

BUY Tech Mahindra

ASIAMONEY BROKERS POLL - 2023

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An all-round miss; execution remains key

Information Technology ▶ Result Update ▶ July 27, 2023

TARGET PRICE (Rs): 1,200

TechM's revenue slumped 4% QoQ (4.2% CC) to USD1.6bn, missing our estimates. EBITM declined by 440bps QoQ to 6.8%, well below our estimate even after adjusting for one-offs. The sharp decline in CME (-9.4% QoQ), owing to cut in discretionary spending and closure of network services projects, largely explains the revenue miss. Deal wins remain weak, and stand at USD359mn (TTM deal-intake down ~25% YoY). Mgmt attributed the weak performance to cut in discretionary spend/delay in decision making amid macro uncertainties. It expects performance to recover in H2. We cut FY24E EPS by ~17%, factoring-in a weak Q1 and near-term uncertainty, while lowering FY25-26E EPS by <2%, in anticipation of demand improvement/better execution. TechM has failed to capitalize on its strength in the areas of communications, ER&D, BPO, XDS, etc, and deliver consistent performance in the past. We believe leadership change gives more credence to turnaround efforts, entailing better execution, sustainable margin expansion and scaling of BFSI & other verticals (ex-CME). We retain BUY; TP: Rs1,200, at 16x Jun-25E EPS.

Tech Mahindra: Financial Snapshot (Consolidated)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	446,460	532,902	530,325	588,614	648,566
EBITDA	80,200	80,288	71,241	99,457	111,126
Adj. PAT	55,660	48,313	41,159	62,370	71,200
Adj. EPS (Rs)	63.4	54.9	46.7	70.8	80.9
EBITDA margin (%)	18.0	15.1	13.4	16.9	17.1
EBITDA growth (%)	17.1	0.1	(11.3)	39.6	11.7
Adj. EPS growth (%)	25.2	(13.4)	(14.9)	51.5	14.2
RoE (%)	21.5	18.5	14.5	20.9	22.4
RoIC (%)	30.3	22.8	18.4	28.5	32.2
P/E (x)	18.0	20.8	24.5	16.1	14.1
EV/EBITDA (x)	11.6	11.8	13.1	9.2	8.1
P/B (x)	3.7	3.6	3.5	3.3	3.1
FCFF yield (%)	4.8	4.9	4.7	6.8	7.7

Source: Company, Emkay Research

Results Summary

Q1FY24 revenue declined 4% QoQ (4.2% in cc terms) to USD1.6bn, lower than our estimate. The revenue decline was led by sharp fall of 9.4% QoQ in CME. Within enterprises, BFSI declined 3.2% QoQ, while Retail, Transportation & Logistics and 'others' also saw a marginal decline. Manufacturing and Technology reported an uptick of 1.8% and 0.1% QoQ, respectively. Revenue from Europe, ROW and Americas fell 6.7%, 8.2% and 0.5% QoQ, respectively. EBITM declined by 440bps QoQ to 6.8%, on account of one-time provision pertaining to client-specific bankruptcy (-200bps), weak revenue performance (-200bps), and Comviva seasonality (around -40bps). IT Services segment margin contracted by 510bps QoQ to 9.1%, while BPO segment margin reduced by 170bps QoQ to 16.3%. Net new-deal wins for Q1FY24 clocked at USD359mn, down by 39% QoQ. Headcount declined for the third straight quarter, down 4,103 QoQ in Q1FY24 (~10% decline in the last 3 quarters). Utilization further improved to 87.2%, from 86.5% in Q4FY23. **What we liked:** Added reduction in attrition (12.8% in Q1 vs 14.8% QoQ), healthy cash conversion (~79% OCF/EBITDA in Q1). **What we did not like:** Weak operating performance with miss on revenue and EBITM, lesser new-deal wins.

