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3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey with check	Red
Right Quality (RQ)	Green	Grey	Red
Right Valuation (RV)	Green	Grey	Red
	+ Positive	= Neutral	- Negative

What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Green	↔	Green

ESG Disclosure Score NEW

ESG RISK RATING	11.65			
Updated Feb 08, 2023				
Low Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 1,05,699 cr
52-week high/low:	Rs. 1,575 / 944
NSE volume: (No of shares)	26 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	63.1 cr

Shareholding (%)

Promoters	35.2
FII	28.0
DII	23.7
Others	13.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.3	-2.6	2.7	-24.0
Relative to Sensex	9.0	2.3	1.0	-32.5

Sharekhan Research, Bloomberg

Tech Mahindra Ltd

Navigating the challenging macro, Maintain Buy

IT & ITes	Sharekhan code: TECHM		
Reco/View: Buy	↔	CMP: Rs. 1,085	Price Target: Rs. 1,220 ↔
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Tech Mahindra stated that although it was seeing some pause in decision-making by clients due to the ongoing near-term global macroeconomic challenges, demand for business transformation projects among enterprise customers is expected to continue.
- The company expects EBIT margins to improve in FY24 (hit in FY23 by M&A, large deals and wage hikes) driven by operational efficiency, large deals and business & geo-mix changes. However, the company expects to reach FY22 EBIT margin levels only by FY26.
- The company identified Products & Platforms and Co-creation with customers as new business streams that would witness higher investments and expects 2x revenues in the next 2-3 years. The management reflected a stable to healthy outlook on all verticals particularly with greater optimism on Hi-tech vertical.
- The outlook for FY24 is likely to be uncertain as highlighted by the company due to concerns of delays in decision making on account of global headwinds with possibility of a slow gradual recovery. However, we maintain Buy on the stock with an unchanged price target (PT) of Rs. 1,220 given the industry leading growth in BPS business, stable to healthy outlook on its verticals and scope for margin improvement. We advise investors to adopt a staggered approach to invest from a long-term perspective.

We attended Tech Mahindra's Investor Day 2023, wherein the management highlighted trends shaping future of IT services – Enterprise Tech Intensity, Cloud & Data Services, Emerging Technologies, Business Transformation and Partnerships. The management identified one of the areas of improvement from the above trends was to focus on alliances and partnership as the current revenues influenced by alliance and partners is currently at 30% versus the industry level of 40%. Hyperscalers, cloud and cybersecurity are focus areas needed to meet emerging trends. The company stated that although it was witnessing some pause in decision making by clients due to ongoing global macroeconomic challenges in the near term, demand for business transformation projects among enterprise customers is expected to continue. The company also stated that the outlook based on interaction with customers around the world was that Innovation, Digital and business transformation is still a huge conversation and corporates are expected to continue on that agenda. The company laid out internal framework with focus on execution through 1) Growth levers 2) Technology Bets 3) Operational rigour and 4) Catalyzing talent development. The company will invest Rs 500-700 crore in the newly carved out Products & Platforms unit over the next 2-3 years. The company believes that the unit can become a \$1-billion business in the same period. The management emphasized on co-creation with customers and show cased some use cases. The company stated that it would focus on organic growth, margin expansion and drive portfolio synergies while continuing on the capital allocation being followed. The outlook for FY24 is likely to be uncertain as highlighted by the company due to concerns of delays in decision making on account of global headwinds with possibility of slow gradual recovery. However, we maintain Buy rating on the stock with an unchanged price target (PT) of Rs. 1,220 given industry leading growth in BPS business, stable to healthy outlook on its verticals and scope for margin improvement. We advise investors to adopt a staggered approach to invest from long term perspective.

