

Tech Mahindra

Estimate change 

TP change

Rating change 

CMP: INR1,144

TP: INR1,080 (-6%)

Neutral

Slowdown in Communication to drag FY24 growth

Weak margin base to impede ability to invest

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Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USD\$b)	1115.2 / 13.6
52-Week Range (INR)	1270 / 968
1, 6, 12 Rel. Per (%)	-3/-2/-4
12M Avg Val (INR M)	3005

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	533	537	594
Adj. EBIT Margin (%)	11.4	10.6	12.2
Adj. PAT	50.7	45.1	56.4
Adj. EPS (INR)	57.3	50.9	63.7
PAT	48.3	42.4	53.8
EPS (INR)	54.6	47.9	60.7
EPS Gr. (%)	(12.8)	(12.2)	26.7
BV/Sh. (INR)	317.3	324.1	334.0
RoE (%)	18.5	15.9	19.4
RoCE (%)	18.6	17.1	21.3
Payout (%)	87.3	85.0	85.0
P/E (x)	19.9	22.4	17.9
P/BV (x)	3.6	3.5	3.4
EV/EBITDA (x)	12.2	13.2	10.9
Div Yield (%)	4.4	3.8	4.7

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	35.2	35.2	35.2
DII	27.1	26.0	20.9
FII	25.7	26.9	30.4
Others	12.0	11.9	13.4

FII Includes depository receipts

- Tech Mahindra (TECHM) delivered a weak 1QFY24 performance, with revenue declining 4.2% QoQ in CC to USD1.6b, missing our estimate of a 2.5% decline. The weakness was primarily due to a slowdown in CME (down 9.5% QoQ), while Enterprise saw a marginal dip vs. 4QFY23. 1Q EBIT margin (adjusted for client-specific write-off) was down 240bp QoQ at 8.8% (est. 10.6%). TECHM delivered weak TCW for the second straight quarter at USD359m, down 39% QoQ after a 25% QoQ decline in Q4.
- Given the slowdown in Communications business across IT services peers in the last few weeks, there was a concern about a weak revenue performance from TECHM. But we were still surprised by the sharp drop in CME vertical (38% of revenues in 1Q) even after adjusting for the Comviva seasonality. While we expect the segment to return to growth in 2Q, we remain concerned about near-term demand in the space, given the adverse read-through from the global ecosystem, including telecom hardware makers. We factor in USD revenue decline of 7.1% YoY in the vertical in FY24.
- On the other hand, we expect the Enterprise vertical to grow this year by 2.7% YoY in USD, though the weak TCW addition during the last two quarters will remain an overhang. With our base case factoring in a pick-up in FY25, we expect TECHM to deliver a USD revenue CAGR of 4.7% over FY23-25.
- Due to the sharp dip in revenue, TECHM also saw a steep fall in profitability, exacerbated by a 200bp one-time impact from bankruptcy of a client. We expect the company's profitability to improve from 2Q onward, partially through sharp cost control and headcount cuts despite high utilization. We see FY24E (adj)/FY25E EBIT margins at 10.6%/12.2%, resulting in a muted INR PAT CAGR of 5.5% in FY23-25E despite a low FY23 base (PAT -8.9% YoY).
- While we expect a potential for performance improvement after the leadership refresh in Jun'23, we believe this will take time given the macro headwinds and limited flexibility to invest in growth because of weak current profitability.
- We remain on the sidelines as we feel the current valuation fairly factors in the uncertainties around growth and margin. We cut our FY24/FY25 EPS estimates by 8-10% on weak margin and muted outlook. **We remain Neutral on the stock with a TP of INR1,080 (17x FY25E EPS).**

Big miss on both revenue and margins

- Revenue stood at USD1.6b, down 4.2% QoQ CC (est. -2.5% QoQ CC decline).
- IT service growth was down 5.0% QoQ, while BPO was up 1.3% QoQ.
- CME saw a significant decline of 9.5%, followed by BFSI down 2.8%. Retail and Technology were flat QoQ. Manufacturing was up 2.0% QoQ.
- EBIT margin was down 440bp QoQ/430bp YoY at 6.8% (est. 10.6%).
- The employee count declined for the third consecutive quarter by 4.1k (-2.6% QoQ). Utilization (ex. trainees) was up by 100bp QoQ at 87%. LTM attrition improved by 200bp QoQ to 13%.

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- NN Deal TCV was weak at USD359m, down 39.4% QoQ/55.2% YoY.
- PAT stood at INR6.9b (down 48% QoQ), below our estimate of INR11.0bn.
- FCF conversion to PAT stood at 126% vs. 104% in Q4.

