

Tech Mahindra

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Macro uncertainties to weigh in the near term; Confident on medium-term growth prospects

- TechM gave further insights into its NXT.NOW growth strategy, focusing on connectivity, experience, cloud, engineering, and sustainability through differentiated offerings. The company also highlighted the progress made on large deals, client mining, and alliances to accelerate revenue growth while driving delivery excellence to steer margin expansion.
- The company expects the leadership transition to be smooth as it is a planned succession and executed diligently with a reasonable time period to transition to the new leader and the growth strategy laid out is unlikely to change. While management anticipates near-term weakness in revenue growth, it is optimistic about its medium-term growth outlook, driven by 5G, cloud, engineering, sustainability, and Industry 4.0.
- Management unveiled its plan to focus on building a products and platform business and scaling up the co-creating business. The products and platform business is currently at ~USD450mn run rate and has the potential to scale to USD1bn in the next three years.
- We roll forward our TP to Mar-25E EPS and maintain Buy with a TP of Rs1,270 (earlier 1,220) at 16x its Mar-25E EPS, considering the anticipated improvement in the margin trajectory, better capital allocation, and reasonable valuation.

NXT.NOW growth strategy evolving from being resilient to being relevant: TechM has provided further insights into its NXT.NOW growth strategy, focusing on connectivity, experience, cloud, engineering, and sustainability through differentiated offerings. TechM highlighted five key trends – 1) growing enterprise tech intensity (CX and digital engineering), 2) cloud and data services (led by data and analytics, cloud native, industry cloud, and security), 3) increased interest in emerging technologies (5G, Metaverse, and AI), 4) business transformation using industry solutions and co-creation, and 5) partnerships (focus on top-10 partnerships). The company expects strong execution of its growth strategy, focusing on five above-mentioned areas, client mining, large deals, alliances expansion, and products and platforms, which would drive sustainable revenue growth while improving profitability.

Products and Platform – The next big thing at TechM: TechM will reorganize the platform business under one brand – Comviva 2.0, which will be launched in April-23. The business is currently worth ~USD450mn and has the potential to scale to USD1bn in the next three years. The company plans to invest USD60-90mn in the business to accelerate revenue growth. TechM is also working on scaling up co-creation with its customers.

Focus remains on driving M&A synergies: TechM highlighted that since 2019, the company has invested ~USD1.18bn+ (includes upfront payment, yearly payouts till date, and estimates for FY23-FY25) on M&As. These acquisitions delivered a 4.3% revenue CQGR from the acquisition to Q3FY23. For three major acquisitions (CTCO, DigitalonUS, and Allyis), standalone growth has been in line with expectations. While profitability for DigitalonUS and Allyis has been at par, CTCO's profitability was impacted by its exposure to Eastern Europe. Management remains confident on the integration and realization of benefits from its M&As.

Financial Snapshot (Consolidated)

| (Rs mn) | FY21 | FY22 | FY23E | FY24E | FY25E |
|-------------------|---------|---------|---------|---------|---------|
| Revenue | 378,551 | 446,460 | 532,878 | 577,397 | 640,318 |
| EBITDA | 68,471 | 80,200 | 82,987 | 97,649 | 110,798 |
| EBITDA Margin (%) | 18.1 | 18.0 | 15.6 | 16.9 | 17.3 |
| APAT | 44,281 | 55,660 | 51,372 | 60,445 | 69,648 |
| EPS (Rs) | 50.7 | 63.4 | 58.4 | 68.7 | 79.2 |
| EPS (% chg) | 9.5 | 25.2 | (7.9) | 17.7 | 15.2 |
| ROE (%) | 19.0 | 21.5 | 18.6 | 20.8 | 22.6 |
| P/E (x) | 21.4 | 17.1 | 18.6 | 15.8 | 13.7 |
| EV/EBITDA (x) | 12.2 | 11.0 | 10.6 | 8.8 | 7.7 |
| P/BV (x) | 3.8 | 3.5 | 3.4 | 3.2 | 3.0 |

Source: Company, Emkay Research

| | |
|-----------------------|---------------------|
| CMP | Target Price |
| Rs 1,085 | Rs 1,270 (▲) |
| as of (March 4, 2023) | 12 months |
| Rating | Upside |
| BUY (■) | 17.0 % |

Change in Estimates

| | |
|--------------------------|-----|
| EPS Chg. FY23E/FY24E (%) | -/ |
| Target Price change (%) | 4.1 |
| Target Period (Months) | 12 |
| Previous Reco | BUY |

