Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Tech Mahindra Ltd

Miss on all fronts, Downgrade to Reduce

IT & ITeS	Sharekhan code: TECHM
Reco/View: Reduce ↓	CMP: **Rs. 1,144** / Price Target: **Rs. 1,050** ↓

↑ 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 11.60

Updated Jul 08, 2023

Low Risk

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

Source: Morningstar

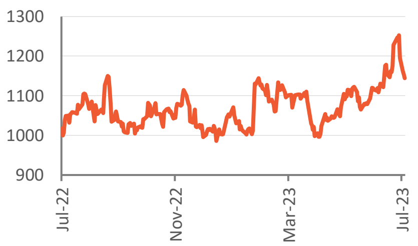
Company details

Market cap:	Rs. 1,11,510 cr
52-week high/low:	Rs. 1,270 / 983
NSE volume: (No of shares)	26.9 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	63.1 cr

Shareholding (%)

Promoters	35.2
FII	25.7
DII	26.9
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.8	14.8	8.9	14.5
Relative to Sensex	-3.1	4.2	-1.9	-6.2

Sharekhan Research, Bloomberg

Summary

- Constant currency revenue declined 4.1% q-o-q, missing our estimates of 1.9% decline q-o-q, due to weak revenues from CME and BFSI verticals, down 9.4%/3.2% q-o-q.
- EBIT margin contracted sharply by ~440 bps q-o-q to 6.8 %, below our estimates of 10.8% due to revenue drop impacting margin, one-time provisioning and seasonality.
- Net new deal win (TCV) for the quarter stood at $359 million, down 39% q-o-q/ 55% y-o-y. The number of active clients declined by 42 to 1255.Net headcount declined by 4,103 taking the total headcount to 1,48,297.
- Tech Mahindra reported the weakest performance among Tier 1 IT service companies with declining trajectory of Net new deal wins which places its earnings outlook at risk. Hence, we downgrade Tech Mahindra to Reduce with revised PT of Rs 1050. At CMP, the stock trades at 21.2/15.5x FY24E/FY25E EPS.

Tech Mahindra reported weak performance for Q1FY24 missing on all fronts. Constant currency revenue declined 4.1% q-o-q, missing our estimates of 1.9% decline q-o-q, due to weak revenues from CME and BFSI vertical, down 9.4%/3.2% q-o-q. USD revenue declined 4.0% q-o-q to $1600.7 million versus our estimate of $1640.8 million. IT services revenues declined 5% q-o-q while BPO segment revenues grew 1.3% q-o-q. EBIT margin contracted sharply by ~440 bps q-o-q to 6.8 %, below our estimates of 10.8% due to revenue drop impacting margin, q-o-q. Company had to take a one-time provisioning the quarter, mainly driven by certain customers declaring bankruptcy and the seasonality. Net profit came at Rs. crore 692.5 crore, down 47.9% q-o-q missing our estimates of Rs 1194.4 crore .Net new TCV for the quarter stood at $359 million, down 39% q-o-q/ 55% y-o-y. The number of active clients declined by 42 to 1255. Net headcount declined by 4,103 taking the total headcount to 1,48,297. LTM attrition improved 200 bps q-o-q to 13% while Utilisation improved 100 bps q-o-q to 87%. Tech Mahindra has delivered the weakest set of numbers among its peers, with disappointing performance from its key CME vertical, declining net new TCV, and sharp loss in net headcount for the quarter. Tech Mahindra reported the weakest performance among Tier 1 IT service companies with declining trajectory of Net new deal wins which places its earnings outlook at risk. Hence, we downgrade Tech Mahindra to Reduce with revised PT of Rs 1050. At CMP, the stock trades at 21.2/15.5x FY24E/FY25E EPS.

Key positives

- LTM Attrition moderated to 13% in Q1FY24 down 200 bps q-o-q.
- IT Utilisation improved to 87%, up 100 bps q-o-q.

Key negatives

- Net new deal wins (TCV) for the quarter stood at $359 million, down 39% q-o-q/ 55% y-o-y.
- Net headcount declined by 4,103 taking the total headcount to 1,48,297.
- Number of active clients declined by 42 to 1255 from 1297 in Q4FY23.
- DSO days rose to 98 days in Q1FY24 from 96 days in Q4FY2023.

