5,956.8	6,846.5
% YoY growth	24.3	-3.3	10.7	14.9
Adjusted EPS (Rs.)	62.8	61.2	67.7	77.8
P/E (x)	16.5	16.9	15.3	13.3
P/B (x)	3.4	3.0	2.8	2.5
EV/EBITDA (x)	11.6	10.5	8.9	7.4
RoNW (%)	21.5	19.1	19.2	20.0
RoCE (%)	23.3	20.4	20.8	22.0

Source: Company; Sharekhan estimates

Key result highlights from earnings call

- **Decent growth in Retail, technology and CME vertical:** For Q3FY23 Tech Mahindra reported revenues at $1668 mn up 1.8%/8.8% q-o-q/ y-o-y respectively led by growth in Retail, Technology, CME verticals. However, the reported CC revenue growth of 0.2% q-o-q, missed our cc revenue growth estimates of 0.7% q-o-q. Retail/ Technology/CME verticals grew 6.9%/ 3.8%/2.1% q-o-q respectively, while Manufacturing and BFSI contracted 0.1% and 0.7% q-o-q. RoW and Europe grew 6.8% and 1.4% q-o-q respectively while America reported a decline of 0.4% q-o-q.
- **Delay in deal closure decisions:** The management said that while demand drivers are strong, they are anticipating a slowdown in H1CY23. The company cited that they are witnessing decision making being more spread out. However, they expect a lot more cost take out opportunities fructifying and while they are optimistic on Retail and Manufacturing, they are seeing tepidness in the Hi-tech vertical.
- **SGA expense and subcontracting costs:** SGA expenses in Q2FY23 expanded sharply by 6.7% sequentially to Rs. 1,796.9 crore. Subcontracting costs moderated to 1974.1 crore at 14.4% of its revenue in Q3FY2023.
- **Deal wins rebounds:** Deals wins picked up with net new deal TCV at $795 million versus $716 million in Q2FY23.
- **Margin levers:** The management stated that margin improvement for FY24 would be based on levers of normalisation of subcontracting expenses, focus on driving offshore, divesting of non-strategic portfolios companies and delivery excellence.
- **Net additions fell while LTM attrition rate moderated:** For Q3FY23, there was a sharp decline in net additions by 6,844 employees, taking total headcount to 1,57,068 chiefly attributable to BPO professional which declined by 4820 employees. The company's utilisation rate improved by 100 bps sequentially to 86%. LTM attrition rate moderated to 17% in Q3FY23 from 20% in Q2FY2023.
- **Weak growth in top accounts:** Revenue from top-5 and top-10 declined by 3.0% q-o-q, and 1.8% q-o-q respectively while revenue from Top -20 grew 2.1% q-o-q,
- **Strong cash generation:** Tech Mahindra generated a quarterly FCF of $31 million, declining 88% q-o-q. FCF to PAT conversion ratio stood at 20% due to normalization (versus 159% in Q2FY2023). Cash & cash equivalents declined to $780 million in Q3FY2023 compared to $947 million in Q2FY2023.
- **DSO days stable:** DSO days remained stable at 98 days in Q3FY2023.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenues In USD (mn)	**1,668.0**	**1,533.5**	**8.8**	**1,638.0**	**1.8**
Revenues In INR	**13,734.6**	**11,450.8**	**19.9**	**13,129.5**	**4.6**
Cost of Services	9,793.7	8,008.8	22.3	9,461.4	3.5
Gross profit	**3,940.9**	**3,442.0**	**14.5**	**3,668.1**	**7.4**
SG&A	1,796.9	1,381.9	30.0	1,684.0	6.7
EBITDA	**2,144.0**	**2,060.0**	**4.1**	**1,984.1**	**8.1**
Depreciation	498.1	362.1	37.6	491.7	1.3
EBIT	**1,645.9**	**1,697.9**	**-3.1**	**1,492.4**	**10.3**
Other Income	247.2	223.1	10.8	290.2	-14.8
PBT	**1,780.2**	**1,887.1**	**-5.7**	**1,703.6**	**4.5**
Provision for taxes	485.9	508.2	-4.4	364.7	33.2
Adjusted net profit	**1,296.6**	**1,368.5**	**-5.3**	**1,309.8**	**-1.0**
Non Recurring / Exceptional Items	0.0	0.0	-	24.4	-
Reported net profit	**1,296.6**	**1,368.5**	**-5.3**	**1,285.4**	**0.9**
EPS (Rs) Excl Treasury Shares	14.6	15.5	-5.3	14.5	0.8
Margin (%)			**BPS**		**BPS**
EBITDA Margins	15.6	18.0	-238	15.1	50
EBIT Margin	12.0	14.8	-284	11.4	62
PAT Margin	9.4	12.0	-251	10.0	-54
Tax rate	27.3	26.9	36	21.4	589