Emkay vs. Consensus

| EPS Estimates | | |
|-------------------------|----------|-------|
| | FY23E | FY24E |
| Emkay | 58.4 | 68.7 |
| Consensus | 58.4 | 68.0 |
| Mean Consensus TP (12M) | Rs 1,118 | |

Stock Details

| | |
|------------------------------|---------------|
| Bloomberg Code | TECHM IN |
| Face Value (Rs) | 5 |
| Shares outstanding (mn) | 974 |
| 52 Week H/L | 1,526 / 914 |
| M Cap (Rs bn/USD bn) | 1,057 / 12.89 |
| Daily Avg Volume (nos.) | 2,615,410 |
| Daily Avg Turnover (US\$ mn) | 33.7 |

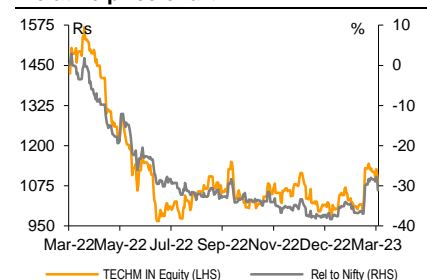
Shareholding Pattern Dec-22

| | |
|-------------------|-------|
| Promoters | 35.2% |
| FIIs | 28.0% |
| DIIIs | 23.9% |
| Public and Others | 12.9% |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|----------------------|----|-----|----|------|
| Absolute | 7 | (3) | 5 | (21) |
| Rel. to Nifty | 8 | 3 | 5 | (27) |

Relative price chart



Source: Bloomberg

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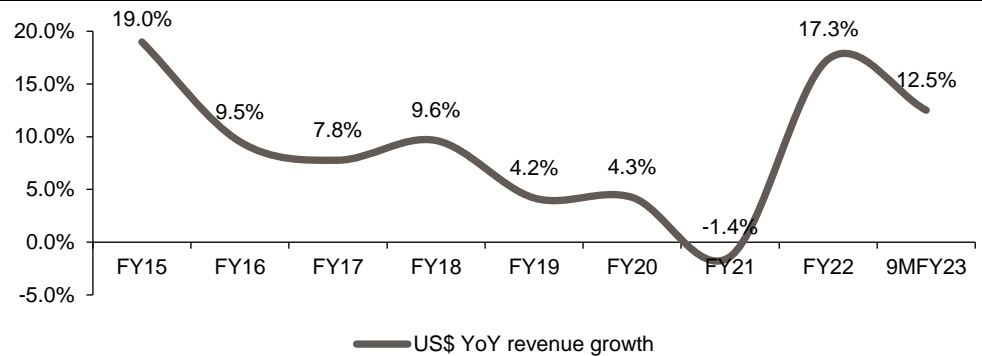
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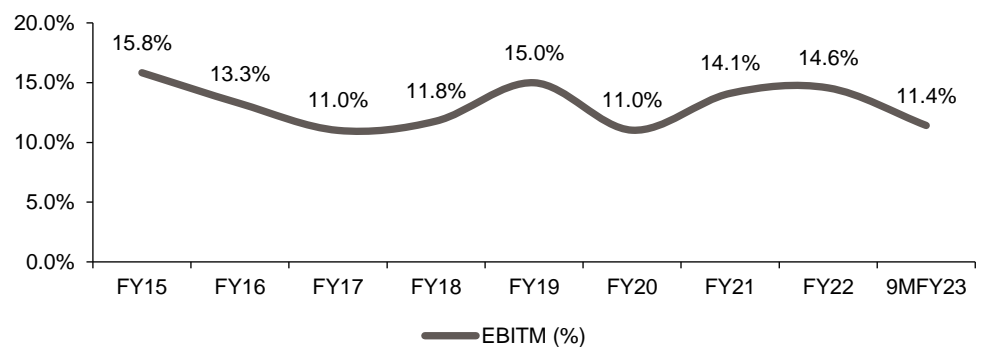
Story in charts