Management Commentary

- The management indicated levers for margin improvement such as lowering subcon, increasing offshore mix, generalization. pyramid rationalization and divestment of some non-profitable businesses. Management expects recovery to be gradual with good progress this quarter and recovery in H2FY24.
- Reprioritisation is happening as clients have pushed the decisions. 5G is going to take longer than anticipated. However, the company does not think their investments are in jeopardy. Devices, network, software platform continue to do well.

Revision in estimates – We have revised our estimates for FY24/25 to factor weak Q1FY24 performance and persisting macro overhang.

Our Call

Valuation – Weak Q1, Downgrade to Reduce: The weak Q1 performance on all fronts reflects the severity of persisting headwinds. Further, Tech Mahindra's Net new deal win (TCV) trajectory has been trending downward since past few quarters unlike its peers who have shown greater resilience despite a muted quarter. Hence, we downgrade Tech Mahindra to Reduce with revised PT of Rs 1050 as earnings outlook remains at risk given weak performance. At CMP, the stock trades at 21.2/15.5x 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	55,080.0	62,335.7
OPM (%)	18.0	15.1	14.3	16.9
Adjusted PAT	5,566.1	5,249.3	4,738.4	6,516.1
% YoY growth	24.3	-5.7	-9.7	37.5
Adjusted EPS (Rs.)	62.8	59.7	53.8	74.0
P/E (x)	18.2	19.2	21.2	15.5
P/B (x)	3.7	3.6	3.3	3.0
EV/EBITDA (x)	12.9	13.0	12.4	8.9
RoNW (%)	21.5	19.2	16.3	20.4
RoCE (%)	23.3	20.5	18.3	23.0

Source: Company; Sharekhan estimates

Key result highlights from earnings call

- **Weak Revenue growth:** Tech Mahindra sharply missed revenue estimates on account of weak revenues from CME and BFSI verticals. Constant currency revenue declined 4.1% q-o-q, missing our estimates of 1.9% decline q-o-q, on account of weak revenues from CME and BFSI vertical, down 9.4%/3.2% q-o-q. Manufacturing grew 1.8% q-o-q while Technology, Retail and Others declined marginally q-o-q. USD revenue declined 4.0% q-o-q to $1600.7 million versus our estimate of $1640.8 million. IT services revenue declined 5% q-o-q while BPO segment revenues grew 1.3% q-o-q. In terms of geographies, Europe and ROW fell 6.7%/8.2% q-o-q while North Americas was down 0.5% q-o-q.
- **SG&A expenses and subcontracting costs:** SG&A expenses rose by 4.7% sequentially to Rs. 2040.5 crore. Sub-contracting costs moderated to 1842.5 crore at 14.0% of its revenue in Q1FY2023. The management aspires to get subcontracting costs to less than 10%.
- **Deal wins:** Net new deal wins (TCV) for the quarter stood at $359 million, down 39% q-o-q/ 55% y-o-y. Number of active clients declined by 42 to 1255.
- **EBIT margin:** EBIT margin contracted sharply by ~440 bps q-o-q to 6.8 %, below our estimates of 10.8%. due to revenue drop impacting margin, q-o-q. Company had to take a one-time provisioning during the quarter, mainly driven by certain customers declaring bankruptcy Seasonality also impacted the Ebit margin during the quarter
- **Net additions fell while LTM attrition rate moderated:** Net headcount declined by 4,103 taking the total headcount to 1,48,297. LTM attrition fell 200 bps q-o-q to 13% while IT Utilisation improved 100 bps q-o-q to 87%
- **Top accounts:** Revenue from top-5/top-10 and Top-20 declined by 4.0%/0.3% and 6.4% respectively.
- **Cash generation:** Free Cash Flow (FCF) stood at $106 million, down 25% q-o-q with FCF to net income ratio at 126.3%. Net Cash stood at $ 939 million versus $ 905 million in Q4FY23.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	Y-o-Y %	Q4FY23	Q-o-Q %
Revenues In USD (mn)	**1,600.7**	**1,632.5**	**-1.9**	**1,667.6**	**-4.0**
Revenues In INR	**13,159.0**	**12,707.9**	**3.5**	**13,718.2**	**-4.1**
Cost of Services	9,780.5	9,116.2	7.3	9,748.2	0.3
Gross profit	**3,378.5**	**3,591.8**	**-5.9**	**3,970.0**	**-14.9**
SG&A	2,040.5	1,711.6	19.2	1,949.3	4.7
EBITDA	**1,338.0**	**1,880.1**	**-28.8**	**2,020.7**	**-33.8**
Depreciation	446.6	476.7	-6.3	490.2	-8.9
EBIT	**891.4**	**1,403.4**	**-36.5**	**1,530.5**	**-41.8**
Other Income	191.7	122.1	57.0	305.5	-37.3
PBT	**963.4**	**1,485.2**	**-35.1**	**1,742.6**	**-44.7**
Provision for taxes	267.6	338.0	-20.8	399.9	-33.1
Adjusted net profit	**692.5**	**1,131.6**	**-38.8**	**1,330.4**	**-47.9**
Non Recurring / Exceptional Items	0.0	0.0	-	212.6	-
Reported net profit	**692.5**	**1,131.6**	**-38.8**	**1,117.8**	**-38.0**
EPS (Rs) Excl Treasury Shares	7.8	12.8	-38.8	12.6	-38.0
Margin (%)			**BPS**		**BPS**
EBITDA Margins	10.2	14.8	-463	14.7	-456
EBIT Margin	6.8	11.0	-427	11.2	-438
PAT Margin	5.3	8.9	-364	9.7	-444
Tax rate	27.8	22.8	502	22.9	483

