

Tech Mahindra Limited. Major good deal wins, a decline in attrition rate and the technology segment shows strong growth

CMP	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 1,015	INR 1,181	~16.4%	INR 980,084	BUY	Internet Software & Services

Synopsis:

Tech Mahindra Ltd (TECHM) has received a net new deal win of USD 795 million and has a free cash flow for the quarter of USD 31 million. The revenue from operations has increased to INR 137,346 million in Q3 FY23 from INR 131,295 million in Q2 FY23, an increase of 4.61% on a QoQ basis and an increase of 19.94% on a YoY basis. The number of active clients has also increased to 1290 and the percentage of repeat business is in the range of 92% - 95%. The concentration rate for the top 5 and top 10 clients' have also decreased to 18% and 27% respectively in Q3 FY23 from 23% and 31% respectively in Q2 FY23. The employee attrition rate has significantly decreased to 17% in Q3 FY23 from 20% in Q2 FY23 and 24% in Q3 FY22. The utilization rate (excluding trainees) has also been significantly improving to 86% in Q3 FY23 from 85% in Q2 FY23 and from 84% in Q3 FY22. The IT onsite revenue split has been steadily increasing from 27.1% in Q3 FY22 to 27.3% in Q2 FY23 and similarly, the offshore revenue split has been declining from 72.9% in Q3 FY22 to 72.7% in Q2 FY23. The company was awarded an 'A' rating in MSCI ESG ratings 2022.

MARKET DATA

Shares outs (Mn)	878
Mkt Cap (INR Mn)	980,084
52 Wk H/L (INR)	1,575 / 944
Volume Avg (3m K)	3140.4
Face Value (INR)	5
Bloomberg Code	TECHM IN

KEY FINANCIALS

(INR Mn)	Q3FY23A	Q2FY23A	Q3FY22A	QoQ	YoY
USD Revenue	1,668	1,638	1,534	1.83%	8.74%
Revenue	1,37,346	1,31,295	1,14,508	4.61%	19.94%
EBIT	20,311	14,924	20,261	3610%	0.25%
PAT	12,966	12,854	13,685	0.87%	- 5.25%
OPM (%)	14.79%	14.51%	17.69%	28 bps	- 290 bps
NPM(%)	9.44%	9.79%	11.95%	- 35 bps	- 216 bps

Source: Company, KRChoksey Research

Technology segment sees a good jump in revenue

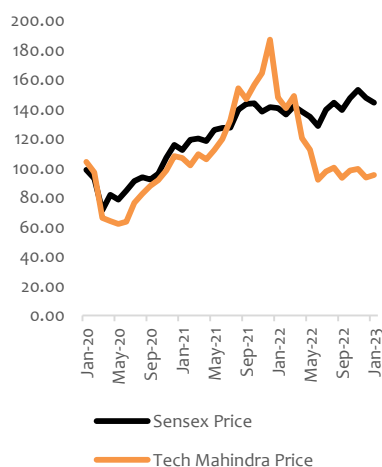
TECHM has reported a revenue of USD 1,668 million; up of 1.8% QoQ and up of 8.8% YoY. The constant currency revenue growth is 0.2% on a QoQ basis. All the business segments have witnessed growth on a QoQ basis except Banking, Financial Services and Insurance (BFSI) segment, marginally declining by 0.5%; while these segments have registered good growth on a YoY basis. There has been a substantial improvement in the Technology segment, a growth of 32.2% on a YoY basis and 3.3% growth on a QoQ basis; whereas the Retail, Transport and Logistic segment reported a growth of 8.2% on a YoY basis and 6.0% growth on a QoQ basis. There has been a decline in revenue from the top clients as a couple of customers are going through a process of business restructuring and this is expected to improve from Q4 FY23 onwards. The company also believes the Retail, BFSI and manufacturing segment will do well in the upcoming quarter but the Hi-Tech segment might see some slowdown as the execution for the same was delayed. However, we believe that this slowdown in Hi-Tech is one-off and will eventually grow.