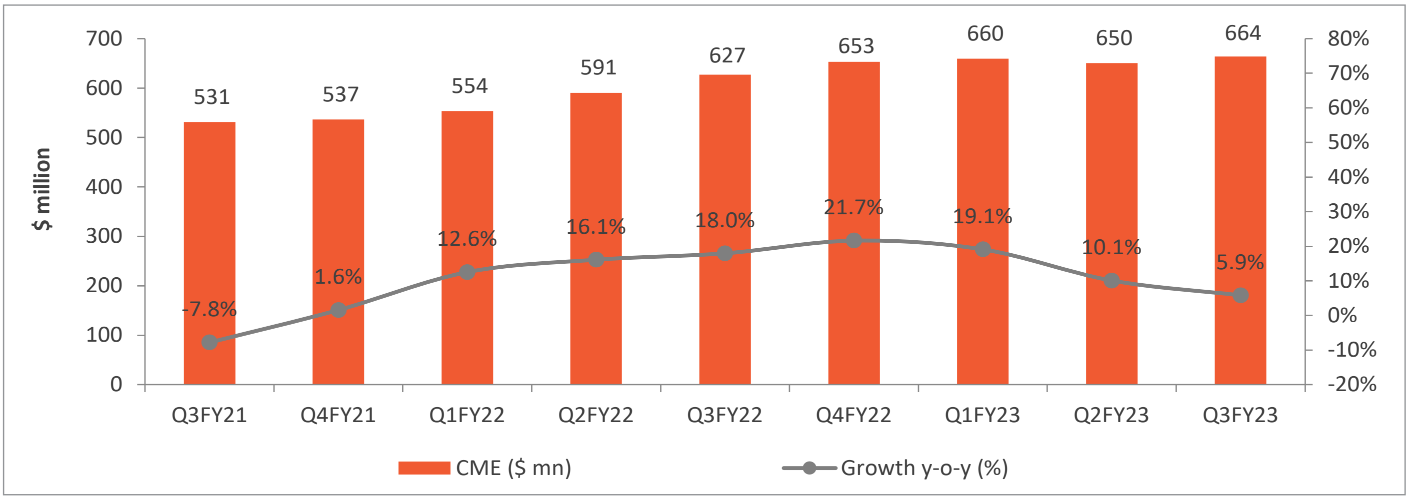
Source: Company, Sharekhan Research

Revenue mix: Geographies, industry verticals, and other operating metrics

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%) q-o-q	$ Growth (%) y-o-y
Revenues ($ mn)	1,668	100	1.8	8.8
Geographic mix				
America	829	49.7	-0.4	10.6
Europe	407	24.4	1.4	3.9
RoW	432	25.9	6.8	10.1
Industry verticals				
CME	664	39.8	2.1	5.9
Manufacturing	262	15.7	-0.1	7.9
Technology	172	10.3	3.8	32.7
BFSI	265	15.9	-0.7	12.1
Retail, transpost and logistics	142	8.5	6.9	8.5
Others	165	9.9	2.9	-1.1
Clients' contribution				
Top 5	300	18.0	-3.0	-13.6
Top 10	450	27.0	-1.8	-6.5
Top 20	667	40.0	2.1	2.7
Revenue by services				
IT	1,434	85.9	0.6	7.2
BPO	235	14.1	8.7	21.3