Key highlights from the management commentary

- The decline in revenue was due to multiple key factors: (1) reprioritization of spending on the IT service side and network part of the Telecom space, (2) cyclicity in the Comviva business, (3) anticipated multiple project closures in Q1, (4) bankruptcy filed by one its clients, impacted the topline by ~USD6-7m in Q1, and (5) slowdown in decision-making on the digital transformation projects and cost takeout deals.
- The deal pipeline is healthy at this moment; however, the conversion remains a challenges as the enterprise business is witnessing slower decision-making. Otherwise, the company is chasing multiple deals and many of them are under the maturity stage.
- The weakness in the NN deal TCV for Q1 was on account of unanticipated deal pushouts due to slower decision-making and restructuring activities at clients.
- The substantial impact on margins was on accounts of: (1) provision created for the bankruptcy filed by one of its clients (~200bp QoQ), (2) missing operating leverage due to revenue decline (~100bp QoQ), (3) wage hike impact (130bp QoQ), and (4) Cyclicity in Comviva (~50bp QoQ).

Valuation and view

- Although its 1Q performance was weak, TECHM's high exposure to the Communications vertical offers a potential opportunity, as a broader 5G rollout is likely to result in a new spending cycle in this space.
- Near-term growth remains weak and we await greater comfort on margins. We value the stock at 17x FY25E EPS. **We maintain our Neutral rating on the stock.**

Quarterly performance

Y/E March	FY23				FY24				FY23	FY24E	FY24	Var.
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE				
Revenue (USD m)	1,633	1,638	1,668	1,668	1,601	1,621	1,641	1,685	6,607	6,548	1,635	-2.1
QoQ (%)	1.5	0.3	1.8	0.0	-4.0	1.3	1.2	2.7	10.1	-0.9	-1.9	-208bp
Revenue (INR b)	127	131	137	137	132	133	135	138	533	537	134	-2.1
YoY (%)	24.6	20.7	19.9	13.2	3.5	1.2	-2.0	0.7	19.4	0.8	5.8	-224bp
GPM (%)	28.3	27.9	28.7	28.9	25.7	27.0	28.2	28.9	28.5	27.5	28.7	-303bp
SGA (%)	13.5	12.8	13.1	14.2	13.5	13.4	13.4	13.4	13.4	13.4	14.5	-99bp
Adj. EBITDA	19	20	21	20	16	18	20	21	80	75	19	-16.1
EBITDA Margin (%)	14.8	15.1	15.6	14.7	12.2	13.6	14.8	15.5	15.1	14.0	14.2	-203bp
Adj. EBIT	14	15	16	15	12	13	15	17	61	57	14	-19.0
EBIT Margin (%)	11.0	11.4	12.0	11.2	8.8	10.1	11.3	12.1	11.4	10.6	10.6	-183bp
Other income	1	2	1	2	1	1	1	1	6	3	1	-46.4
ETR (%)	22.8	21.4	27.3	22.9	21.8	25.0	25.0	25.0	23.7	24.3	26.5	-468bp
Adj. PAT	11	13	13	13	10	11	12	13	51	45	11	-15.7
QoQ (%)	-24.9	15.8	-1.0	2.6	-28.2	10.6	12.7	9.5			-14.8	-1340bp
YoY (%)	-16.4	-2.2	-5.3	-11.6	-15.5	-19.3	-8.1	-2.0	-8.9	-11.1	0.2	-1576bp
Extra-Ordinary Item	0.0	-0.2	0.0	-2.1	-2.6	0.0	0.0	0.0	-2.4	-2.6	0.0	
Reported PAT	11	13	13	11	7	11	12	13	48	42	11	-38.9
EPS (INR)	12.8	14.5	14.7	12.6	7.8	11.9	13.4	14.7	54.6	47.9	12.8	-39.0

