Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Tech Mahindra Ltd

Weak Q4, Downgrade to Hold

IT & ITeS	Sharekhan code: TECHM
Reco/View: Hold ↓	CMP: **Rs. 1,004** / Price Target: **Rs. 1,100** ↓

↑ 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 Feb 08, 2023

Low Risk

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

Source: Morningstar

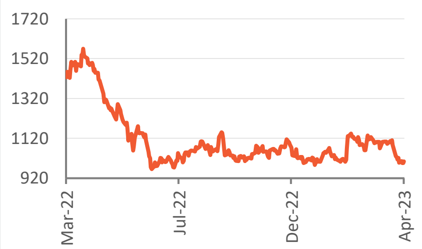
Company details

Market cap:	Rs. 97825 cr
52-week high/low:	Rs. 1,297 / 944
NSE volume: (No of shares)	25.42 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	63.1 cr

Shareholding (%)

Promoters	35.2
FII	26.9
DII	25.7
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.2	-2.5	-	-20.9
Relative to Sensex	-11.4	-4.7	-	-26.3

Sharekhan Research, Bloomberg

Summary

- Tech Mahindra reported revenue of $1667.6 million with constant currency (cc) revenue growth of 0.3% q-o-q beating our estimates of -0.2% cc revenue growth owing to muted growth across verticals.
- EBIT margin fell to 11.2%, down ~80 bps q-o-q, missed our estimates of 11.9% due to currency impact (60bps) and SG&A (90bps) offset by subcon reduction (70bps) Deal wins fell sharply with net new deal TCVs at $592 million, down 25.5% q-o-q.
- Management anticipates a cautious H1FY23 and expects better H2FY23. Company cited that they are witnessing delays in decision making with discretionary spending undergoing added lengths of evaluation.
- We downgrade Tech Mahindra to Hold with revised PT of Rs. 1100 as earnings outlook remains at risk given tepid outlook for H1FY24 on global macro headwinds and advise investors to wait for a better entry point. At CMP, the stock trades at 15.6x/13.3x FY24E/FY25E EPS.

Tech Mahindra reported a revenue of $1667.6 million on a constant currency (cc) basis, that rose 0.3% q-o-q. This beat our estimates of -0.2% CC revenue growth owing to muted growth across verticals. Revenue in rupee terms stood at Rs 13,718.2 crore down 0.1% q-o-q/up 13.2% y-o-y, missing our estimates of Rs 13,802.4 crore. EBIT margin fell to 11.2%, down 82 bps q-o-q and was also below our estimates of 11.9%. Adjusted PAT (excluding impairment) fell by 11.6% y-o-y to Rs 1330.4 crore. The company reported a PAT of Rs 1117.8 crore. Net new deal wins(TCV) dropped to $592 million in Q4FY23 Vs $795 million in Q3FY23. Manufacturing/CME verticals grew 1.2%/ 0.7% while Technology and BFSI reported flat growth. A sharp dip of 10.4% q-o-q was seen in the retail, transport and logistics verticals. LTM Attrition fell 200 bps q-o-q to 15% in Q4FY23. Net additions fell by 4668 taking the total headcount to 1,52,400. The management anticipates a cautious H1FY23 and expects better H2FY23. The company is seeing delays in decision making with discretionary spending undergoing added lengths of evaluation. We downgrade Tech Mahindra to Hold with revised PT of Rs 1100 as earnings outlook remains at risk given tepid outlook for H1FY24 on global macro headwinds and advise investors to wait for a better entry point. At CMP, the stock trades at 15.6x/13.3x FY24E/FY25E EPS.

Key positives

- LTM attrition moderated to 15% in Q4FY23 down 200 bps q-o-q.
- Number of active clients improved to 1297 from 1290 in Q3FY23
- DSO days dropped to 96 days in Q4FY23 from 98 days in Q3FY2023.