Earnings Call KTAs

i) Q1FY24 operating performance was impacted by some transformational projects coming to an end, one client filing for bankruptcy, and Company failing to balance revenue and costs within a shorter time-frame. ii) Management believes that most headwinds for the CME business are behind, and expects gradual recovery, as telcos are cautiously spending on capex and opex. Budgetary pressures on discretionary spending impacted performance of the verticals. iii) Offshoring, pyramid rationalization, subcon optimization, recovery in revenue growth, and divestment of the non-core portfolio remain the medium-to-long-term margin levers. Subcon as a % of revenue stands at ~14% in Q1 which Management aims to bring down to ~10%. Management sees further headroom of 4-5% improvement in offshore. iv) Management highlighted structural drivers for margins: increase in share of revenue from developed markets like the US/Europe; increase in revenue contribution from BFSI, Manufacturing, and Health Services; reselling some offerings as platforms; looking at potential JVs with some customers, to develop new-service offerings or new niches. v) Salary hike for most employees were implemented in Q1 (-130bps impact), with some (for senior employees) to be implemented in Q2. vi) There was a USD6-7mn revenue hit sequentially from client bankruptcy in Q1. vii) Management expects deal closures to be impacted in H1 due to weak macro conditions, and hopes for a recovery from H2. viii) Weakness in CME was largely attributable to reprioritization in the IT digital domain and network services.

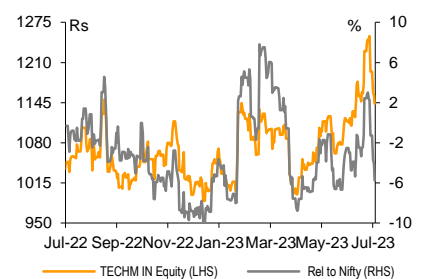
Target Price - 12M	Jun-24
Change in TP (%)	-
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	5.0
CMP (26-Jul-23) (Rs)	1,143.2

Stock Data	Ticker
52-week High (Rs)	1,271
52-week Low (Rs)	968
Shares outstanding (mn)	974.7
Market-cap (Rs bn)	1,114
Market-cap (USD mn)	13,590
Net-debt, FY24E (Rs mn)	-74,864
ADTV-3M (mn shares)	3
ADTV-3M (Rs mn)	2,863.8
ADTV-3M (USD mn)	34.9
Free float (%)	64.0
Nifty-50	19,778
INR/USD	82.0
Shareholding, Jun-23	
Promoters (%)	35.2
FPIs/MFs (%)	25.7/27.0

Price Performance

(%)	1M	3M	12M
Absolute	2.8	14.7	16.4
Rel. to Nifty	(2.8)	3.3	(3.0)

1-Year share price trend (Rs)



Dipesh Mehta

dipeshkumar.mehta@emkayglobal.com
+91 22 6612 1253

Ayush Bansal

ayush.bansal@emkayglobal.com
+91 22 6612 1344

Pulkit Chawla

pulkit.chawla@emkayglobal.com
+91 22 6642 4258

Exhibit 1: Quarterly snapshot

(Rs mn)	Q1FY24	Q4FY23	QoQ (%)	Q1FY23	YoY (%)
Revenue (USD mn)	1,601	1,668	-4.0	1,632	-1.9
Net sales	131,590	137,182	-4.1	127,079	3.5
Total Income	131,590	137,182	-4.1	127,079	
Operating expenses	118,210	116,977		108,278	
EBITDA	13,380	20,205	-33.8	18,801	-28.8
- Margin (%)	10.2	14.7	-460	14.8	-460
Depreciation	4,466	4,902		4,767	
EBIT	8,914	15,303	-41.8	14,034	-36.5
- Margin (%)	6.8	11.2	-440	11.0	-430
Interest	(1,197)	(934)		(403)	
Other income	1,917	3,055		1,221	
Pre-tax profit	9,634	17,424	-44.7	14,852	-35.1
Tax provided	2,676	3,999		3,380	
Profit after tax	6,958	13,425	-48.2	11,472	-39.4
MI	(33)	(123)		(156)	
Reported Profit After tax	6,925	11,176	-38.0	11,316	-38.8
Emkay - Net Profit	6,925	13,302	-47.9	11,316	-38.8
EPS (Rs)	7.9	15.1	-48.0	12.9	-39.0

Source: Company, Emkay Research

Exhibit 2: Actuals vs estimates

(Rs mn)	Actual	Estimate		Variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenue (USD mn)	1,601	1,644	1,639	-2.6%	-2.3%	USD revenue growth was below our expectations
Sales	131,590	135,159	134,517	-2.6%	-2.2%	
EBIT	8,914	14,103	14,124	-36.8%	-36.9%	Margins came below our expectations
EBIT margin	6.8%	10.4%	10.5%	-370 bps	-370 bps	
Profit	6,925	11,091	11,299	-37.6%	-38.7%	Profit missed our expectations due to operating performance miss