Deal momentum has improved from the decline in the last quarter

The company has witnessed improvement in deal wins after a decline in the last quarter. The company has received a net new deal wins of USD 795 million in Q3 FY23 against USD 704 million in Q3 FY22 and USD 716 million in Q2 FY23, an increase of 11.45% on a YoY basis and an increase of 11.03% on a QoQ basis. Some of the eminent deals are – (i) TECHM has been selected as the digital transformation partner for a Swedish manufacturer of specialty oil to modernize enterprise IT architecture and establish efficient work processes across the business, deliver transparency across the value chain and harness the power of next-generation platforms. (ii) The company has announced a strategic partnership with Altice Labs, an innovation center of Altice Group, to co-create, innovate, and jointly offer end-to-end solutions in BSS-OSS connectivity, fiber & 5G powered by advanced data-driven analytics, AI-led digital and cloud-native solutions. With such kind of a great deal wins along with a high customer retention ratio of 92% - 95%, we believe that the company will have steady revenue growth.

Margins to improve in the coming quarter

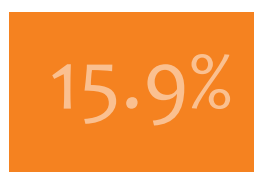
The EBIT margin has moderately improved by 28 bps on a QoQ basis and reached 14.79% in Q3 FY23 from 14.51% in Q2 FY23 but still misses the mark of Q3 FY22 EBIT margin (i.e., 17.69%). We believe that the EBIT margin will attempt the Q3 FY22 level as the attrition rate has been declining from 24% in Q3 FY22 to 17% in Q3 FY23. The utilization rate (excluding trainees) has also gradually improved from 84% in Q3 FY22 to 86% in Q3 FY23. Hence, we believe that the attrition rate would further go down to 15% and the utilization rate can further increase to 90% which would eventually increase the EBIT margin.

SHARE PRICE PERFORMANCE

MARKET INFO

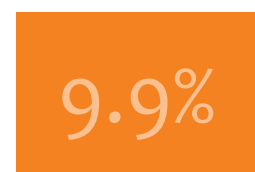
SENSEX	59,500.41
NIFTY	17,648.95

SHARE HOLDING PATTERN (%)

Particulars	Jan-23	Sep-22	Jun-22
Promoters	35.2	35.2	35.2
FIIs	27.9	28.2	30.4
DIIs	23.7	23.8	20.9
Others	13.1	12.8	13.4
Total	100	100	100



Revenue CAGR between FY22 and FY24E



PAT CAGR between FY22 and FY24E

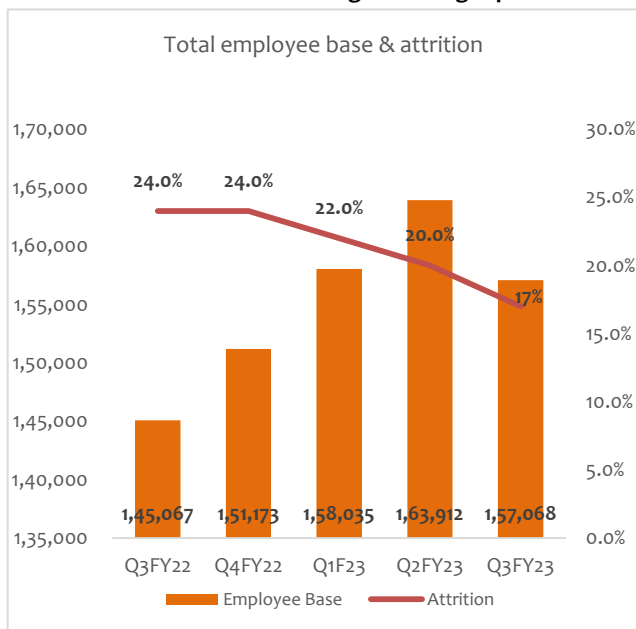
Tech Mahindra Limited.