Key negatives

- Net new deal TCV at $ 592 million in Q4FY23 versus $795 million in Q3FY23, down 25.5% q-o-q
- Sharp decline in net additions by 4668 employees taking total headcount to 1,52,400

Management Commentary

- The management indicated that there are 4-5 levers for margin improvement such as subcon, offshoring rates, pyramid rationalization and stated that would look to divest some non-profitable business. The management also stated some of their large deals are maturing and are anticipating margin improvement from there as well. However, the company would drive the margin action irrespective of macro environment.
- Management shared that the macro would be cautious during the first half and get better in the second half. The management stated that the deal pipeline continues to remain robust with modernization and operational efficiency initiatives continuing. However, the company cited that the discretionary expenditure is undergoing through added length of evaluations.

Revision in estimates – We have revised our estimates for FY24/25 owing to macro-overhang.

Our Call

Valuation – Weak Q4, Downgrade to Hold: We downgrade Tech Mahindra to Hold with revised PT of Rs 1100 as earnings outlook remains at risk given tepid outlook for H1FY24 on global macro headwinds and advise investors to wait for better entry point. We expect 7.8%/12.4% Sales and PAT CAGR over FY23-25E. We believe that likely joining of the new MD & CEO will provide earnings clarity for H2FY24 but at the same time we expect more attrition at mid-level. At CMP, the stock trades at 15.6x/13.3x FY24E/FY25E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. Contagion effect of banking crisis, macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	44,646.0	53,290.2	55,576.0	61,884.8
OPM (%)	18.0	15.1	16.3	17.1
Adjusted PAT	5,566.1	5,249.3	5,667.8	6,633.7
% YoY growth	24.3	-5.7	8.0	17.0
Adjusted EPS (Rs.)	62.8	59.7	64.4	75.4
P/E (x)	16.0	16.8	15.6	13.3
P/B (x)	3.2	3.1	2.8	2.6
EV/EBITDA (x)	11.2	11.3	9.2	7.5
RoNW (%)	21.5	19.2	19.3	20.5
RoCE (%)	23.3	20.5	21.4	22.9