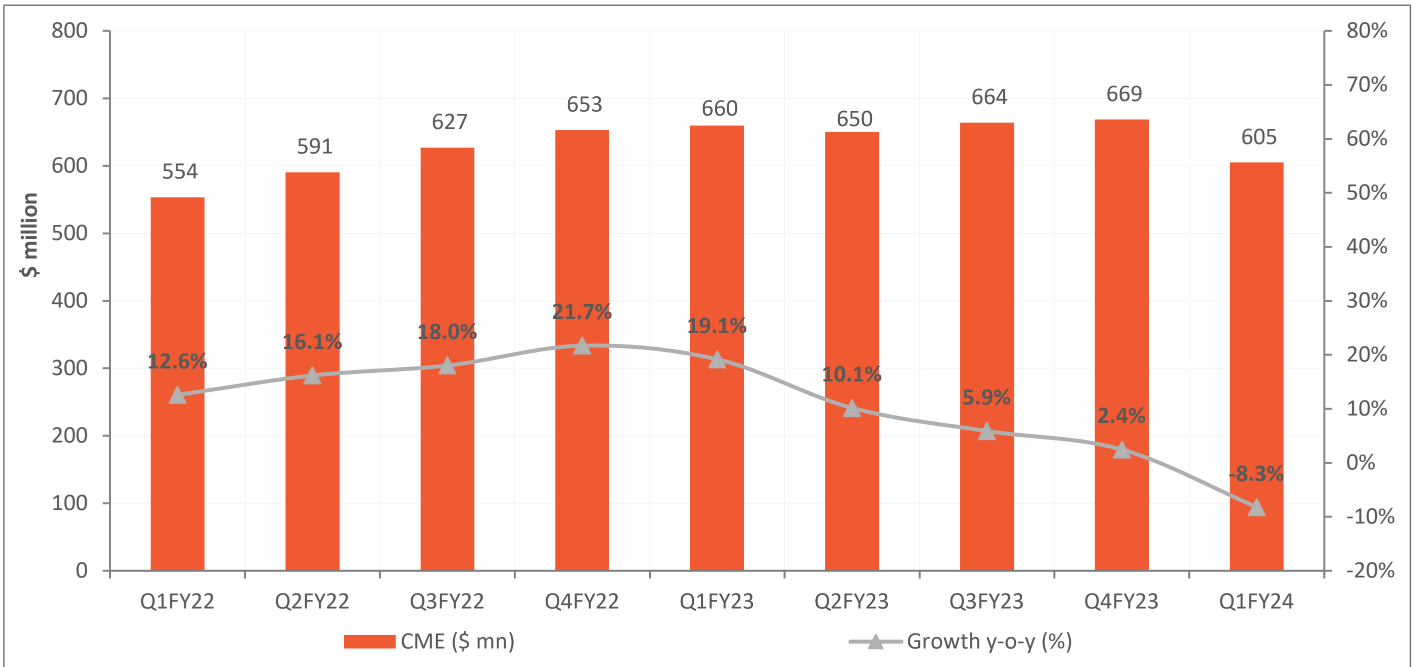
Source: Company; Sharekhan Research

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

Particulars	Revenues	Contribution	$ Growth (%)	
	($ mn)	(%)	Q-o-Q %	Y-o-Y %
Revenues ($ mn)	1,601	100	-4.0	-1.9
Geographic mix				
America	823	51.4	-0.5	1.6
Europe	394	24.6	-6.7	-5.4
RoW	384	24.0	-8.2	-5.5
Industry verticals				
CME	605	37.8	-9.5	-8.3
Manufacturing	271	16.9	2.0	8.3
Technology	171	10.7	-0.3	8.2
BFSI	258	16.1	-2.8	-5.5
Retail, transpost and logistics	126	7.9	-0.2	-1.9
Others	170	10.6	-0.2	3.9
Clients contribution				
Top 5	272	17.0	-4.0	-18.7
Top 10	432	27.0	-0.3	-11.5
Top 20	624	39.0	-6.4	-7.4
Revenue by services		(%)	q-o-q	y-o-y
IT	1,392	85.2	-3.0	-2.6
BPO	242	14.8	3.5	16.8