- New business streams - Products & platforms and Co-creation with customers:** Tech Mahindra will invest Rs 700 crore in its new division of products and platforms in the next two years. The company is present in the products and platforms business with the acquisition of Conviva and other offerings which are delivering an annual revenue run-rate of \$450 million. Product and platform business will be a key differentiator for the company and management expect 2x or more growth in three years. It will be getting people internally and hiring specialized talent with domain expertise from outside for the new division. The investments are not expected to be significant and will be made using its existing balance sheet strength. The investments will be in technology, which will involve research and development tools and creation of labs.
- Trends shaping future of IT services:** Management highlighted trends shaping future of IT services as Enterprise Tech Intensity, Cloud & Data Services, Emerging Technologies, Business Transformation and Partnerships. Management identified one of the areas of immediate improvement from among the above trends was to focus on alliances and partnership as the current revenues influenced by alliance and partners is currently 30% vs the industry level of 40%. Hyperscalers, cloud and cybersecurity are focus areas needed to meet the emerging trends.
- BPS business – Industry-leading growth momentum to continue:** The company has been delivering industry-leading growth for the last eight quarters in its BPS business. The company's BPS business generated revenue of \$235 million (up 8.7% q-o-q) in Q3FY2023. BPS has added \$700 million in TCV and still sees headroom for growth. There are three verticals within the BPS, which are above the \$100 million run rate mark. The management does not see any impact from chatGPT/Generative AI in the near term on BPS business..
- Investments for long-term impacting margins in near term:** The management highlighted the dip in margins in FY23 from FY22 was due to company's investments through inorganic route, large deals wins, and wage increases mitigated by pricing and operating excellence. The company's investments through the inorganic route for improving and integrating competencies for the long term has impacted margins in the near term due to accounting charges.
- Consistent capital allocation:** The management reiterated that any free cash flow generated minus the M&A would go back as capital returns to the shareholder. For FY22 and FY21 the payout as % of PAT was 87% compared to the average payout of 51% between FY16-20.

Our Call

Valuation – Navigating the challenging macro, maintain Buy: We expect the outlook for FY24 to be uncertain as highlighted by the company due to concerns of delays in decision making on account of global headwinds with possibility of slow gradual recovery. However, we maintain Buy rating on the stock with an unchanged price target (PT) of Rs. 1,220 given the industry leading growth in BPS business, stable to healthy outlook on its verticals and scope for margin improvement. 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)

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)	17.3	17.7	16.0	14.0
P/B (x)	3.5	3.2	2.9	2.6
EV/EBITDA (x)	12.2	11.1	9.4	7.8
RoNW (%)	21.5	19.1	19.2	20.0
RoCE (%)	23.3	20.4	20.8	22.0

Source: Company; Sharekhan estimates

- ◆ **Financial performance largely in line with communicated strategy:** The management highlighted that financials were in line with its communicated strategy barring EBIT margin, which saw a dip due to the near-term impact of integrating competencies due to M&A, large deals and wage increases. There has been a decent step-up in long-term performance on large deal TCVs, CQGR, FCF/PAT, payout ratio and ROCE rising 1.8x/2.4x/80bps/1.8x and 60 bps respectively in the last eight quarters up to Q3FY23 versus historical average between FY16-FY20.
- ◆ **Strategy & Execution:** The company identified 1) Organic growth 2) Margin expansion 3) Portfolio synergy and 4) Consistent capital returns as the way forward. The company expects to achieve organic growth from large deal wins, differentiated strategies, penetration deeper into accounts, changing investment patterns with higher investments in Product & platforms and co-investments with customers. For FY24, the company intends to expand spends in Product & platforms and Co-investments with customers while in FY23, the company had increased its spends toward new-age technologies and transformation initiatives. The company aims to achieve the FY22 EBIT margin level by FY26, through operational efficiency, large deals and business & geographical -mix changes. The management highlighted that M&A is the part of its growth strategy as it helps to enhance its capabilities to win more deals and through talent developments. The company would follow M&A strategy to acquire capabilities, gain access and scale up. The management indicated synergy as growth catalyst with \$1.2 billion synergy large deal wins and robust synergy pipeline of \$1 billion. The management reiterated that any free cash flow generated minus the M&A would go back as capital return to the shareholder.