Source: Company; Sharekhan estimates

Key result highlights from earnings call

- **Revenue growth muted:** Tech Mahindra reported revenue of $1667.6 million with constant currency (cc) revenue growth of 0.3% q-o-q beating our estimates of -0.2% cc revenue growth. Revenue in rupee terms stood at Rs. 13,718.2 crore down 0.1% q-o-q/up 13.2% y-o-y missing with our estimates of Rs. 13,802.4 crore. Manufacturing/CME verticals grew 1.2%/ 0.7% while Technology and BFSI reported flat growth. Sharp dip was seen in retail, transport & logistics down 10.4% q-o-q. Europe grew 3.7% q-o-q while America and RoW regions reported a decline of 0.2% and 3.1% q-o-q respectively.
- **SG&A expenses and subcontracting costs:** SG&A expenses in Q4FY23 expanded sharply by 8.5% sequentially to Rs. 1,949.3 crore due to investments from longer term perspectives and some year end costs. The company views SG&A to be around 13.5% and should normalise going forward. Sub-contracting costs moderated to 1935.8 crore at 14.1% of its revenue in Q4FY2023.
- **Deal wins:** Deals wins plunged with net new deal TCV at $592 million versus $795 million in Q3FY23, down 25.5% y-o-y.
- **Margin levers:** The management stated that margin improvement for FY24 would be based on levers of reduction of sub-contracting expenses, focus on driving offshore, divesting of non-strategic portfolios companies and pyramid rationalisation.
- **Net additions fell while LTM attrition rate moderated:** For Q4FY23, there was a sharp decline in net additions by 4668 employees, taking total headcount to 1,52400 chiefly attributable to BPO professional which declined by 3466 employees. LTM attrition rate moderated by 200 bps q-o-q to 15% in Q4FY23
- **Weak growth in top accounts:** Revenue from top-5/top-10 declined by 5.6% q-o-q/ 3.7% q-o-q respectively while revenue from Top -20 was flat q-o-q.
- **Cash generation:** FCF stood at $142 million with FCF cash flow to PAT at 104% vs 19.9% in Q3FY23. Full year FCF/PAT at 84%. Cash & cash equivalents improved to Rs 7435.1 crore in Q4FY2023 compared to Rs 6449.4 Crore in Q3FY23.
- **DSO days improved:** DSO days dropped to 96 days in Q4FY23 from 98 days in Q3FY2023.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	Y-o-Y %	Q3FY23	Q-o-Q %
Revenues In USD (mn)	**1,667.6**	**1,608.1**	**3.7**	**1,668.0**	**0.0**
Revenues In INR	**13,718.2**	**12,116.3**	**13.2**	**13,734.6**	**-0.1**
Cost of Services	9,748.2	8,560.3	13.9	9,793.7	-0.5
Gross profit	**3,970.0**	**3,555.9**	**11.6**	**3,940.9**	**0.7**
SG&A	1,949.3	1,467.6	32.8	1,796.9	8.5
EBITDA	**2,020.7**	**2,088.4**	**-3.2**	**2,144.0**	**-5.8**
Depreciation	490.2	484.2	1.2	498.1	-1.6
EBIT	**1,530.5**	**1,604.1**	**-4.6**	**1,645.9**	**-7.0**
Other Income	305.5	319.8	-4.5	247.2	23.6
PBT	**1,742.6**	**1,868.7**	**-6.7**	**1,780.2**	**-2.1**
Provision for taxes	399.9	328.0	21.9	485.9	-17.7
Adjusted net profit	**1,330.4**	**1,505.6**	**-11.6**	**1,296.6**	**2.6**
Non Recurring / Exceptional Items	-212.6	0.0	-	0.0	-
Reported net profit	**1,117.8**	**1,505.6**	**-25.8**	**1,296.6**	**-13.8**
EPS (Rs) Excl Treasury Shares	12.6	16.9	-25.5	14.6	-13.8
Margin (%)			**BPS**		**BPS**
EBITDA Margins	14.7	17.2	-251	15.6	-88
EBIT Margin	11.2	13.2	-208	12.0	-83
PAT Margin	11.2	12.4	-118	9.4	181
Tax rate	22.9	17.6	540	27.3	-435