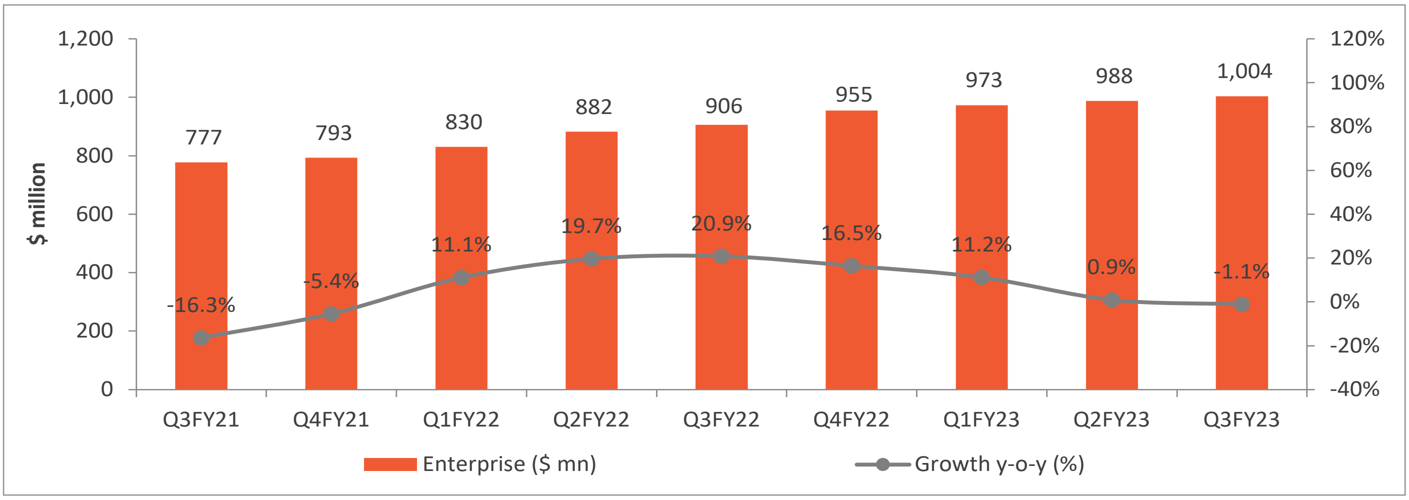
Source: Company, Sharekhan Research

CME vertical revenue growth trend



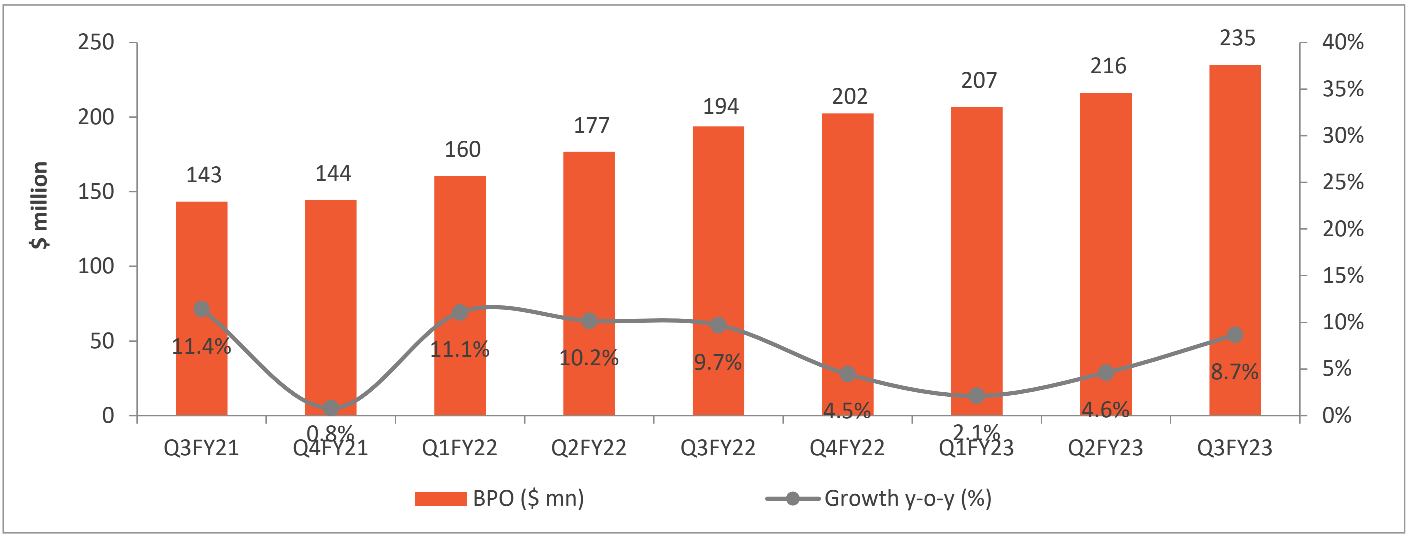
Source: Company; Sharekhan Research

Enterprise vertical revenue growth trend