Exhibit 1: Revenue growth momentum moderated in 9MFY23



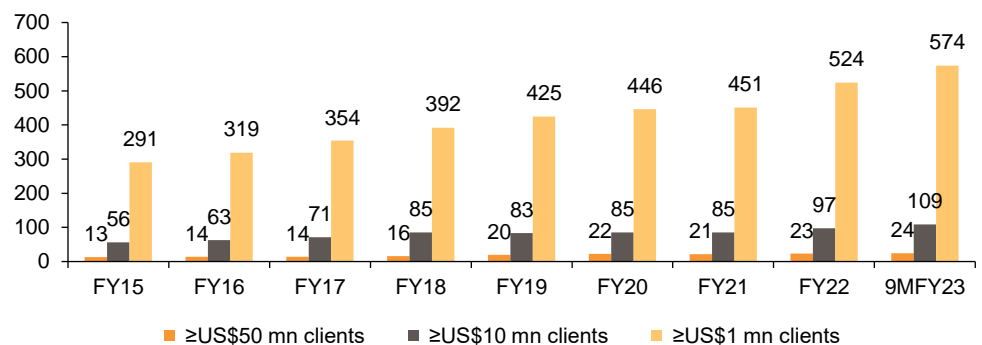
Source: Company, Emkay Research

Exhibit 2: Management is confident about margin expansion in the coming quarters



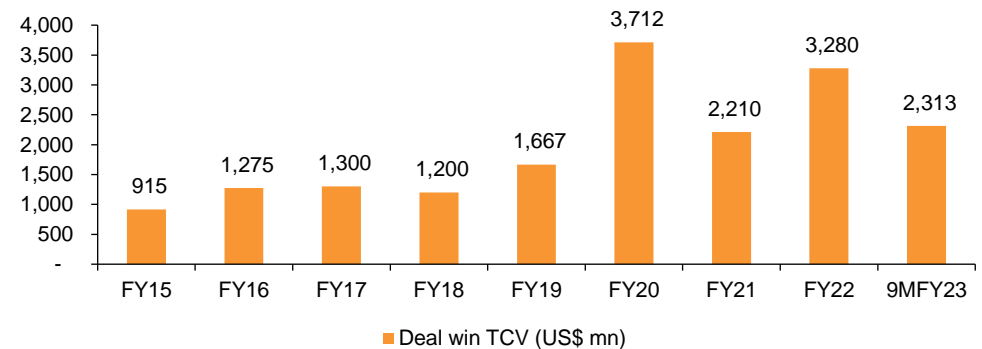
Source: Company, Emkay Research

Exhibit 3: Steady expansion in engagements with clients across buckets



Source: Company, Emkay Research

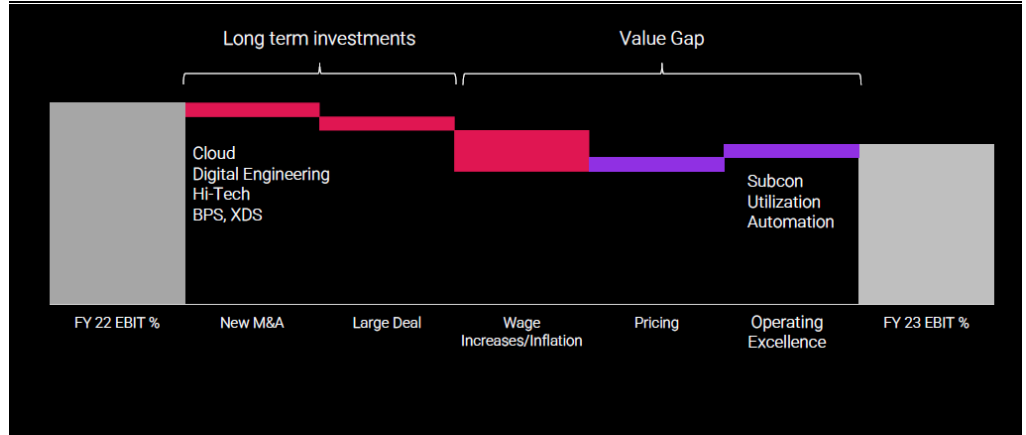
Exhibit 4: Deal wins momentum remains healthy



Source: Company, Emkay Research

Supply-side challenges and investments in capabilities impacted FY23 margins: TechM indicated that 1) long-term investments in building capabilities organically and via M&A in technologies such as cloud, digital engineering, hi-tech, BPS, and XDS coupled with a refresh in commercial and sales team should drive large deal engine; and 2) supply-side challenges leading to above-average wage increases/inflation dragged down margins in FY23. Management remains confident about margin expansion on account of the progress made on pyramid rationalization, offshoring shift, subcontracting costs optimization, portfolio pruning, synergy realization with portfolio companies, business and geo mix changes, SG&A leverage, and operational rigor although remained non-committal on the pace of improvement. The company suggested that the focus remains on driving organic growth, margin expansion, realizing portfolio synergy, and delivering consistent capital return.