Future of Digital Technology

- ◆ **Emerging trends in 2023:** These include - 1) Customer Experience (CX) to Human Experience (HX) 2) Hyper Personalization 3) Educative commerce 4) Immersive Journeys and 5) Data Sciences and Insights. CX to HX - Customer Experience (CX) is evolving to human centered purpose driven experience or Human centric. Hyper Personalisation- Customers are looking at the ability to adapt and change things for themselves. Educative commerce - educating customers through content creation to facilitate conversion. Immersive journeys - creating, displaying, and interacting with applications, content and experiences. Data Sciences & Insights- assisting in making informed decisions.
- ◆ **Company offerings in light of changing trends:** The company over the last year has written significant amount of new codes to create new solutions with inputs taken from markets and customers from customer advisory boards so as enable productive business outcomes. On cloud opportunity, the company is not only helping enterprises migrate, modernize and monetize across the cloud stack but also moving to industry cloud solutions. On AI, data AI and generative AI, the company has created its own suite of offering called AmplfAI that help deliver amplified business outcomes for customers. On generative AI, the company has created a platform that not only understands but also creates use cases across aspects of video, documents, images and explore business cases to improve productivity from 20-40%. The company is now looking at cyber-security market broadly versus enterprise cyber security. Cyber security is one area where the company has significantly scaled up with their partners. On Emerging technologies, the company is significantly investing in technologies like Metaverse, Blockchain and Quantum that enables enterprises to create use cases and then deploy them for scale.
- ◆ **Trend in BPS:** The Management highlighted its leadership in CX and smart diversification of portfolio and indicated use of new technologies like metaverse and generative AI, customers moving contact centers on to Cloud and customers looking at engaging in dedicated partnerships and sees these trends to continue in the future.

- ◆ **Market potential of ESG offering:** ESG consulting services spends is expected to be \$43.2 billion by 2026. The annual cost of adapting to the climate crisis for developing countries is expected to be \$160-\$340 billion.
- ◆ **Impact of 5G on markets, business and growth strategy:** Based on the conversations with several CXOs the management highlighted that with respect to network the customers are looking at three areas 1) Simplify 2) Modernize and 3) Monetise. The customers require simplifying the network due to the complexities built in over the years, modernization of full technology stack and ways to monetize their investments in 5G. Apart from the better experience through 5G the customers want to identify new revenues from their investments in 5G. The CXOs are looking at unlocking the value of their network assets. The company has been working on similar themes of simplifying the network, making it more automated and less people centric and are working at providing their customers with use-cases to enable them to monetize their investments in network/ 5G.

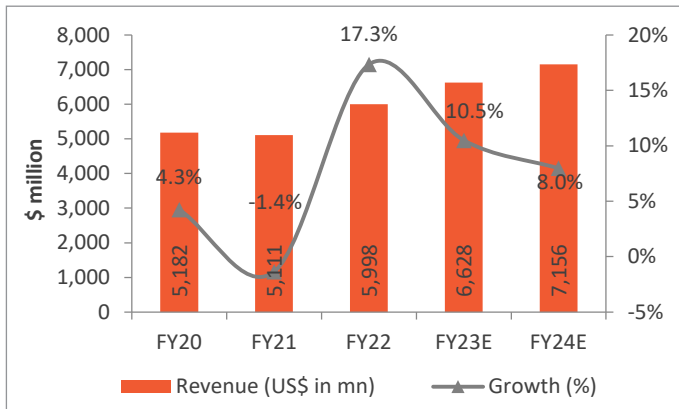
Stable to healthy outlook on verticals

The company stated that it is focused on 4+1 strategy (CME, Manufacturing, BFSI, Hi-tech+ Healthcare)