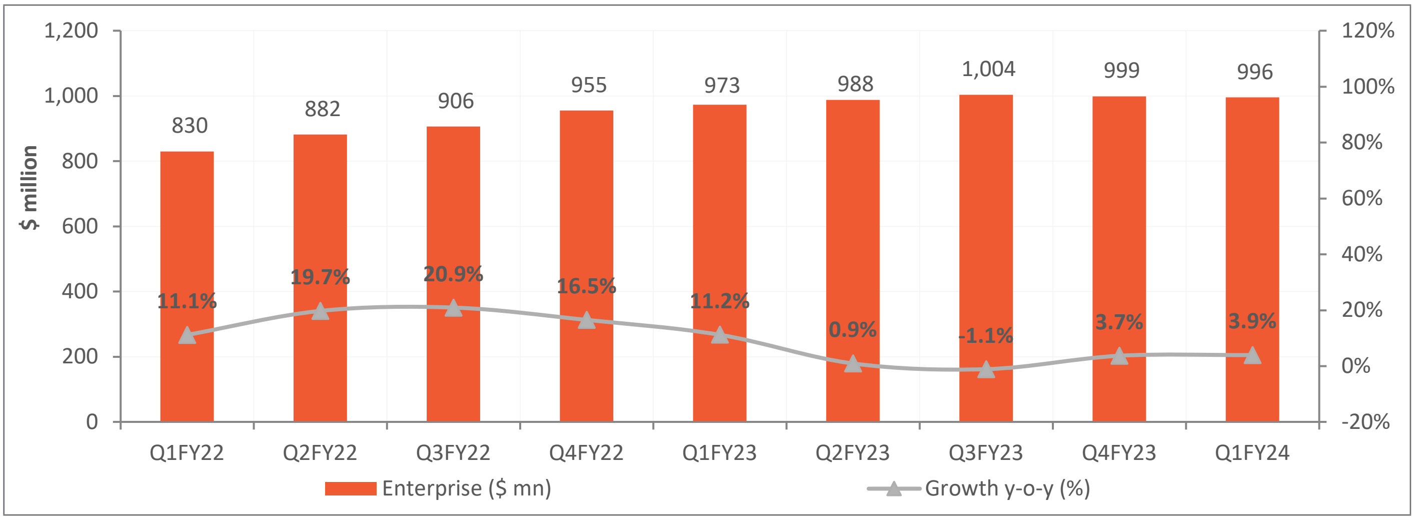
Source: Company; Sharekhan Research

CME vertical revenue growth trend



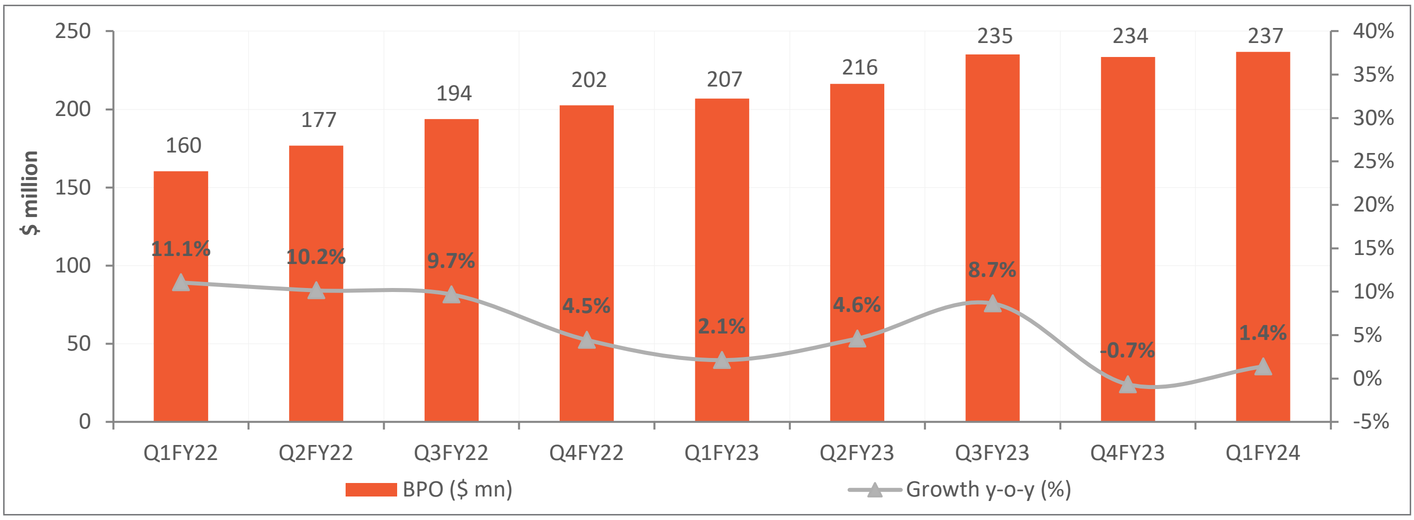
Source: Company; Sharekhan Research