Exhibit 5: Investments for long-term impacted margin in FY23



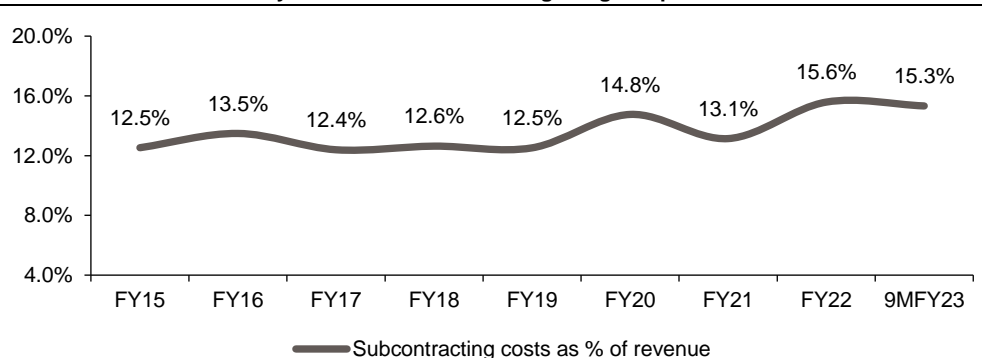
Source: Company, Emkay Research

Exhibit 6: Focused initiatives to aid margin expansion in the coming years



Source: Company, Emkay Research

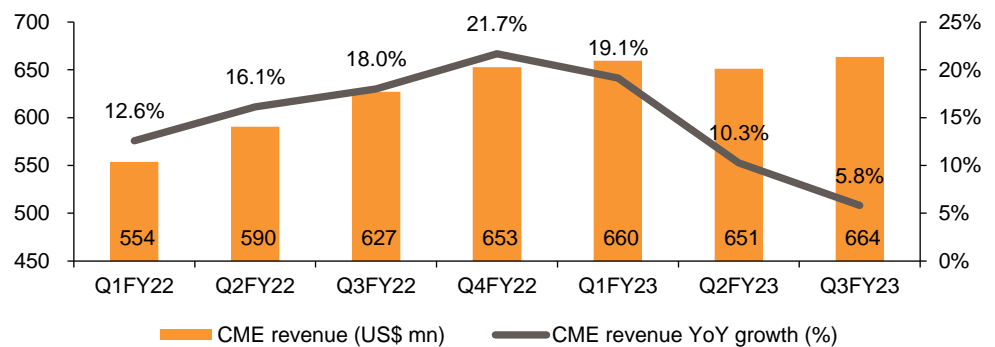
Exhibit 7: Subcon cost likely to trend downward aiding margin expansion



Source: Company, Emkay Research

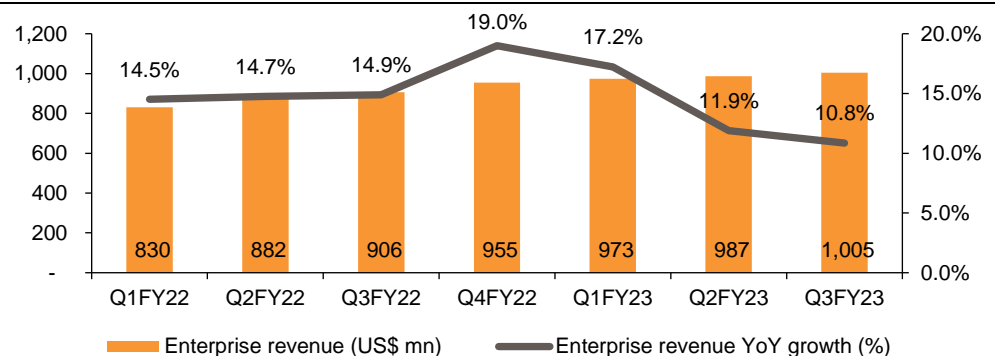
Expect broad-based growth across CME and enterprise business: TechM highlighted that the 5G revenue run rate in FY23 was ~USD1bn. TechM has a comprehensive growth strategy in place to capitalize on 5G opportunities, encompassing CSPs (CX, Network, and Digital OSS/BSS), enterprises (industry solutions, private networks, Edge intelligence), and Ecosystem (network platforms and device platforms) by leveraging products, platforms, people, and partnerships. CME delivered an 11%+ YoY growth and added 15 new logos in the past 12 months. Management indicated that M&E is seeing good traction and grew 2x YoY, albeit on a relatively smaller base and is expected to sustain this momentum. Revenue from the enterprise business stood at ~USD1bn in Q3FY23. Growth in FYTD23 was led by manufacturing (grew by 12%; 6 large deals; added 21 new logos), BFSI (grew by 16%; 6 large deals; added 28 new logos), hi-tech (grew by 34%; 7 large deals; added 19 new logos; among the top-5 GSI for Microsoft), and HLS (added 13 new logos). The company plans to scale up its partnership with top-10 partners and increase its revenue from partnerships to ~40% from ~30% currently. Management indicated that the revenue run rate in a couple of troubled top accounts is likely to bottom out in Q4. The company is witnessing increased cautiousness among clients, leading to a delay in decision-making, softness in discretionary spending, and overall tightness in spending amid macro uncertainties. Macro uncertainties and a cautious approach by clients are expected to weigh on near-term growth.