- ◆ **CME:** The CME vertical, accounts for 41% of revenues, reported stable growth on the back of the increasing contribution of 5G. CME revenues grew by ~11% y-o-y with 2x y-o-y in media and Entertainment. 5G revenues are expected to be around \$1 billion for FY23E. The company reported 15% growth in deal TCVs. The company would follow the strategy to simplify, modernize and monetise.
- ◆ **Hi-tech – On a strong growth trajectory:** Hi-tech has been the fastest growing vertical growing at 34% y-o-y. The company added 19 new logos and had 7 large deals in FY23. Within Hitech the management highlighted the 3 subsets 1) Semicon 2) Software OEM 3) Hardware vendors. On continuity of high growth, the management stated they have invested considerable energy and effort in bringing a 360-degree partnership, with one of their largest customer and hyperscalers 2) forefront of joint development with most of their key customers 3) traction with key partner status with 3 biggest customers in Hi-tech 4) High value added work from acquisitions done in the last 24 months in areas of semicon, semicon engineering, semicon ecosystem and gaming.
- ◆ **Manufacturing:** In the past year, the vertical grew 12% y-o-y, had 6 large deals and added 21 new logos. In the last one year Management stated that the quality of revenue has improved significantly, have grown chip to cloud revenue at healthy rate and large deal win rate has improved. In terms of positioning for future the management highlighted three areas 1) EV and Electrification (chip to cloud) 2) Industry 4.0 and resilient supply chain and 3) Sustainability.
- ◆ **BFSI:** The BFSI vertical has grown at 16% over last year. The vertical had 6 large deal wins in FY23 and added 28 new verticals and 20+ next gen Ips. The management stated that the reason they were able to show growth in the last three years despite being crowded market place was due to the focus on specific segments digital adoption, focused industry solutions on digital adoptions and digital channels.
- ◆ **Healthcare:** The vertical has added 13 new logos in FY23. The Management highlighted three areas of growth which they are aggressively looking at for the next twelve to eighteen months through 1) Electronic medical records (EMRs) and electronic health records (EHRs) transformation 2) Modernizing the core tech and 3) Using experience design services to transform and alleviate patient experience.

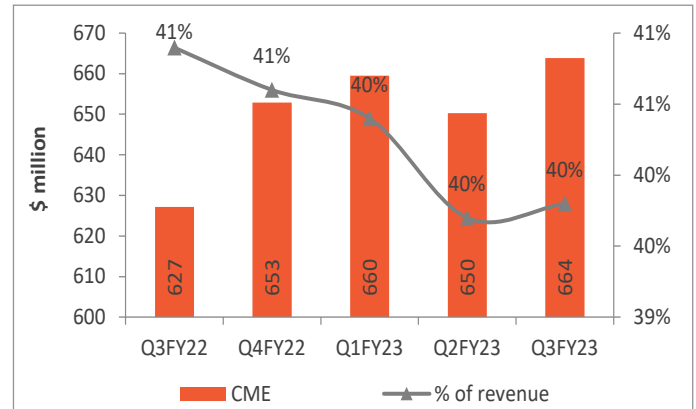
Financials in charts

Revenue (\$ million) and growth (%)