Key Concall Highlights:

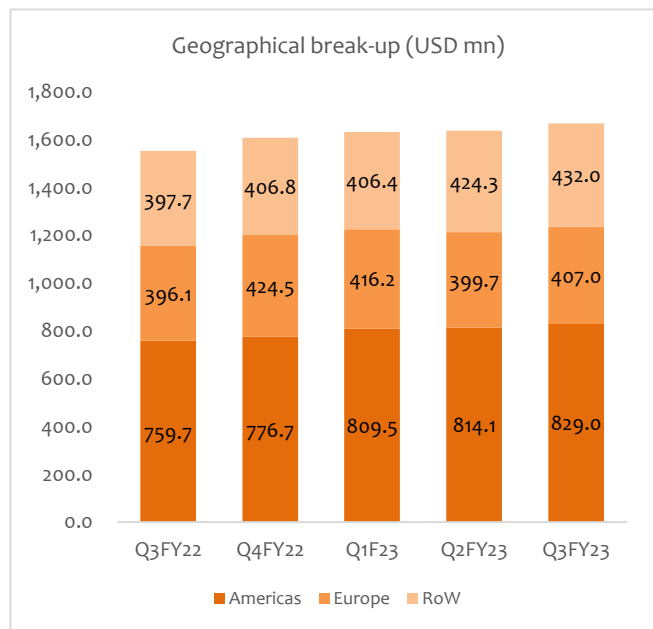
(i) Tech Mahindra Ltd. partnered with Airtel to deploy a captive private network at Mahindra’s Chakan manufacturing facility which is near Pune, making it India’s first 5G enabled Auto manufacturing plant under Tech Mahindra’s ‘5G for Enterprise program’. (ii) The management believes that the performance for this quarter was good despite this quarter being a low-earning quarter. (iii) The company expects further improvement in EBIT margin and due to digital transformation and business transformation there is an improvement in deal growth and revenue growth. (iv) Few clients have stopped working with Tech Mahindra due to the macro environment conditions but the management expects that this impact is temporary and the company still have a high customer retention rate. (v) Revenue from the top 5 clients is declining and is expected to stay at the same level till Q4 FY23, post which there can be an improvement. (vi) The company is planning to retrieve the loss of business. (vii) The management expects to reach a pre-COVID utilization rate in the upcoming quarter. (viii) The company is looking to remove the low-margin business.

Valuation and view

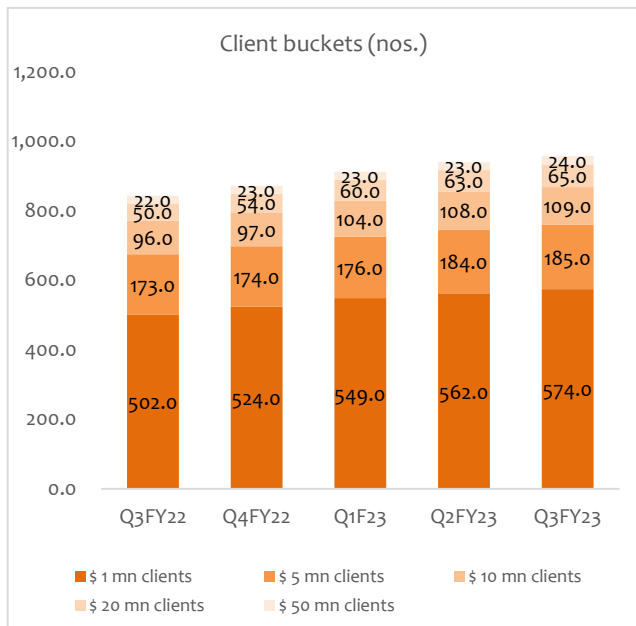
Tech Mahindra is currently trading at a valuation with a P/E multiple of 15.9x/13.3x on FY23E/FY24E earnings. The story is premised on pipeline commentary, improved services portfolio (design, engineering and consulting) & acquisition synergies, and 5G-related spending and reduction in the attrition rate and hence we are assigning a P/E multiple of 15.5x to the FY24E estimated EPS of INR 76.2 to arrive at a target price of INR 1,181, with an upside of around 16.4%. Accordingly, we have changed our rating to a “BUY” for “Accumulate” will maintaining same target price.