E: MOFSL estimates

Key Performance Indicators

Y/E March	FY23				FY24				FY23	FY24E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Revenue (QoQ CC %)	3.5	2.9	0.2	0.3	-4.2					
Margins (%)										
Gross Margin	28.3	27.9	28.7	28.9	25.7	27.0	28.2	28.9	28.5	27.5
Adj. EBITDA margin	14.8	15.1	15.6	14.7	12.2	13.6	14.8	15.5	15.1	14.0
Adj. EBIT Margin	11.0	11.4	12.0	11.2	8.8	10.1	11.3	12.1	11.4	10.6
Adj. Net Margin	8.9	10.0	9.4	9.7	7.3	8.0	8.9	9.4	9.5	8.4
Operating Metrics										
Headcount (k)	158	164	157	152	148				152	
Util excl. trainees (%)	83.3	84.9	86.4	86.5	87.2				85.3	
Attrition (%)	22.2	19.6	17.3	14.8	12.8				14.8	
Deal TCV (USD m)	802	716	795	592	359				2,905	
Key Verticals (QoQ %)										
Communication	1.0	-1.4	2.1	0.7	-9.5				9.0	
Enterprise	1.8	1.5	1.7	-0.5	-0.3				10.9	
Key Geographies (QoQ%)										
North America	4.2	2.8	-0.4	-0.2	-0.5				14.6	
Europe	-2.0	-3.6	1.4	3.6	-6.7				4.7	



Highlights from the management commentary

Demand and industry outlook

- TECHM posted a revenue decline of 4.2% QoQ CC in 1QFY24, majorly attributed to IT Service, down 5.0% QoQ CC. BPO was up 1.3% QoQ CC.
- The revenue decline was on accounts of multiple key factors: (1) Reprioritization of spending on the IT service side and network part of the Telecom space, (2) Cyclicity in the Comviva business, (4) Anticipated multiple project closures in Q1, (4) Bankruptcy filed by one its clients, impacted the topline by ~USD6-7m in Q1, and (4) Slowdown in decision-making on the digital transformation projects and cost takeout deals.
- Under CME, the management believes that the worst is behind for the space and it should see a gradual recovery from here. As the global telcos keep a tight budget, reprioritizing opex and cutting discretionary spends, it affected TECHM's revenue growth in Q1. The management expects 2Q to stabilize and 2H should see a recovery for the segment.
- The company expect sustainable growth for manufacturing. Demand in Automotive and Aerospace is driving the overall segmental performance. There is a massive shift from Mechanical to EV, which is creating incremental opportunities around connectivity, embedded software and mobility, while the increase in air traffic volume is augmenting engineering work under Aerospace.
- On a geo stand point, Europe has more exposure to the CME vertical, which led the sharp decline (6.7% QoQ) in Q1. The reprioritization of digital projects, opex on 5G and business support system saw the major hit in the region.
- In ROW, the Comviva seasonality and the anticipated project closure led the decline.
- The deal pipeline is healthy at this moment, however, the conversion remains a challenges as the enterprise business is witnessing slower decision-making. Otherwise, the company is chasing multiple deals and many of them are under the maturity stage.
- The weakness in the NN deal TCV for 1Q was on account of unanticipated deal pushouts due to slower decision-making and restructuring activities at a client.

- The company believes that digital transformation projects are taking a pause at this moment due to the macro onset and not getting stopped completely.
- The company is focusing on growing the BFSI proportion of the overall pie in the US region.

Margin performance

- The substantial margin impact was on accounts of: (1) provision created for the bankruptcy filed by one of its clients (~200bp QoQ), (2) missing operating leverage due to revenue decline (~100bp QoQ), (3) wage hike impact (130bp QoQ), and (4) cyclical in Comviva (~50bp QoQ).
- The majority of the wage hikes have been rolled out during the quarter at the junior and mid-level, while the proportion for the senior leadership team would be given out in 2Q.
- The company is reducing subcon expenses while replacing the same with the similar skillset of full-time hire.
- The company touched upon multiple margin levers and expects a gradual recovery from the current level: (1) Juniorization of pyramid, (2) Drive offshoring up by 400-500bp in the medium term, (3) Divesting in non-strategic portfolio, and (4) Reducing subcon % of revenue by 400bp to 10% from the current level.

Exhibit 1: CME dragged down growth in 1QFY24

Verticals	Contribution to revenue (%)	Growth (QoQ %)
Comm., Media, and Ent.	37.8	-9.5
Manufacturing	16.9	2.0
Technology	10.7	-0.3
BFSI	16.1	-2.8
Retail, Transport, and Logistics	7.9	-0.2
Others	10.6	-0.2

Exhibit 2: Europe was weakest in 1QFY24

Geographies	Contribution to revenue (%)	Growth (QoQ %)
Americas	51.4	-0.5
Europe	24.6	-6.7
Rest of the World	24.0	-8.2

Valuation and view

- Although its 1Q performance was weak, TECHM's high exposure to the Communications vertical offers a potential opportunity, as a broader 5G rollout is likely to result in a new spending cycle in this space.
- Near-term growth remains weak and we await greater comfort on margins. We value the stock at 17x FY25E EPS. **We maintain our Neutral rating on the stock.**