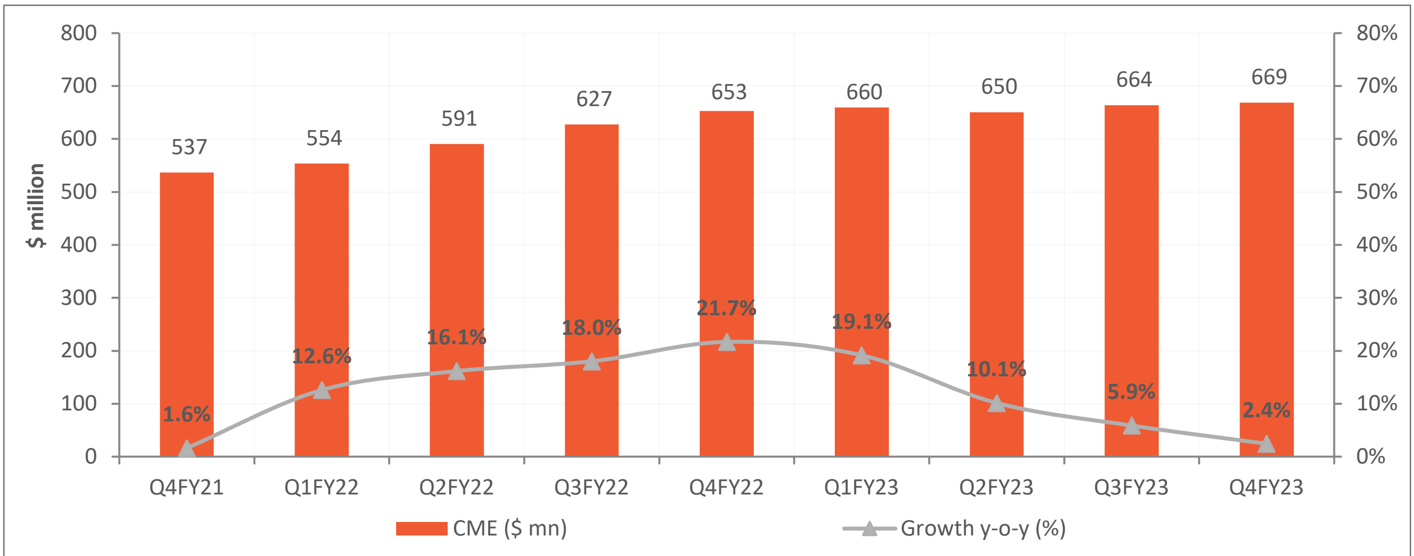
Source: Company; Sharekhan Research

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

Particulars	Revenues	Contribution	$ Growth (%)	
	($ mn)	(%)	Q-o-Q %	Y-o-Y %
Revenues ($ mn)	1,668	100	0.0	3.7
Geographic mix				
America	827	49.6	-0.2	6.5
Europe	422	25.3	3.7	-0.6
RoW	419	25.1	-3.1	2.9
Industry verticals				
CME	669	40.1	0.7	2.4
Manufacturing	265	15.9	1.2	10.7
Technology	172	10.3	0.0	14.8
BFSI	265	15.9	0.0	-5.2
Retail, transpost and logistics	127	7.6	-10.6	3.7
Others	170	10.2	3.0	3.7
Clients contribution				
Top 5	283	17.0	-5.6	-20.2
Top 10	434	26.0	-3.7	-13.6
Top 20	667	40.0	0.0	-2.9
Revenue by services		**(%)**	**q-o-q**	**y-o-y**
IT	1,434	86.0	0.0	1.9
BPO	234	14.0	-0.7	15.3