Enterprise vertical revenue growth trend



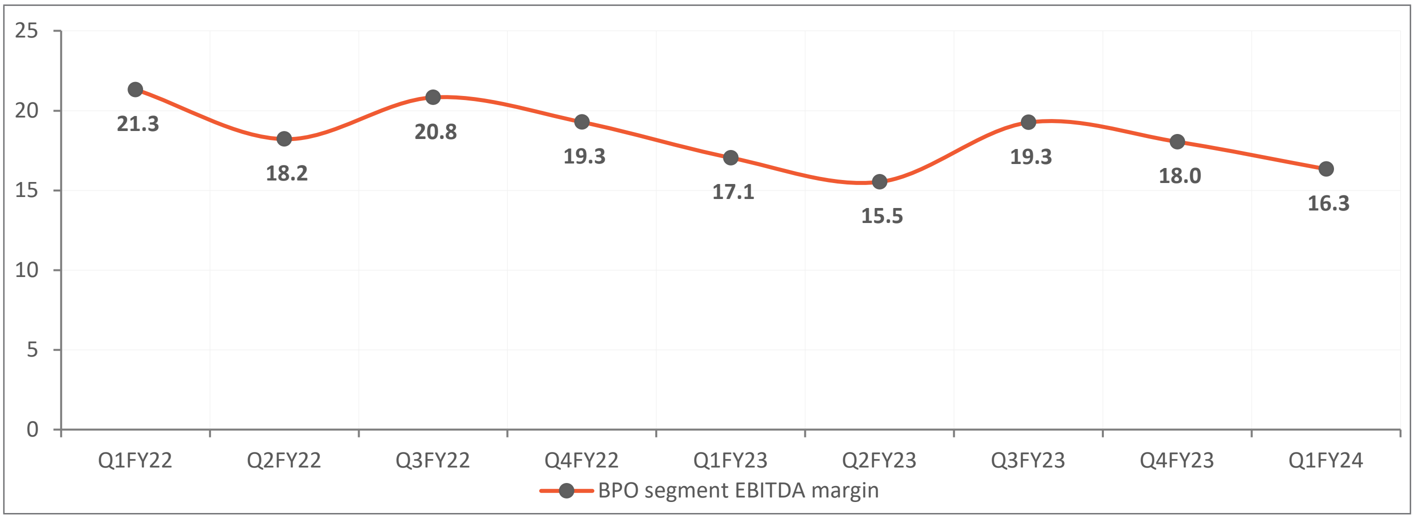
Source: Company; Sharekhan Research

BPO revenue growth trend



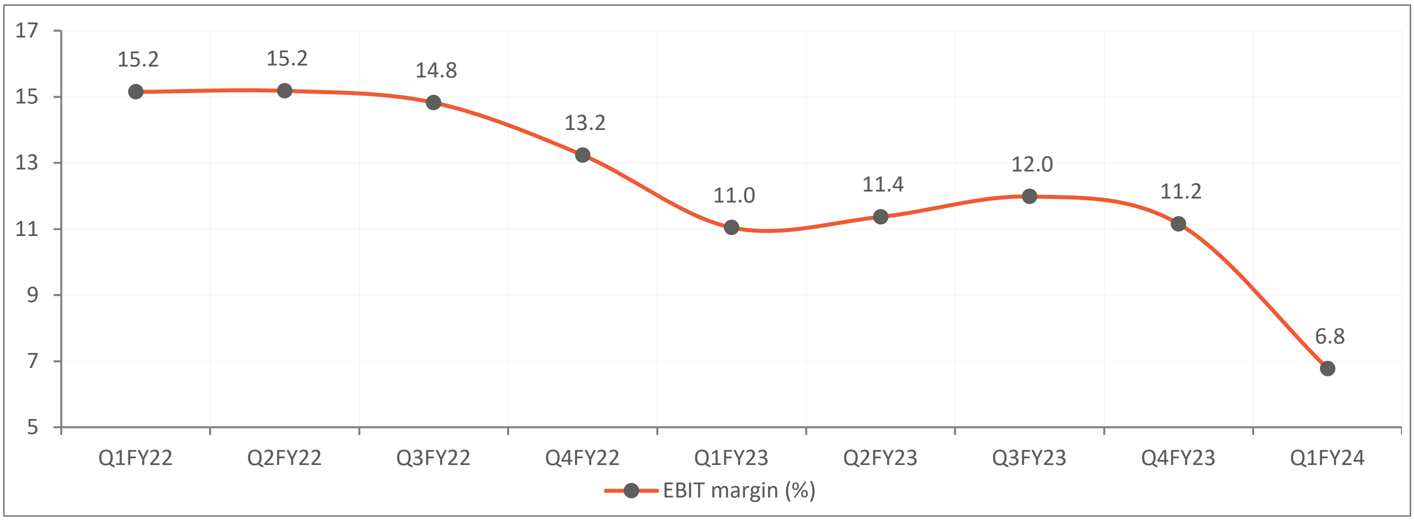
Source: Company; Sharekhan Research