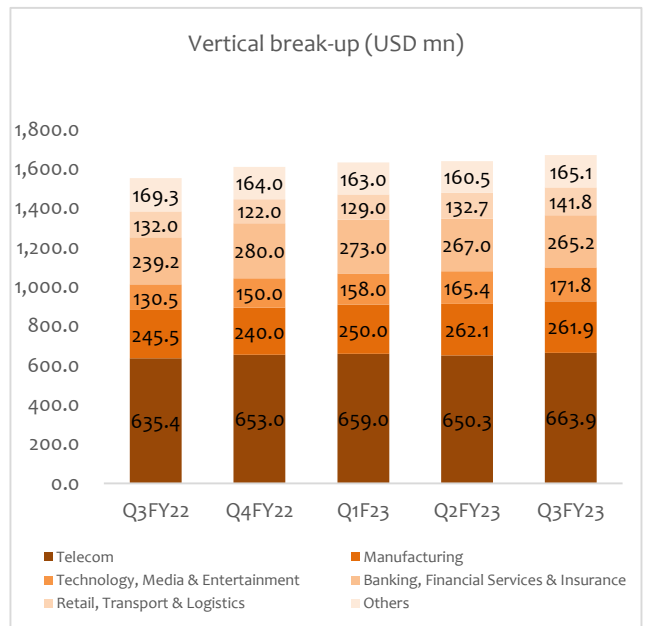
Source: Company, KRChoksey Research



Source: Company, KRChoksey Research



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Source: Company, KRChoksey Research

Tech Mahindra Limited.

KEY FINANCIALS

Exhibit 1: Balance Sheet

Particulars (INR Mn)	FY19	FY20	FY21	FY22	FY23E	FY24E
Property, plant and equipment	26,229	26,609	24,632	22,992	19,620	17,254
Right-of-use asset	-	11730	10072	10072	10072	10072
CWIP	2,763	501	1,183	1,183	1,183	1,183
Goodwill	28,163	33,877	40,082	40,082	40,082	40,082
Intangible assets	14,512	15,060	14,508	14,508	14,508	14,508
Investments	7,520	2,360	5,757	5,757	5,757	5,757
Loans	43	45	47	47	47	47
Other non current assets	33,490	43,187	38,813	44,054	47,936	53,022
Total non current assets	1,12,720	1,33,369	1,35,094	1,38,695	1,39,205	1,41,925
Inventories	752	358	242	242	242	242
Investments	65,899	56,123	96,619	96,619	96,619	96,619
Trade receivables	69,586	75,772	64,728	79,754	93,109	1,05,324
Cash & equivalent	20,427	30,167	26,904	39,173	62,545	61,982
Other current assets	58,994	69,303	64,060	67,444	68,932	72,035
Deferred tax assets	6091	8443	9133	9133	9133	9133
Total current assets	2,21,749	2,40,166	2,61,686	2,92,365	3,30,581	3,45,335
Total assets	3,34,469	3,73,535	3,96,780	4,31,060	4,69,785	4,87,259
Equity share capital	4,437	4,359	4,370	4,370	4,370	4,370
Other equity	1,98,407	2,13,772	2,44,280	2,73,814	3,12,162	3,26,344
Equity attributable to owners of the company	2,02,844	2,18,131	2,48,650	2,78,184	3,16,532	3,30,714
Non controlling interest	4,777	3,933	3,795	3,795	3,795	3,795
Total equity	2,07,621	2,22,064	2,52,445	2,81,979	3,20,327	3,34,509
Loan fund	2,086	1,787	1,658	1,326	1,244	1,161
Long term provisions	8,821	19,370	17,796	17,796	17,796	17,796
Lease liabilities	0	8,539	8,077	8,077	8,077	8,077
Other long term liabilities	325	214	1725	1725	1725	1725
Amount pending investigation	12304	12304	12304	12304	12304	12304
Total non current liabilities	23,536	42,214	41,560	41,228	41,146	41,063
Sundry creditors	24,893	32,566	27,850	29,892	31,477	35,977
Short term borrowings	11,961	22,495	14,960	17,996	16,871	15,747
Other liabilities	62,506	46,373	50,651	50,651	50,651	50,651
Provision	3,952	4,364	5,311	5,311	5,311	5,311
Lease liabilities	0	3,459	4,003	4,003	4,003	4,003
Total current liabilities	1,03,312	1,09,257	1,02,775	1,07,853	1,08,313	1,11,688
Total liabilities	3,34,469	3,73,535	3,96,780	4,31,060	4,69,785	4,87,259

Source: Company, KRChoksey Research

Tech Mahindra Limited.