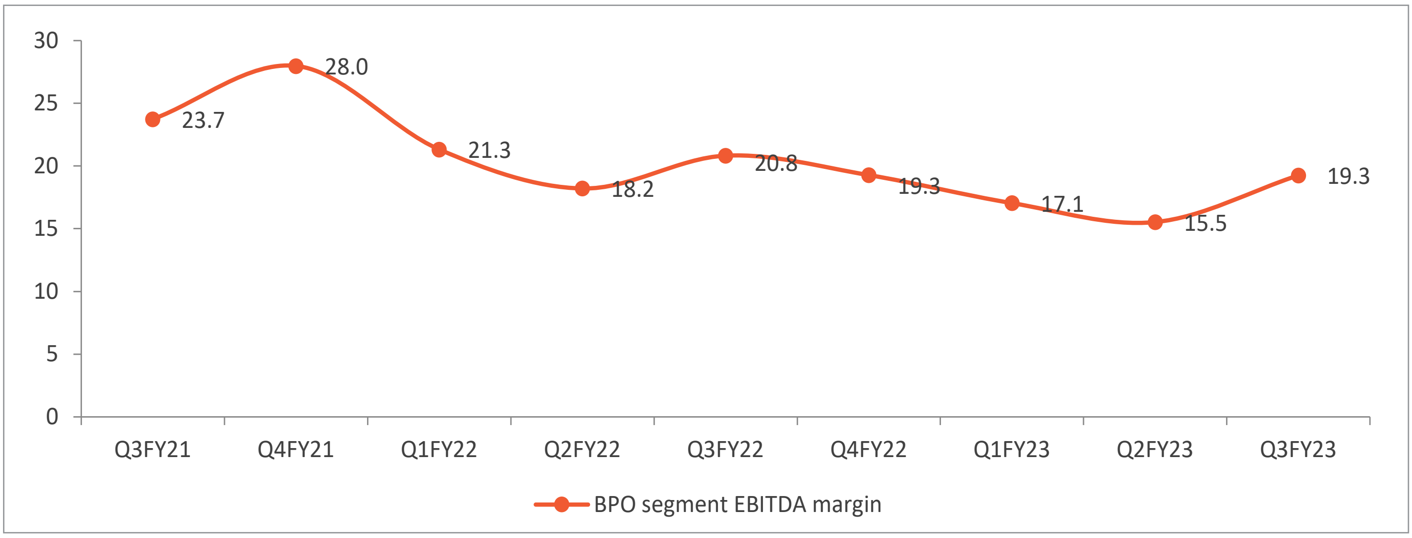
Source: Company; Sharekhan Research

BPO revenue growth trend



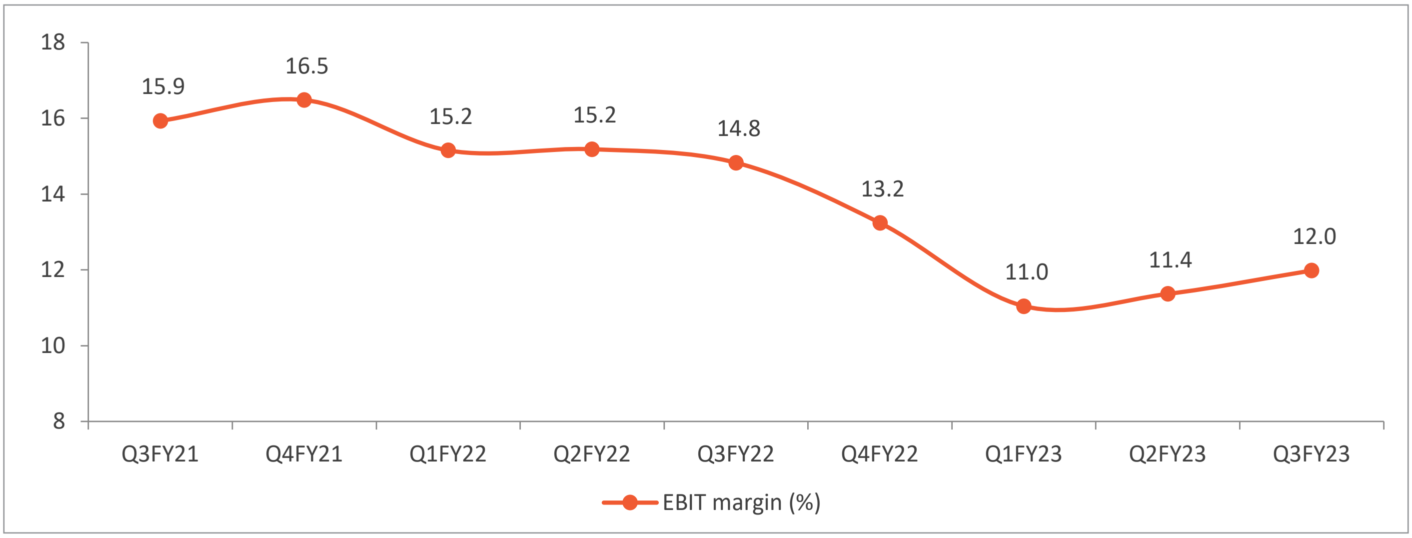
Source: Company; Sharekhan Research

BPO segment's EBITDA margin trend