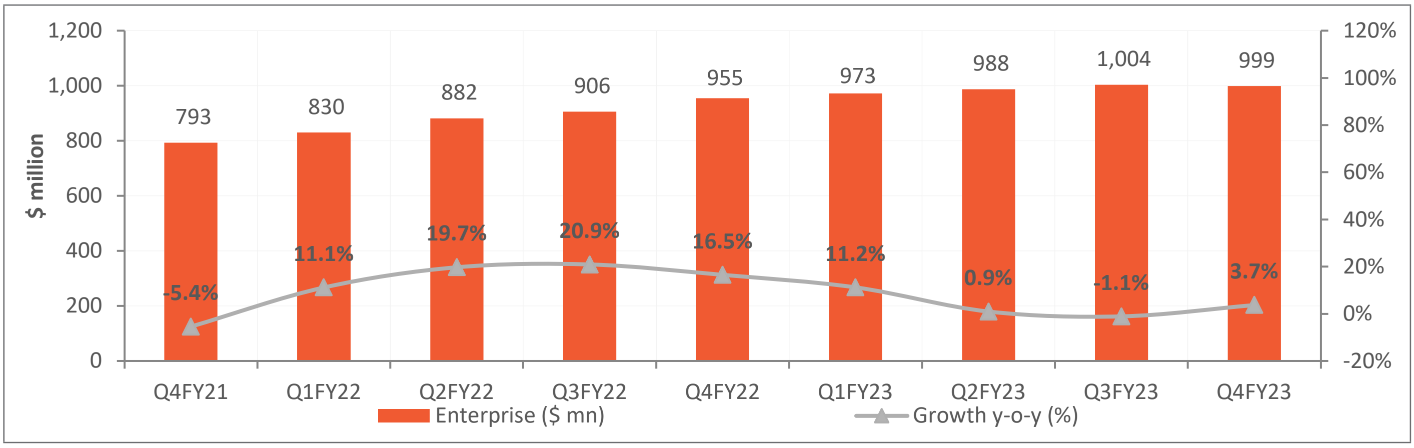
Source: Company; Sharekhan Research

CME vertical revenue growth trend



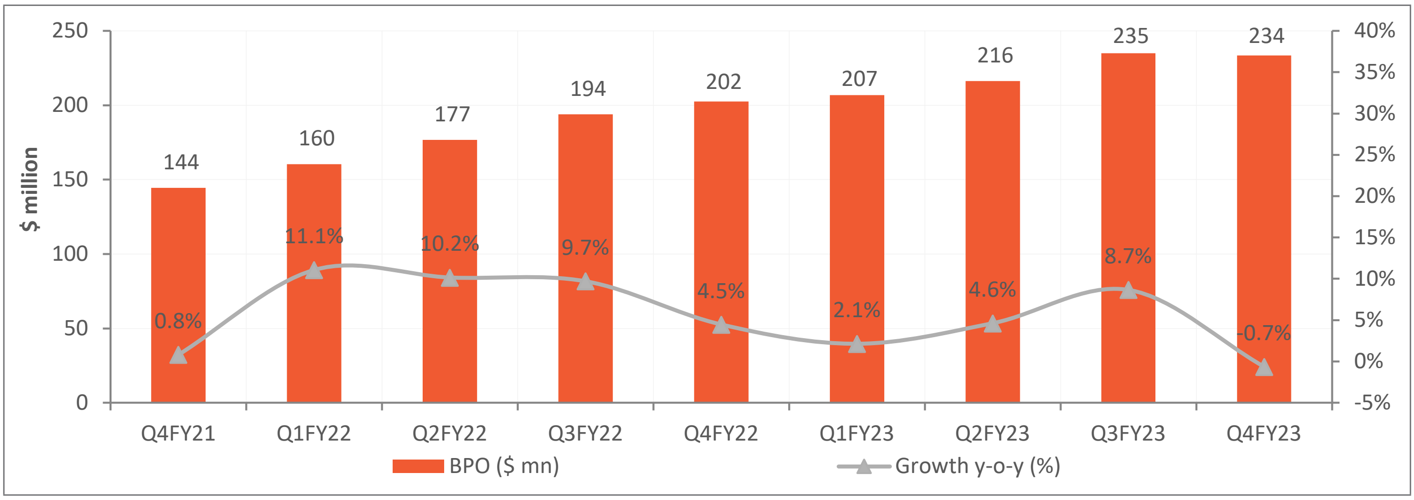
Source: Sharekhan Research

Enterprise vertical revenue growth trend



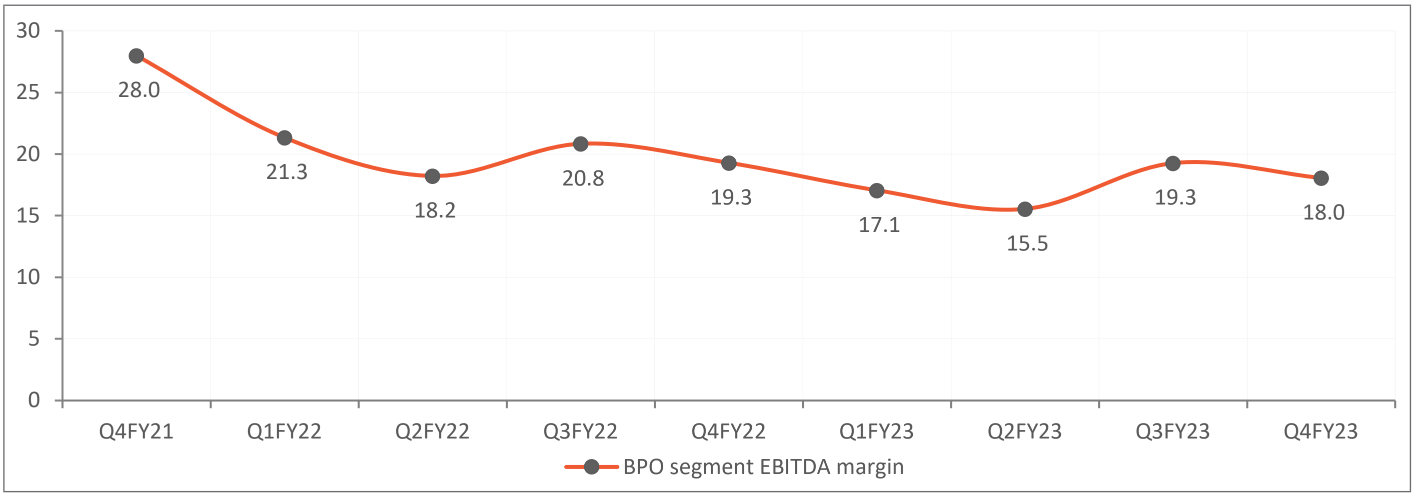