KEY FINANCIALS

Exhibit 2: Profit & loss statement

Particulars (INR Mn)	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenue	3,47,421	3,68,677	3,78,551	4,46,460	5,29,702	6,00,212
Total operating cost	2,84,052	3,11,416	3,10,081	3,66,260	4,36,564	4,91,879
EBITDA	63,369	57,261	68,470	80,200	93,139	1,08,333
Depreciation	11,292	14,458	14,577	15,204	19,510	19,902
EBIT	52,077	42,803	53,893	64,996	73,629	88,431
Other income, net	5,342	11,924	7,871	11,123	9,575	9,419
Finance costs	1,332	1,919	1,740	1,626	1,694	1,724
Pre-tax income	56,087	52,808	60,024	74,493	81,510	96,126
Income tax expense	12,544	11,604	15,999	18,220	24,675	28,278
Net profit	43,543	41,204	44,025	56,273	56,835	67,847
MI, EI & share of profit from associates	567	874	-255	640	640	640
Net profit after MI, EI & profit from associates	42,976	40,330	44,280	55,633	56,195	67,207
Diluted EPS (INR)	47.7	45.9	50.2	63.1	63.7	76.2
Shares in million	901	880	882	882	882	882

Source: Company, KRChoksey Research

Exhibit 3: Free cash flow analysis

Particulars (INR Mn)	FY19	FY20	FY21	FY22	FY23E	FY24E
Net cash generated from operations	50,197	45,836	56,178	69,164	93,153	1,02,628
Net cash flow from/(used in) investing activities	-3,137	-7,416	-16,679	-13,034	-12,137	-13,536
Net cash flow from financing activities	-3,193	10,157	-7,653	2,704	-1,208	-1,208
Others	-43,101	-38,837	-35,109	-46,565	-56,436	-88,448
Net inc/dec in cash equivalents	766	9,740	-3,263	12,269	23,372	-563
Opening balance	19,661	20,427	30,167	26,904	39,173	62,545
Closing balance cash and cash equivalents	20,427	30,167	26,904	39,173	62,545	61,982

Source: Company, KRChoksey Research

Exhibit 4: Ratio analysis

Key Ratio	FY19	FY20	FY21	FY22	FY23E	FY24E
EBIT margin (%)	15.0%	11.6%	14.2%	14.6%	13.9%	14.7%
Tax rate (%)	22.4%	22.0%	26.7%	24.5%	30.3%	29.4%
Net profit margin (%)	12.4%	10.9%	11.7%	12.5%	10.6%	11.2%
RoE (%)	22.0%	19.2%	19.0%	20.7%	23.7%	23.1%
RoCE (%)	19.1%	14.5%	15.6%	17.2%	20.5%	21.8%
Current ratio (x)	2.1	2.1	2.5	2.6	3.0	3.0
EPS (INR per share)	47.7	45.9	50.2	63.1	63.7	76.2

Source: Company, KRChoksey Research

Tech Mahindra Limited.

Tech Mahindra Limited				Rating Legend (Expected over a 12-month period)	
Date	CMP (INR)	TP(INR)	Recommendation	Our Rating	Upside
01-Feb-23	1,015	1,181	BUY	Buy	More than 15%
02-Nov-22	1,071	1,181	ACCUMULATE	Accumulate	5% – 15%
16-May-22	1,190	1,447	BUY	Hold	0 – 5%
02-Feb-22	1,483	1,770	BUY	Reduce	-5% – 0
				Sell	Less than – 5%

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