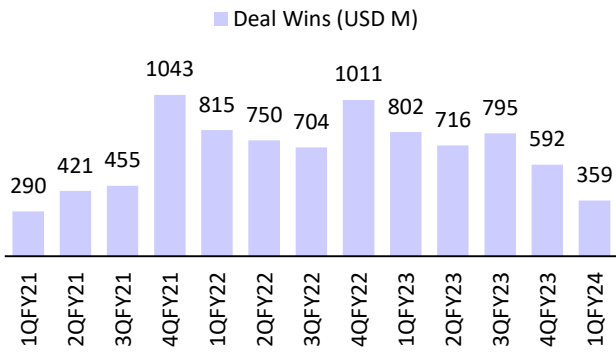
Exhibit 3: Revisions to our estimates

	Revised estimate		Earlier estimate		Change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
USD:INR	82.1	82.0	82.1	82.0	0.0%	0.0%
Revenue (USD m)	6,548	7,246	6,724	7,411	-2.6%	-2.2%
Growth (%)	(0.9)	10.7	1.8	10.2	-270bps	40bps
EBIT margin (%)	10.6	12.2	11.5	12.9	-90bps	-70bps
PAT (INR b)	45	56	50	61	-9.9%	-8.1%
EPS	50.9	63.7	56.5	69.4	-10.0%	-8.2%