Source: Sharekhan Research

BPO revenue growth trend



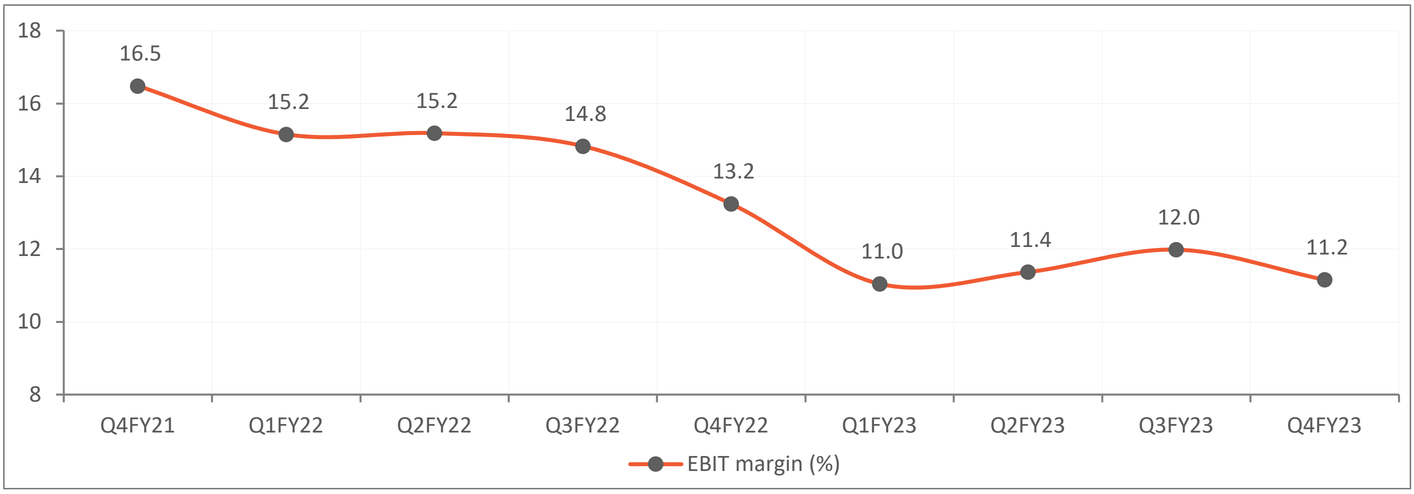
Source: Sharekhan Research

BPO segment's EBITDA margin trend



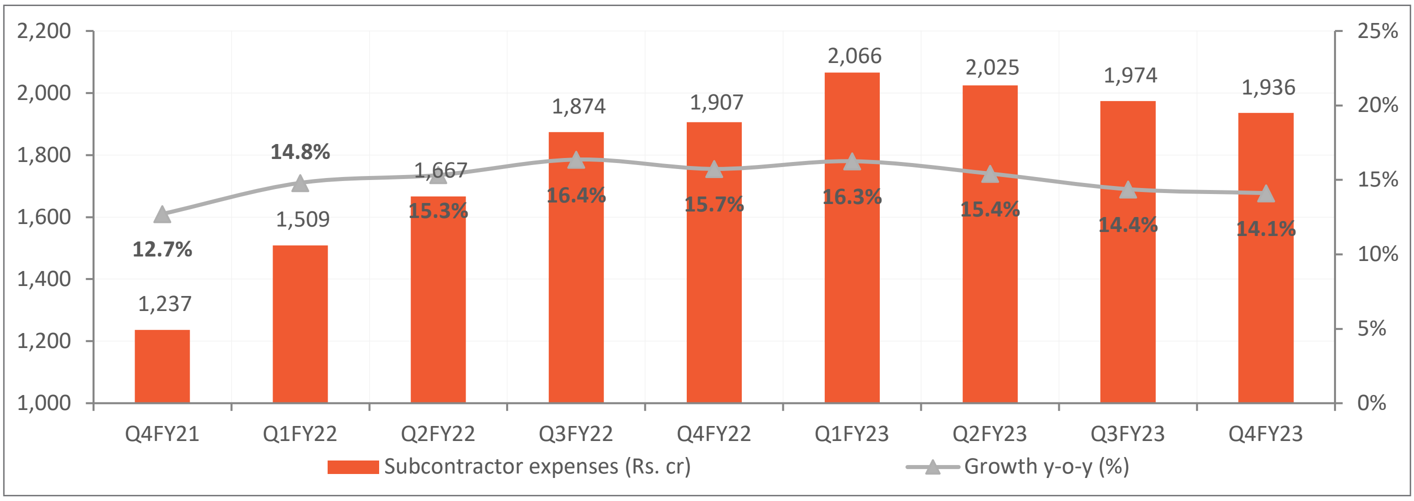
Source: Sharekhan Research

Tech M's EBIT margin trend