BPO segment's EBITDA margin trend



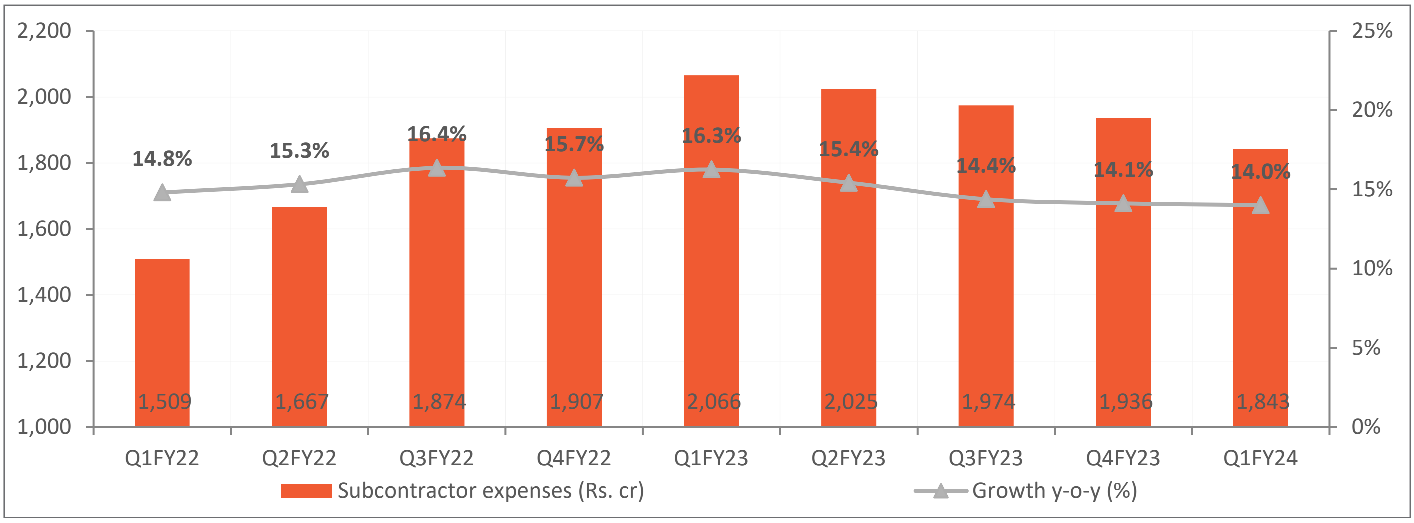
Source: Company; Sharekhan Research

Tech M's EBIT margin trend



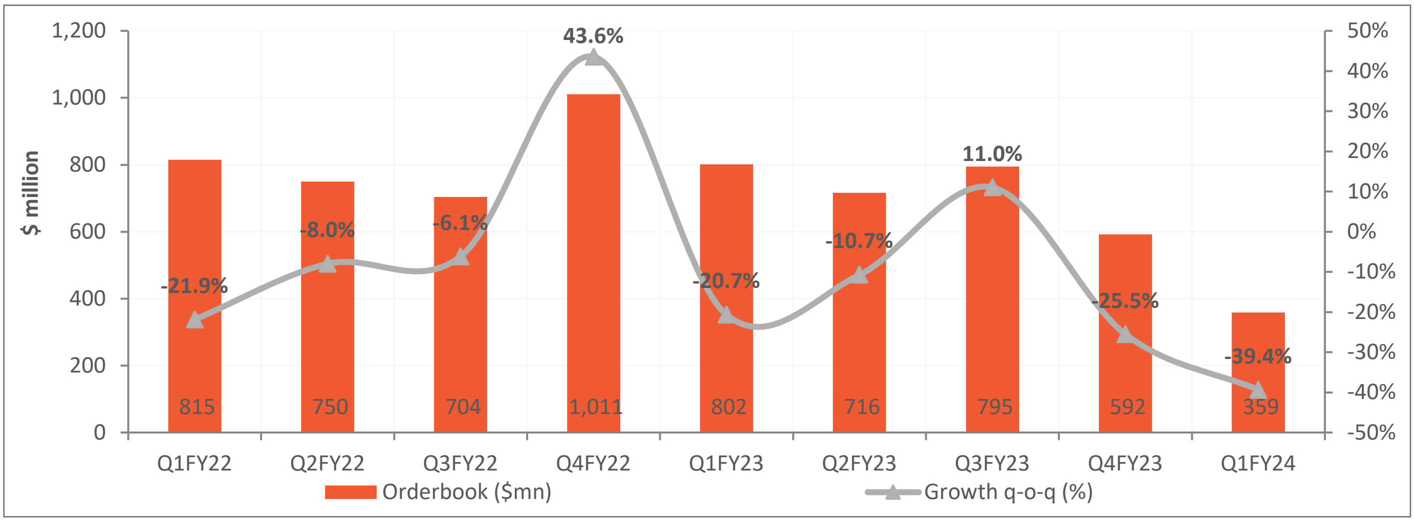
Source: Company; Sharekhan Research

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



Source: Company; Sharekhan Research

New deal win TCV 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.