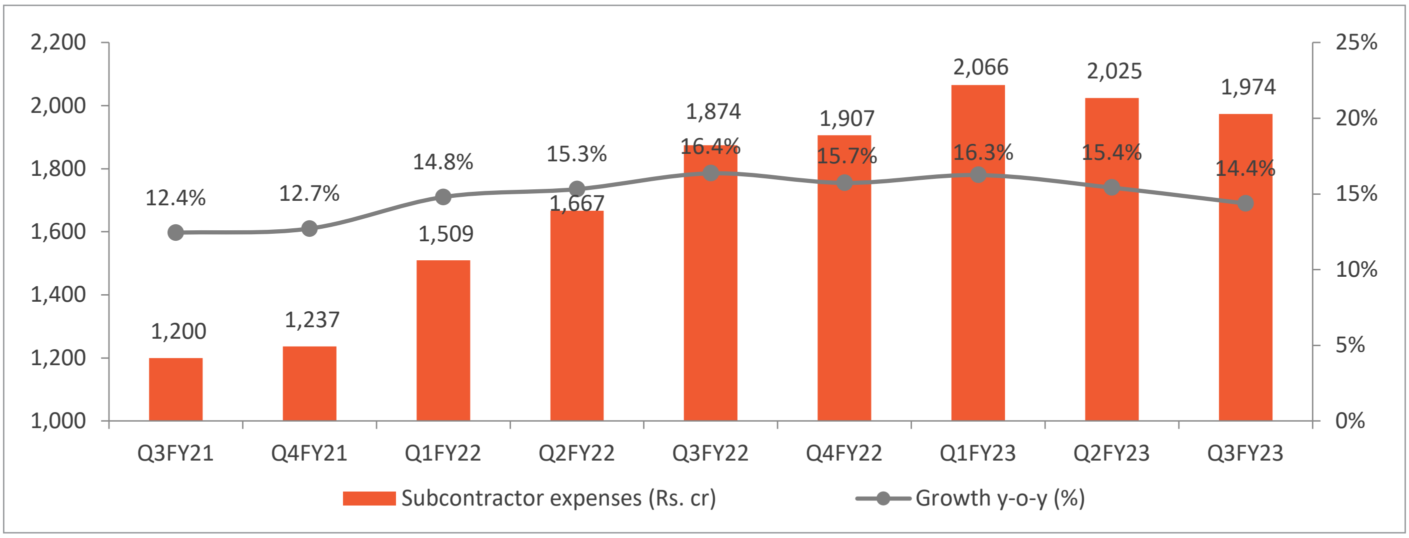
Source: Company; Sharekhan Research

Tech M's EBIT margin trend



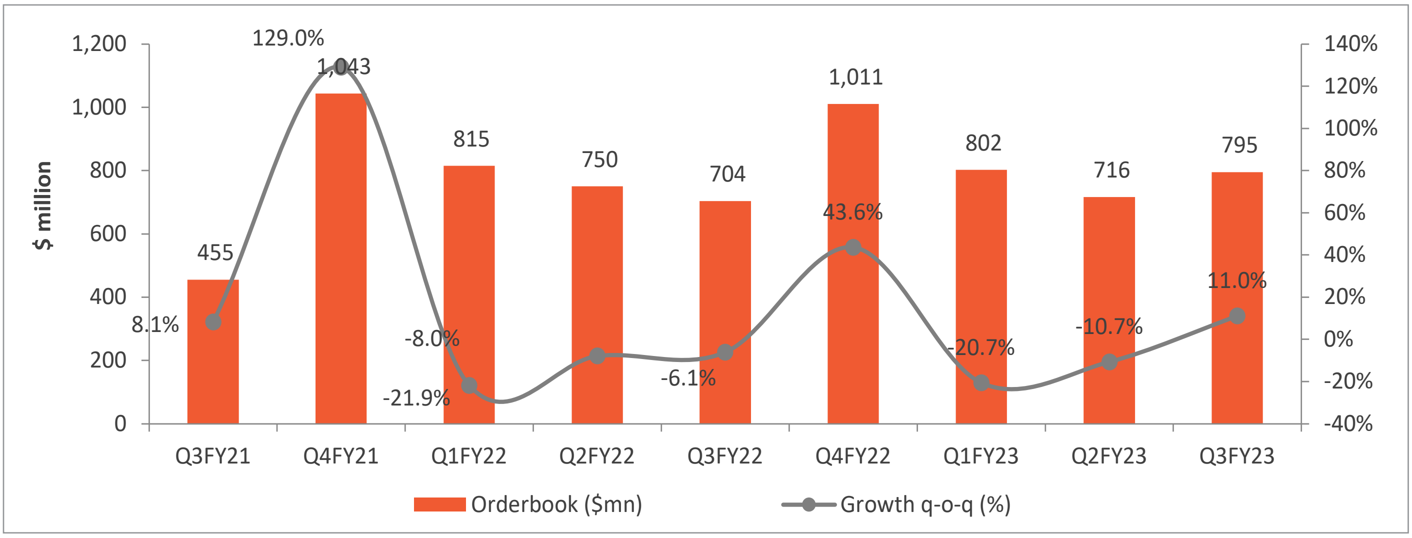
Source: Company; Sharekhan Research

Subcontractor expense (Rs. crore) and as a % of revenues