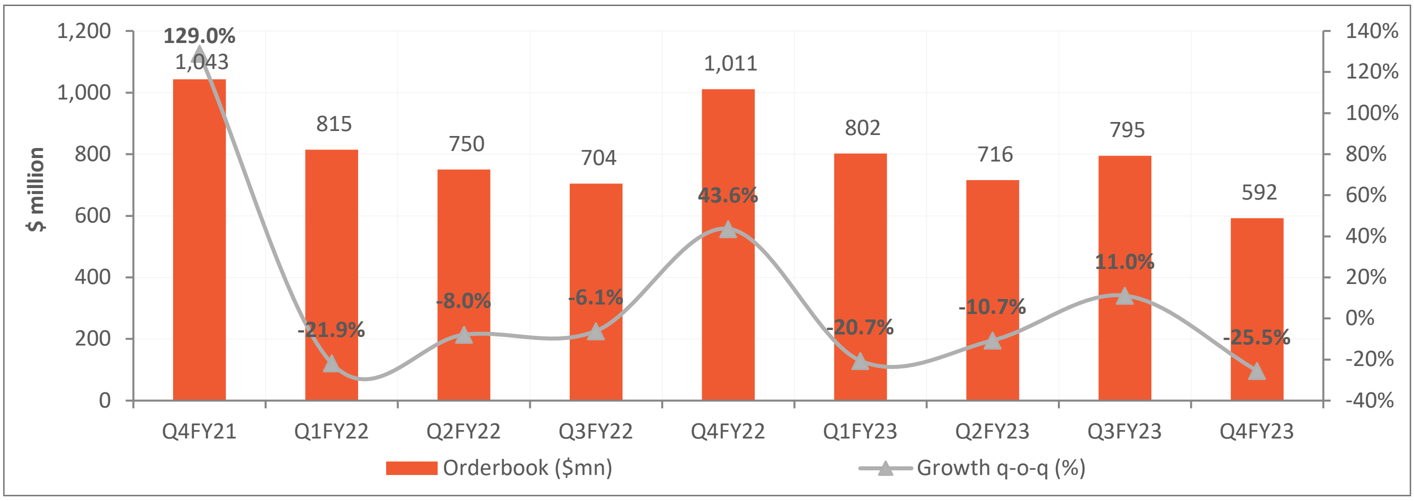
Source: Sharekhan Research

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



Source: Sharekhan Research

New deal win TCV trend



Source: 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.