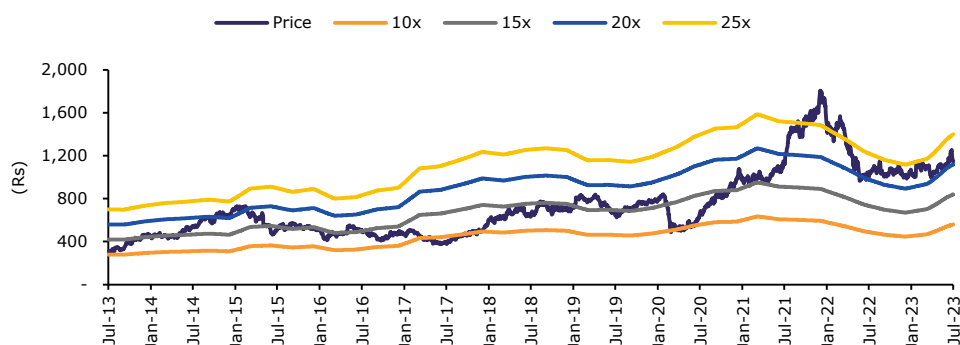
Source: Company, Emkay Research

Exhibit 3: Changes in estimates

(Rs mn)	FY24E			FY25E			FY26E		
	Old	New	Change	Old	New	Change	Old	New	Change
USD Revenue (mn)	6,725	6,544	-2.7%	7,331	7,135	-2.7%	7,992	7,814	-2.2%
- YoY growth	1.8%	-0.9%		9.0%	9.0%		9.0%	9.5%	
Revenue	544,966	530,325	-2.7%	604,803	588,614	-2.7%	663,314	648,566	-2.2%
EBIT (Rs mn)	63,195	52,313	-17.2%	82,311	79,934	-2.9%	92,763	90,878	-2.0%
EBITM (%)	11.6	9.9		13.6	13.6		14.0	14.0	
Net Profit	49,418	41,159	-16.7%	63,626	62,370	-2.0%	71,891	71,200	-1.0%
EPS (Rs)	56.2	46.7	-16.8%	72.3	70.8	-2.0%	81.7	80.9	-1.0%

Source: Company, Emkay Research

Exhibit 4: TechM – One-year forward P/E



Source: Company, Emkay Research

Tech Mahindra: Consolidated Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	446,460	532,902	530,325	588,614	648,566
Revenue growth (%)	17.9	19.4	(0.5)	11.0	10.2
EBITDA	80,200	80,288	71,241	99,457	111,126
EBITDA growth (%)	17.1	0.1	(11.3)	39.6	11.7
Depreciation & Amortization	15,204	19,567	18,928	19,522	20,248
EBIT	64,996	60,721	52,313	79,934	90,878
EBIT growth (%)	21.7	(6.6)	(13.8)	52.8	13.7
Other operating income	0	0	0	0	0
Other income	11,123	9,650	5,935	5,743	6,652
Financial expense	1,626	3,256	2,260	1,423	1,423
PBT	74,493	67,115	55,988	84,255	96,107
Extraordinary items	0	(2,370)	0	0	0
Taxes	18,220	15,885	14,496	21,485	24,507
Minority interest	(613)	(547)	(333)	(400)	(400)
Income from JV/Associates	0	0	0	0	0
Reported PAT	55,660	48,313	41,159	62,370	71,200
PAT growth (%)	25.7	(13.2)	(14.8)	51.5	14.2
Adjusted PAT	55,660	48,313	41,159	62,370	71,200
Diluted EPS (Rs)	63.4	54.9	46.7	70.8	80.9
Diluted EPS growth (%)	25.2	(13.4)	(14.9)	51.5	14.2
DPS (Rs)	45.0	50.0	35.0	50.0	57.5
Dividend payout (%)	70.9	91.0	74.9	70.6	71.1
EBITDA margin (%)	18.0	15.1	13.4	16.9	17.1
EBIT margin (%)	14.6	11.4	9.9	13.6	14.0
Effective tax rate (%)	24.5	23.7	25.9	25.5	25.5
NOPLAT (pre-IndAS)	49,098	46,349	38,768	59,551	67,704
Shares outstanding (mn)	877.6	879.9	880.5	880.5	880.5