Exhibit 8: Weakness in a couple of large clients impacted CME growth; These accounts are likely to bottom out in Q4



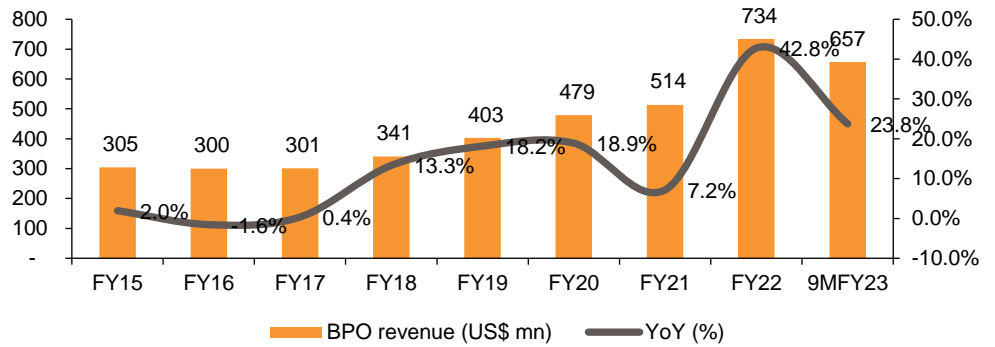
Source: Company, Emkay Research

Exhibit 9: Sustained revenue growth momentum in the enterprise segment



Source: Company, Emkay Research

Exhibit 10: BPO continues to drive the company's growth

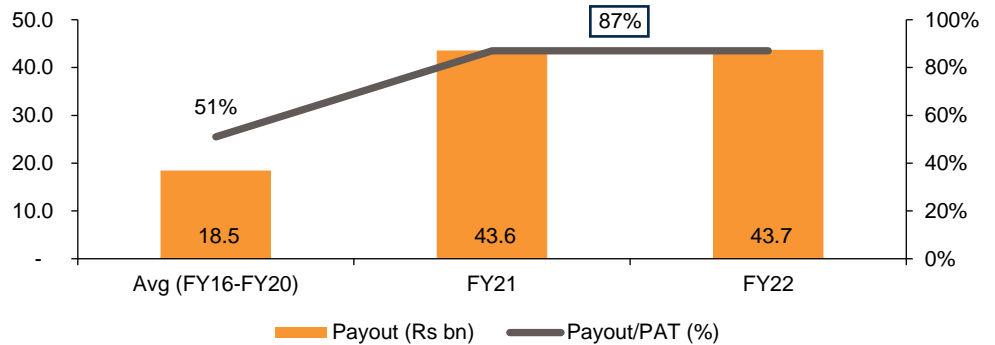


Source: Company, Emkay Research

Management laid out five key focus areas: The company expects execution focus on five areas by – 1) maintaining organic growth momentum, 2) closing the gap on operational excellence to improve productivity, efficiency, and margins, 3) improving the products and platforms business and next-gen technologies' big bets to drive revenue growth, 4) value creation from M&A, portfolio companies, and JVs, and 5) continuing to drive performance-led culture along with talent developments, engagements, and new inductions, all of which will drive sustainable strong operating performance.

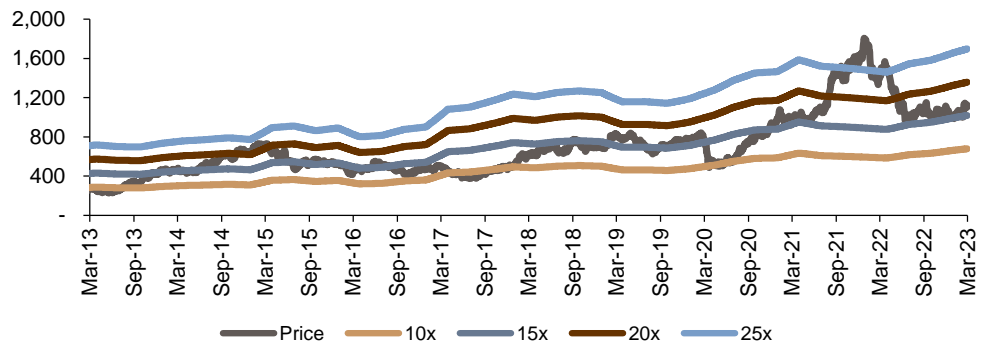
Increased focus on consistent capital allocation: TechM reiterated its capital return policy of distributing excess cash (FCF less the M&A) through a combination of dividends and buybacks. With M&A spending expected to be modest, a healthy capital allocation policy should follow. In FY21 and FY22, the company returned 75% of FCF, up from an average of 54% for FY16-FY20.