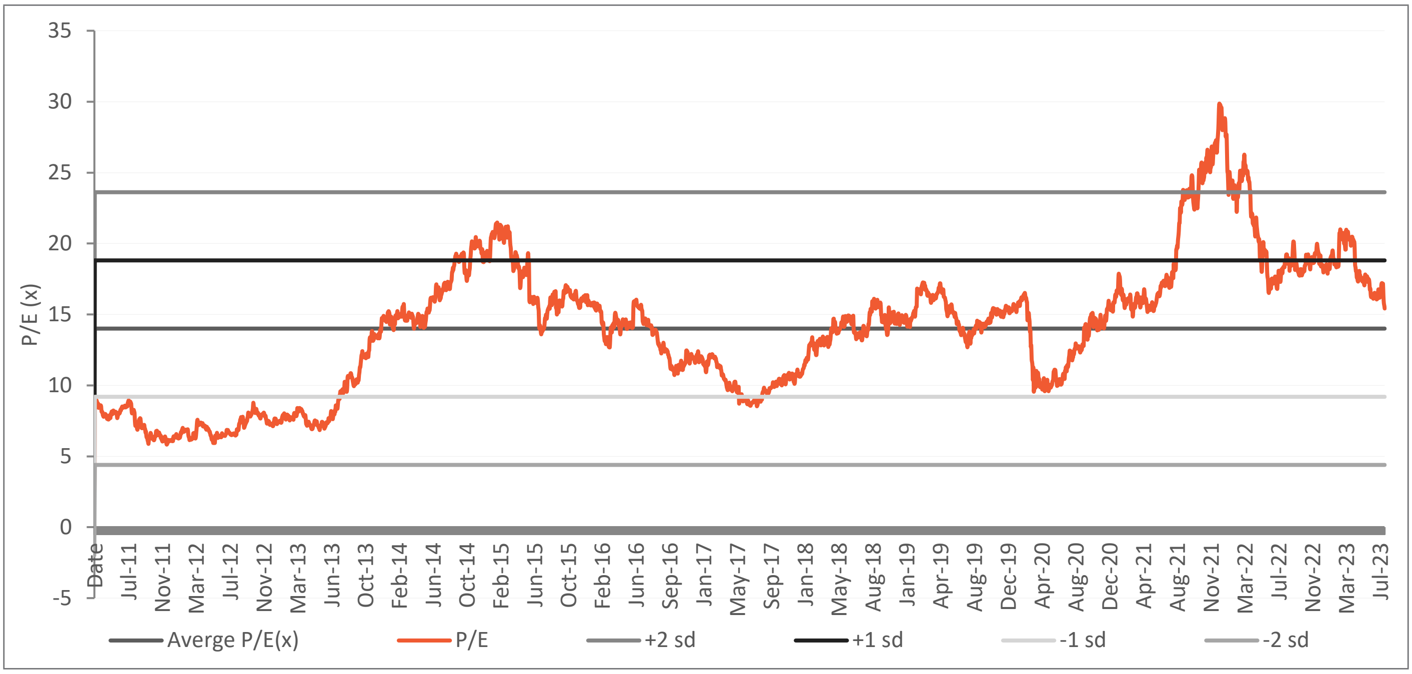
■ Company Outlook – Well-placed to capture 5G opportunity.

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.

■ Valuation – Weak Q1, Downgrade to Reduce

The weak Q1 performance on all fronts reflects the severity of persisting headwinds. Further, Tech Mahindra's Net new deal win (TCV) trajectory has been trending downward since past few quarters unlike its peers who have shown greater resilience despite a muted quarter. Hence, we downgrade Tech Mahindra to Reduce with revised PT of Rs 1050 as earnings outlook remains at risk given weak performance. At CMP, the stock trades at 21.2/15.5x 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

1) 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
Milind Kulkarni	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	9.47
2	SBI Funds Management Ltd	3.95
3	First State Investments ICVC	2.81
4	Mitsubishi UFJ Financial Group Inc	2.34
5	BlackRock Inc	2.15
6	Vanguard Group Inc/The	2.15
7	GOVERNMENT PENSION FUND - GLOBAL	2.05
8	Norges Bank	2.01
9	ICICI Prudential Asset Management	1.83
10	HDFC Asset Management Co Ltd	1.30

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

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

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/ investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

---

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600