Source: Company; Sharekhan Research

New deal win TCV trend



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance by Indian IT companies.

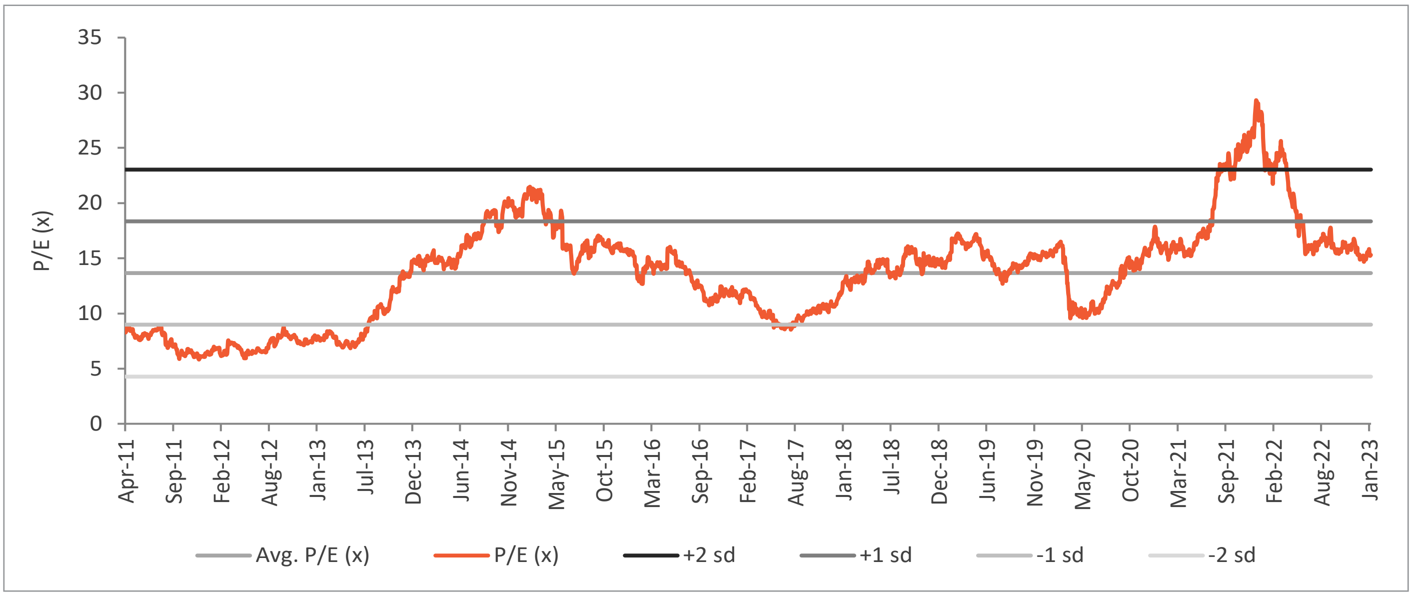
■ Company outlook - Well-placed to capture 5G opportunity