Exhibit 11: 75% of FCF returned to shareholders in FY21 and FY22



Source: Company, Emkay Research

Exhibit 12: TechM's one-year forward P/E chart



Source: Bloomberg, Company, Emkay Research

Key Financials (Consolidated)**Income Statement**

| Y/E March (Rs mn) | FY21 | FY22 | FY23E | FY24E | FY25E |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|
| Revenue | 378,551 | 446,460 | 532,878 | 577,397 | 640,318 |
| Expenditure | 310,080 | 366,260 | 449,891 | 479,749 | 529,520 |
| EBITDA | 68,471 | 80,200 | 82,987 | 97,649 | 110,798 |
| Depreciation | 15,084 | 15,204 | 19,609 | 20,159 | 21,079 |
| EBIT | 53,387 | 64,996 | 63,379 | 77,490 | 89,719 |
| Other Income | 6,131 | 9,497 | 5,441 | 4,733 | 4,941 |
| Interest expenses | 0 | 0 | 0 | 0 | 0 |
| PBT | 59,518 | 74,493 | 68,819 | 82,224 | 94,659 |
| Tax | 15,999 | 18,220 | 16,923 | 21,378 | 24,611 |
| Extraordinary Items | 0 | 0 | 0 | 0 | 0 |
| Minority Int./Income from Assoc. | (762) | 613 | 524 | 400 | 400 |
| Reported Net Income | 44,281 | 55,660 | 51,372 | 60,445 | 69,648 |
| Adjusted PAT | 44,281 | 55,660 | 51,372 | 60,445 | 69,648 |

Balance Sheet

| Y/E March (Rs mn) | FY21 | FY22 | FY23E | FY24E | FY25E |
|--|----------------|----------------|----------------|----------------|----------------|
| Equity share capital | 4,370 | 4,388 | 4,398 | 4,398 | 4,398 |
| Reserves & surplus | 244,280 | 264,469 | 278,032 | 294,500 | 313,575 |
| Net worth | 248,650 | 268,857 | 282,430 | 298,898 | 317,972 |
| Minority Interest | 3,795 | 4,954 | 4,954 | 4,954 | 4,954 |
| Loan Funds | 16,618 | 14,901 | 14,688 | 14,688 | 14,688 |
| Net deferred tax liability | (8,372) | (3,639) | (7,430) | (7,430) | (7,430) |
| Total Liabilities | 260,691 | 285,073 | 294,642 | 311,110 | 330,184 |
| Net block | 90,185 | 147,836 | 143,387 | 134,539 | 132,570 |
| Investment | 102,376 | 48,838 | 50,255 | 50,255 | 50,255 |
| Current Assets | 193,903 | 242,191 | 273,170 | 305,695 | 336,754 |
| Cash & bank balance | 28,352 | 39,745 | 40,201 | 56,443 | 64,488 |
| Other Current Assets | 0 | 0 | 0 | 0 | 0 |
| Current liabilities & Provision | 126,956 | 155,443 | 174,670 | 181,879 | 191,894 |
| Net current assets | 66,947 | 86,748 | 98,499 | 123,816 | 144,859 |
| Misc. exp. | 0 | 0 | 0 | 0 | 0 |
| Total Assets | 260,691 | 285,073 | 294,642 | 311,110 | 330,184 |

Cash Flow

| Y/E March (Rs mn) | FY21 | FY22 | FY23E | FY24E | FY25E |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| PBT (Ex-Other income) (NI+Dep) | 59,529 | 74,521 | 68,819 | 82,224 | 94,659 |
| Other Non-Cash items | 5,343 | 608 | (524) | (400) | (400) |
| Chg in working cap | 15,635 | (14,343) | (15,087) | (9,074) | (12,998) |
| Operating Cashflow | 80,938 | 52,853 | 55,894 | 71,530 | 77,728 |
| Capital expenditure | (17,065) | (54,241) | (16,009) | (11,310) | (19,110) |
| Free Cash Flow | 63,873 | (1,388) | 39,885 | 60,220 | 58,618 |
| Investments | (39,997) | 57,243 | (1,417) | 0 | 0 |
| Other Investing Cash Flow | 0 | 0 | 0 | 0 | 0 |
| Investing Cashflow | (54,501) | 4,815 | (17,426) | (11,310) | (19,110) |
| Equity Capital Raised | 1,257 | 1,175 | 10 | 0 | 0 |
| Loans Taken / (Repaid) | (11,743) | (6,802) | (213) | 0 | 0 |
| Dividend paid (incl. tax) | (17,594) | (39,808) | (37,809) | (43,977) | (50,574) |
| Other Financing Cash Flow | 0 | 0 | 0 | 0 | 0 |
| Financing Cashflow | (29,869) | (46,666) | (38,012) | (43,977) | (50,574) |
| Net chg. in cash | (3,432) | 11,002 | 456 | 16,242 | 8,045 |
| Opening cash position | 30,167 | 26,904 | 37,889 | 38,345 | 54,587 |
| Closing cash position | 28,352 | 39,745 | 40,201 | 56,443 | 64,488 |