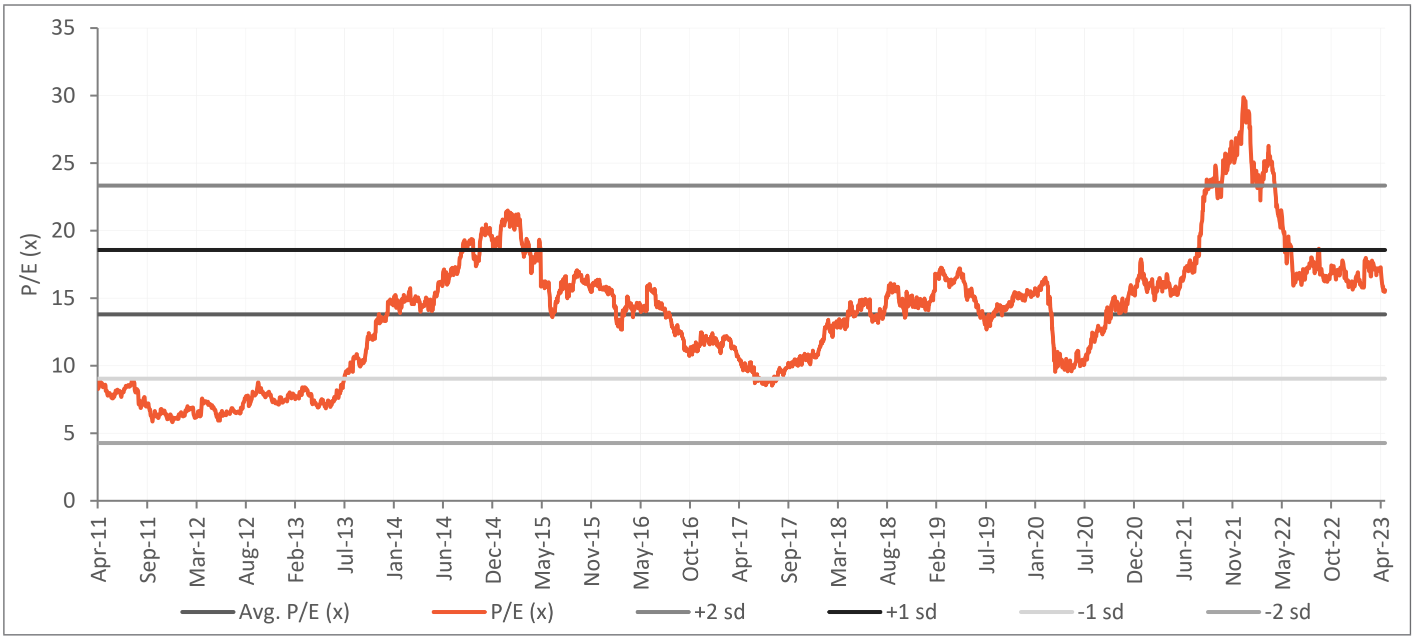
■ **Company Outlook – Well-placed to capture 5G opportunity.**

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 – Weak Q4, Downgrade to Hold**

We downgrade Tech Mahindra to Hold with revised PT of Rs 1100 as earnings outlook remains at risk given a tepid outlook for H1FY24 on global macro headwinds and advise investors to wait for better entry point. We expect a 7.8%/12.4% sales and PAT CAGR over FY23-25E. We believe that likely joining of the new MD & CEO will provide earnings clarity for H2FY24 but at the same time, we expect more attrition at mid-level. At CMP, the stock trades at 15.6x/13.3x FY24E/FY25E EPS.

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, 2) Contagion effect of banking crisis, 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.07
2	SBI Funds Management Ltd	4.27
3	First State Investments ICVC	2.81
4	Vanguard Group Inc/The	2.46
5	BlackRock Inc	2.34
6	Mitsubishi UFJ Financial Group Inc	2.31
7	ICICI Prudential Asset Management	2.28
8	GOVERNMENT PENSION FUND - GLOBAL	2.05
9	Norges Bank	2.01
10	HDFC Asset Management Co Ltd	1.24

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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