TechM is well-placed to capture 5G-related spending from TSPs and OEMs, given its early investments in network capabilities through LCC, investments in IPs, platforms, and investments/partnerships (Intel, Rakuten, and AltioStar, among others) to develop an ecosystem. We remain positive on the company, considering strong demand in the telecom vertical, strategic focus on digital acquisitions, steady pace of deal intake and a continuous focus on diversifying the business. Improvement in execution led by efficient capital allocation is expected to augur well for the company.

■ Valuation - Decent Q3, Maintain Buy

We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. While the company has reflected some concerns of delays in decision making, the consistent deal wins, and healthy deal pipeline provides decent revenue visibility. Hence, we maintain a Buy rating on Tech Mahindra with unchanged PT of Rs 1220. We advise investors to adopt a staggered approach to invest from long term perspective.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1986, TechM was formed with a joint venture between Mahindra & Mahindra and British Telecom Plc, under the name of Mahindra British Telecom. The company has been providing end-to-end services to telecom OEMs and service providers. Over the years, the company has acquired Comviva Technologies, LCC, and Hutchison Global Services to fill gaps in its service offerings in the telecom space. Notably, post the acquisition of Satyam, TechM entered the enterprise solutions space and became the fifth-largest Indian IT player. The company has now diversified its exposure to other verticals such as BFSI and manufacturing. TechM offers a bouquet of services including IT outsourcing services, consulting, next-generation solutions, application outsourcing, network services, infrastructure management services, integrated engineering solutions, business process outsourcing, platform solutions, and mobile value-added services.

Investment theme

TechM is one of the leading players in providing end-to-end services and solutions to telecom OEMs and major global service providers in the communication space (contributes more than 40% to its total revenue). Historically, this has helped the company whenever there is any uptick in technology spends, led by adoption of new technology. As the pace of spending from the roll-out of 5G network is likely to accelerate across the globe, TechM is well positioned to capitalise on the 5G opportunity across networks and IT services, given its investments in network capabilities, IPs, platforms, and partnerships. This has enabled the company to compete with large peers by striving for large deals in the enterprise segment.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

Mr. Anand Mahindra	Chairman
CP Gurnani	Managing Director and Chief Executive Officer
Milind Kulkarni	Chief Financial Officer
Jagdish Mitra	Chief Strategy Officer and Head Of Growth
Manish Vyas	President, Communications, Media &Entertainment Business
Vivek Agarwal	President – BFSI, HLS and Corporate Development

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp. of India	7.44
2	SBI Funds Management Pvt. Ltd.	3.14
3	First State Investments ICVC	2.76
4	BlackRock Inc	2.42
5	Vanguard Group Inc.	2.42
6	Mitsubishi UFJ Financial Group Ltd	2.27
7	ICICI Prudential Asset Management	2.16
8	Government Pension Fund	2.01
9	Norges Bank	1.44
10	UTI Asset Management Co Ltd	1.30

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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