Source: Company, Emkay Research

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Key Ratios

| Profitability (%) | FY21 | FY22 | FY23E | FY24E | FY25E |
|--------------------------|-------------|-------------|--------------|--------------|--------------|
| EBITDA Margin | 18.1 | 18.0 | 15.6 | 16.9 | 17.3 |
| EBIT Margin | 14.1 | 14.6 | 11.9 | 13.4 | 14.0 |
| Effective Tax Rate | 26.9 | 24.5 | 24.6 | 26.0 | 26.0 |
| Net Margin | 11.5 | 12.6 | 9.7 | 10.5 | 10.9 |
| ROCE | 23.9 | 27.3 | 23.7 | 27.1 | 29.5 |
| ROE | 19.0 | 21.5 | 18.6 | 20.8 | 22.6 |
| RoIC | 28.2 | 30.3 | 24.1 | 28.4 | 32.0 |

| Per Share Data (Rs) | FY21 | FY22 | FY23E | FY24E | FY25E |
|----------------------------|-------------|-------------|--------------|--------------|--------------|
| EPS | 50.7 | 63.4 | 58.4 | 68.7 | 79.2 |
| CEPS | 67.9 | 80.7 | 80.7 | 91.6 | 103.2 |
| BVPS | 284.5 | 306.4 | 321.1 | 339.8 | 361.5 |
| DPS | 45.0 | 45.0 | 43.0 | 50.0 | 57.5 |

| Valuations (x) | FY21 | FY22 | FY23E | FY24E | FY25E |
|-----------------------|-------------|-------------|--------------|--------------|--------------|
| PER | 21.4 | 17.1 | 18.6 | 15.8 | 13.7 |
| P/CEPS | 16.0 | 13.4 | 13.4 | 11.8 | 10.5 |
| P/BV | 3.8 | 3.5 | 3.4 | 3.2 | 3.0 |
| EV / Sales | 2.2 | 2.0 | 1.6 | 1.5 | 1.3 |
| EV / EBITDA | 12.2 | 11.0 | 10.6 | 8.8 | 7.7 |
| Dividend Yield (%) | 4.1 | 4.1 | 4.0 | 4.6 | 5.3 |

| Gearing Ratio (x) | FY21 | FY22 | FY23E | FY24E | FY25E |
|--------------------------|-------------|-------------|--------------|--------------|--------------|
| Net Debt/ Equity | (0.5) | (0.3) | (0.3) | (0.3) | (0.3) |
| Net Debt/EBIDTA | (1.7) | (0.9) | (0.9) | (0.9) | (0.9) |
| Working Cap Cycle (days) | 37.2 | 38.4 | 39.9 | 42.6 | 45.8 |

| Growth (%) | FY21 | FY22 | FY23E | FY24E | FY25E |
|-------------------|-------------|-------------|--------------|--------------|--------------|
| Revenue | 2.7 | 17.9 | 19.4 | 8.4 | 10.9 |
| EBITDA | 19.6 | 17.1 | 3.5 | 17.7 | 13.5 |
| EBIT | 31.4 | 21.7 | (2.5) | 22.3 | 15.8 |
| PAT | 9.8 | 25.7 | (7.7) | 17.7 | 15.2 |

| Quarterly (Rs mn) | Q3FY22 | Q4FY22 | Q1FY23 | Q2FY23 | Q3FY23 |
|--------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 114,508 | 121,163 | 127,079 | 131,295 | 137,346 |
| EBITDA | 20,600 | 20,884 | 18,801 | 19,841 | 21,440 |
| EBITDA Margin (%) | 18.0 | 17.2 | 14.8 | 15.1 | 15.6 |
| PAT | 13,684 | 15,056 | 11,316 | 12,854 | 12,966 |
| EPS (Rs) | 15.7 | 17.3 | 13.0 | 14.7 | 14.8 |