Source: Company, Emkay Research

Cash flows					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	74,493	67,115	55,988	84,255	96,107
Others (non-cash items)	15,812	29,647	18,595	19,122	19,848
Taxes paid	(23,137)	(19,931)	(14,496)	(21,485)	(24,507)
Change in NWC	(14,343)	(18,451)	(9,745)	(9,103)	(9,362)
Operating cash flow	52,853	55,720	50,341	72,790	82,086
Capital expenditure	(8,353)	(9,692)	(6,233)	(10,730)	(13,130)
Acquisition of business	(45,888)	(10,672)	0	0	0
Interest & dividend income	1,084	1,448	0	0	0
Investing cash flow	4,815	(2,785)	(23,401)	(10,730)	(13,130)
Equity raised/(repaid)	1,175	442	2	0	0
Debt raised/(repaid)	(1,625)	(1,594)	117	0	0
Payment of lease liabilities	(5,177)	(4,426)	0	0	0
Interest paid	(1,231)	(2,570)	0	0	0
Dividend paid (incl tax)	(39,808)	(42,633)	(30,816)	(44,023)	(50,627)
Others	0	0	0	0	0
Financing cash flow	(46,666)	(50,781)	(30,697)	(44,023)	(50,627)
Net chg in Cash	11,002	2,154	(3,757)	18,036	18,329
OCF	52,853	55,720	50,341	72,790	82,086
Adj. OCF (w/o NWC chg.)	67,196	74,171	60,086	81,892	91,448
FCFF	44,500	46,028	44,108	62,060	68,956
FCFE	43,958	44,220	41,849	60,637	67,533
OCF/EBITDA (%)	65.9	69.4	70.7	73.2	73.9
FCFE/PAT (%)	79.0	91.5	101.7	97.2	94.8
FCFF/NOPLAT (%)	90.6	99.3	113.8	104.2	101.8

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	4,388	4,400	4,402	4,402	4,402
Reserves & Surplus	264,469	274,845	285,187	303,534	324,107
Net worth	268,857	279,245	289,589	307,936	328,509
Minority interests	4,954	4,702	4,702	4,702	4,702
Deferred tax liability (net)	(3,639)	(9,704)	(9,704)	(9,704)	(9,704)
Total debt	14,901	14,858	14,975	14,975	14,975
Total liabilities & equity	285,073	289,101	299,563	317,909	338,482
Net tangible fixed assets	26,823	28,622	26,081	25,853	25,661
Net intangible assets	37,383	33,425	25,871	18,777	11,788
Net ROU assets	9,372	10,972	8,208	6,739	6,801
Capital WIP	1,651	836	1,000	1,000	1,000
Goodwill	74,258	76,657	76,657	76,657	76,657
Investments [JV/Associates]	0	0	0	0	0
Cash & equivalents	88,583	76,428	89,839	107,876	126,205
Current assets (ex-cash)	202,446	221,628	229,968	250,090	270,786
Current Liab. & Prov.	155,443	159,467	158,062	169,081	180,415
NWC (ex-cash)	47,003	62,161	71,906	81,009	90,371
Total assets	285,073	289,101	299,563	317,909	338,482
Net debt	(73,682)	(61,570)	(74,864)	(92,901)	(111,230)
Capital employed	285,073	289,101	299,563	317,909	338,482
Invested capital	194,839	211,837	208,723	209,034	211,278
BVPS (Rs)	306.4	317.4	328.9	349.7	373.1
Net Debt/Equity (x)	(0.3)	(0.2)	(0.3)	(0.3)	(0.3)
Net Debt/EBITDA (x)	(0.9)	(0.8)	(1.1)	(0.9)	(1.0)
Interest coverage (x)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	27.9	24.5	19.8	27.8	29.7