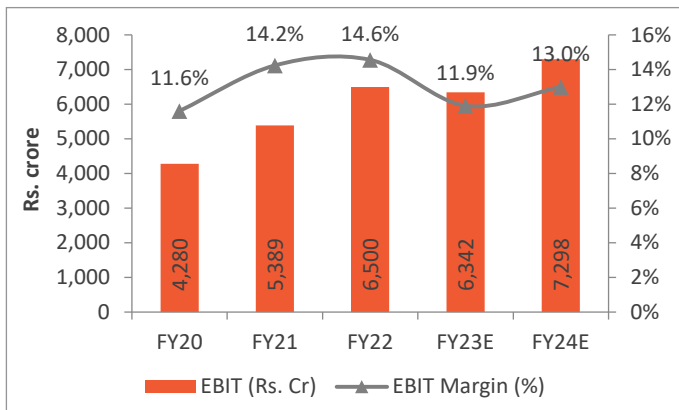
Source: Company, Sharekhan Research

Communication (\$ million) & % of total revenue



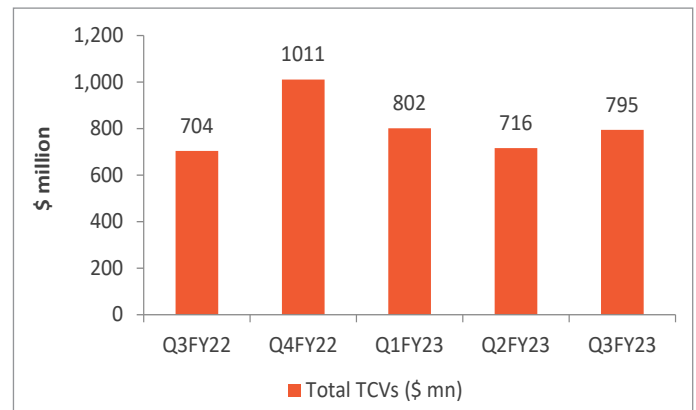
Source: Company, Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



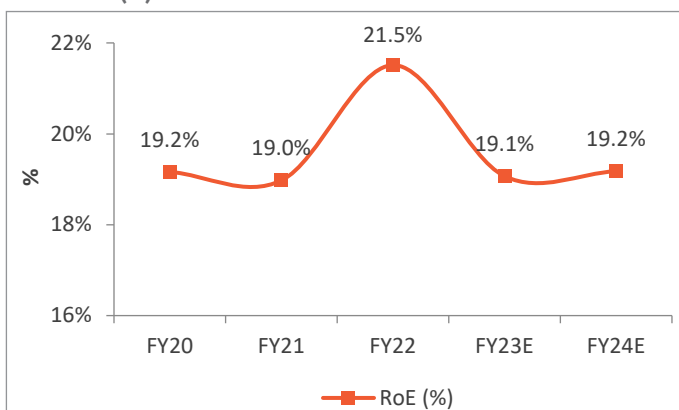
Source: Company, Sharekhan Research

Order book (\$ million)



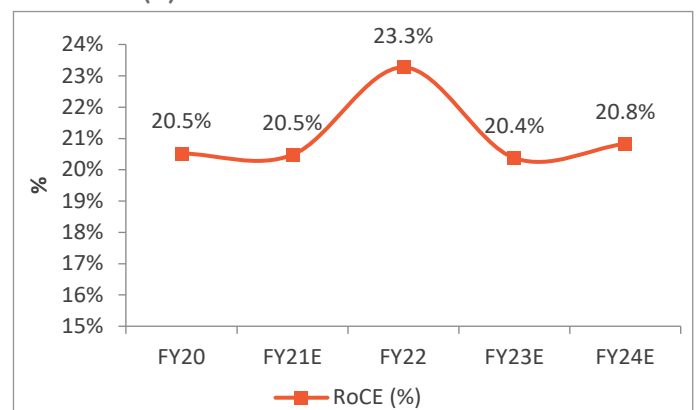
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE 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 among others) to develop an ecosystem.

■ Valuation - Navigating the challenging macro, maintain Buy

The outlook for FY24 is likely to be uncertain as highlighted by the company due to concerns of delays in decision making on account of global headwinds with possibility of slow gradual recovery. However, we maintain Buy rating on the stock with an unchanged price target (PT) of Rs. 1,220 given the industry leading growth in BPS business, stable to healthy outlook on its verticals and scope for margin improvement. 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

- ◆ 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.

Additional Data

Key management personnel

Mr. Anand Mahindra	Chairman
CP Gurnani	Managing Director and Chief Executive Officer
Rohit Anand	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

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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 deteriorating 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

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