Source: Company, Emkay Research

| Shareholding Pattern (%) | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| Promoters | 35.7 | 35.3 | 35.2 | 35.2 | 35.2 |
| FII | 35.4 | 34.3 | 30.4 | 28.2 | 28.0 |
| DII | 17.2 | 18.1 | 20.7 | 23.8 | 23.9 |
| Public and Others | 11.8 | 12.4 | 13.6 | 12.8 | 12.9 |

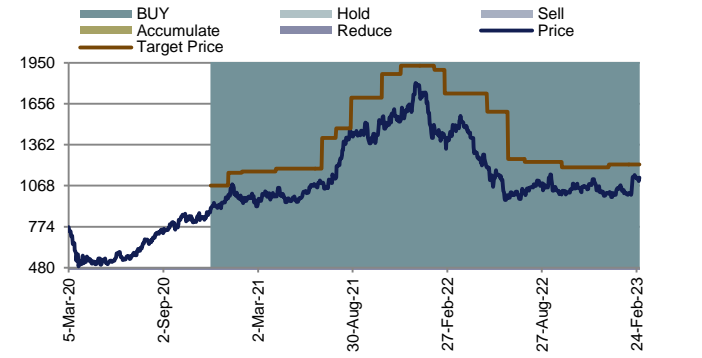
Source: Capitaline

RECOMMENDATION HISTORY TABLE

| Date | Closing Price | TP | Period (months) | Rating | Analyst |
|-----------|---------------|-------|-----------------|--------|-------------------|
| 30-Jan-23 | 1,036 | 1,220 | 12m | Buy | Dipeshkumar Mehta |
| 2-Jan-23 | 1,010 | 1,220 | 12m | Buy | Dipeshkumar Mehta |
| 2-Dec-22 | 1,115 | 1,200 | 12m | Buy | Dipeshkumar Mehta |
| 4-Oct-22 | 1,028 | 1,200 | 12m | Buy | Dipeshkumar Mehta |
| 25-Jul-22 | 1,017 | 1,240 | 12m | Buy | Dipeshkumar Mehta |
| 23-Jun-22 | 991 | 1,260 | 12m | Buy | Dipeshkumar Mehta |
| 14-May-22 | 1,203 | 1,600 | 12m | Buy | Dipeshkumar Mehta |
| 1-Apr-22 | 1,487 | 1,730 | 12m | Buy | Dipeshkumar Mehta |
| 22-Feb-22 | 1,413 | 1,730 | 12m | Buy | Dipeshkumar Mehta |
| 2-Feb-22 | 1,483 | 1,900 | 12m | Buy | Dipeshkumar Mehta |
| 18-Jan-22 | 1,661 | 1,930 | 12m | Buy | Dipeshkumar Mehta |
| 1-Jan-22 | 1,791 | 1,930 | 12m | Buy | Dipeshkumar Mehta |
| 30-Nov-21 | 1,541 | 1,930 | 12m | Buy | Dipeshkumar Mehta |
| 11-Nov-21 | 1,522 | 1,870 | 12m | Buy | Dipeshkumar Mehta |
| 25-Oct-21 | 1,524 | 1,870 | 12m | Buy | Dipeshkumar Mehta |
| 2-Oct-21 | 1,371 | 1,700 | 12m | Buy | Dipeshkumar Mehta |
| 27-Aug-21 | 1,445 | 1,700 | 12m | Buy | Dipeshkumar Mehta |
| 29-Jul-21 | 1,128 | 1,480 | 12m | Buy | Dipeshkumar Mehta |
| 2-Jul-21 | 1,089 | 1,410 | 12m | Buy | Dipeshkumar Mehta |
| 27-Apr-21 | 969 | 1,190 | 12m | Buy | Dipeshkumar Mehta |
| 5-Apr-21 | 998 | 1,190 | 12m | Buy | Dipeshkumar Mehta |
| 18-Mar-21 | 996 | 1,170 | 12m | Buy | Dipeshkumar Mehta |
| 15-Mar-21 | 1,027 | 1,170 | 12m | Buy | Dipeshkumar Mehta |
| 30-Jan-21 | 961 | 1,170 | 12m | Buy | Dipeshkumar Mehta |
| 4-Jan-21 | 1,002 | 1,160 | 12m | Buy | Dipeshkumar Mehta |
| 18-Dec-20 | 934 | 1,070 | 12m | Buy | Dipeshkumar Mehta |
| 1-Dec-20 | 907 | 1,070 | 12m | Buy | Dipeshkumar Mehta |

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

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