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	18.0	20.8	24.5	16.1	14.1
P/CE(x)	14.2	14.3	16.8	12.3	11.0
P/B (x)	3.7	3.6	3.5	3.3	3.1
EV/Sales (x)	2.1	1.8	1.8	1.6	1.4
EV/EBITDA (x)	11.6	11.8	13.1	9.2	8.1
EV/EBIT(x)	14.3	15.6	17.8	11.4	9.9
EV/IC (x)	4.8	4.5	4.5	4.4	4.2
FCFF yield (%)	4.8	4.9	4.7	6.8	7.7
FCFE yield (%)	4.4	4.4	4.2	6.0	6.7
Dividend yield (%)	3.9	4.4	3.1	4.4	5.0
DuPont-RoE split					
Net profit margin (%)	12.5	9.5	7.8	10.6	11.0
Total asset turnover (x)	1.6	1.9	1.8	1.9	2.0
Assets/Equity (x)	1.1	1.0	1.0	1.0	1.0
RoE (%)	21.5	18.5	14.5	20.9	22.4
DuPont-RoIC					
NOPLAT margin (%)	11.0	8.7	7.3	10.1	10.4
IC turnover (x)	2.8	2.6	2.5	2.8	3.1
RoIC (%)	30.3	22.8	18.4	28.5	32.2
Operating metrics					
Core NWC days	38.4	42.6	49.5	50.2	50.9
Total NWC days	38.4	42.6	49.5	50.2	50.9
Fixed asset turnover	7.8	7.1	6.9	7.7	8.5
Opex-to-revenue (%)	82.0	84.9	86.6	83.1	82.9

Source: Company, Emkay Research

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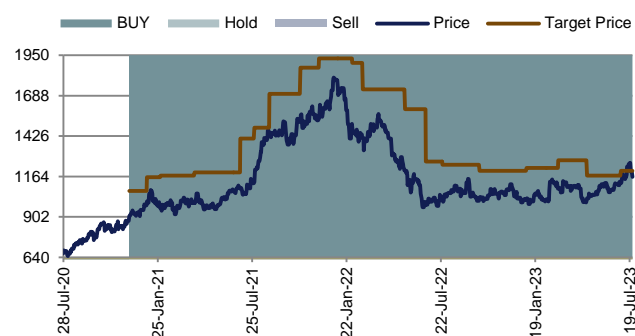
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RECOMMENDATION HISTORY - DETAILS

Date	CMP (INR)	TP (INR)	Rating	Analyst
02-Jul-23	1,131	1,200	Buy	Dipeshkumar Mehta
28-Apr-23	1,024	1,170	Buy	Dipeshkumar Mehta
01-Apr-23	1,102	1,270	Buy	Dipeshkumar Mehta
11-Mar-23	1,061	1,270	Buy	Dipeshkumar Mehta
04-Mar-23	1,085	1,270	Buy	Dipeshkumar Mehta
30-Jan-23	1,036	1,220	Buy	Dipeshkumar Mehta
02-Jan-23	1,010	1,220	Buy	Dipeshkumar Mehta
02-Dec-22	1,115	1,200	Buy	Dipeshkumar Mehta
04-Oct-22	1,028	1,200	Buy	Dipeshkumar Mehta
25-Jul-22	1,017	1,240	Buy	Dipeshkumar Mehta
23-Jun-22	991	1,260	Buy	Dipeshkumar Mehta
14-May-22	1,203	1,600	Buy	Dipeshkumar Mehta
01-Apr-22	1,487	1,730	Buy	Dipeshkumar Mehta
22-Feb-22	1,413	1,730	Buy	Dipeshkumar Mehta
02-Feb-22	1,483	1,900	Buy	Dipeshkumar Mehta
18-Jan-22	1,661	1,930	Buy	Dipeshkumar Mehta
01-Jan-22	1,791	1,930	Buy	Dipeshkumar Mehta
30-Nov-21	1,541	1,930	Buy	Dipeshkumar Mehta
11-Nov-21	1,522	1,870	Buy	Dipeshkumar Mehta
25-Oct-21	1,524	1,870	Buy	Dipeshkumar Mehta
02-Oct-21	1,371	1,700	Buy	Dipeshkumar Mehta
27-Aug-21	1,445	1,700	Buy	Dipeshkumar Mehta
29-Jul-21	1,128	1,480	Buy	Dipeshkumar Mehta
02-Jul-21	1,089	1,410	Buy	Dipeshkumar Mehta
27-Apr-21	969	1,190	Buy	Dipeshkumar Mehta
05-Apr-21	998	1,190	Buy	Dipeshkumar Mehta
18-Mar-21	996	1,170	Buy	Dipeshkumar Mehta
15-Mar-21	1,027	1,170	Buy	Dipeshkumar Mehta
30-Jan-21	961	1,170	Buy	Dipeshkumar Mehta
04-Jan-21	1,002	1,160	Buy	Dipeshkumar Mehta
18-Dec-20	934	1,070	Buy	Dipeshkumar Mehta
01-Dec-20	907	1,070	Buy	Dipeshkumar Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

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Emkay Global Financial Services Ltd.

CIN - L67120MH1995PLC084899

7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India

Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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