Source: MOFSL, Company

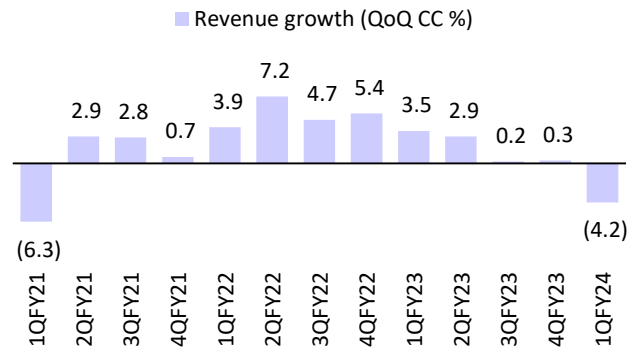
Story in charts

Exhibit 4: Deal wins further moderated in 1QFY24



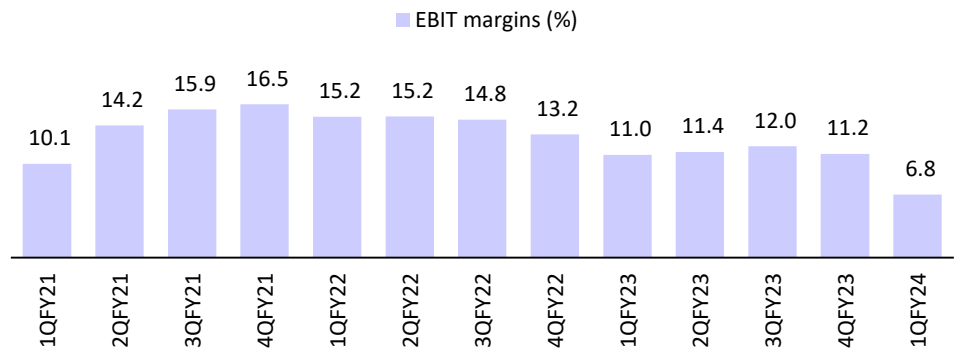
Source: Company, MOFSL

Exhibit 5: Revenue was weak QoQ CC in 1QFY24



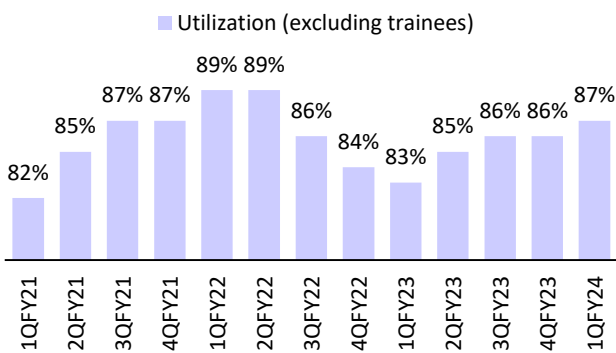
Source: Company, MOFSL

Exhibit 6: EBIT margin saw a sharp decline of 440bp QoQ in 1QFY24



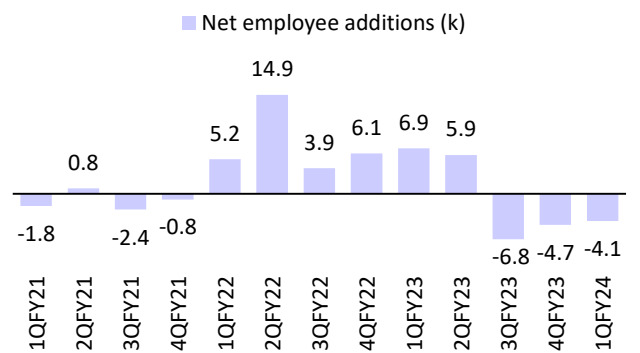
Source: Company, MOFSL

Exhibit 7: Utilization improved by 100bp in 1QFY24



Source: Company, MOFSL

Exhibit 8: Headcount declined for the third straight quarter



Source: Company, MOFSL

Exhibit 9: Operating metrics

	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24
Revenue by Geography (%)									
Americas	46.7	47.8	48.9	48.3	49.6	50.8	49.7	49.6	51.4
Europe	27.2	25.9	25.5	26.4	25.5	24.5	24.4	25.3	24.6
Rest of World	26.1	26.3	25.6	25.3	24.9	24.7	25.9	25.1	24.0
Vertical Split (%)									
Telecom	40.0	40.1	40.9	40.6	40.4	39.7	39.8	40.1	37.8
Manufacturing	16.5	16.0	15.8	14.9	15.3	16.0	15.7	15.9	16.9
Tech Media Entertainment	8.8	9.0	8.4	9.3	9.7	10.1	10.3	10.3	10.7
BFSI	16.4	16.3	15.4	17.4	16.7	16.3	15.9	15.9	16.1
Retail Transport Logistics	7.7	7.8	8.5	7.6	7.9	8.1	8.5	7.6	7.9
Others	10.6	10.8	11.0	10.2	10.0	9.8	9.8	10.2	10.6
Client Metrics									
No. of active clients	1,058	1,123	1,191	1,224	1,262	1,262	1,290	1,297	1,255
% of repeat business	96.0	93.0	92.0	87.0	98.0	98.0	93.0	92.0	98.0
No. of Million \$ clients									
USD1m+	466	488	502	524	549	549	574	582	580
USD5m+	168	169	173	174	176	176	185	186	190
USD10m+	86	90	96	97	104	104	109	112	115
USD20m+	51	50	50	54	60	60	65	65	62
USD50m+	22	22	22	23	23	23	24	24	26
Client concentration (%)									
Top 5 Clients	22.0	22.0	23.0	22.0	21.0	19.0	18.0	18.0	17.0
Top 6-10	9.0	9.0	8.0	9.0	9.0	9.0	9.0	9.0	10.0
Top 11-20	12.0	12.0	11.0	12.0	11.0	12.0	13.0	13.0	12.0
Headcount									
Software professionals	69,877	76,800	81,115	85,830	88,030	86,776	84,874	83,789	81,521
BPO	49,668	57,058	56,297	57,315	61,392	68,388	63,568	60,102	58,079
Sales and support	6,718	7,335	7,655	8,028	8,613	8,748	8,626	8,509	8,697
Total	1,26,263	1,41,193	1,45,067	1,51,173	1,58,035	1,63,912	1,57,068	1,52,400	1,48,297
IT Attrition (LTM %)	17	21	24	24	22	20	17	15	13
IT Utilization (%)	88	87	84	83	83	85	86	86	87
IT Utilization (excl. trainees)	89	89	86	84	83	85	86	86	87
DSO - incl. unbilled	93	92	101	97	100	98	98	96	98
Borrowings (USD m)	218.0	206.0	210.0	209.0	220.0	207.0	212.0	192.0	185.0
Cash and Cash Equivalent (USD m)	1,818.0	1,626.0	1,346.0	1,140.7	1,114.0	947.0	780.0	905.0	939.0
Capital Expenditure (USD m)	22.0	23.0	26.0	46.0	20.0	19.0	31.0	32.0	25.0

Source: Company, MOFSL

Financials and valuations

Income Statement								(INR b)
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Sales	308	347	369	379	446	533	537	594
Change (%)	5.6	12.9	6.1	2.7	17.9	19.4	0.8	10.6
COGS	215	234	260	259	310	381	390	421
SGA expenses	45	50	52	52	57	71	72	80
Total Expenses	261	284	311	310	366	453	462	501
Adj. EBITDA	47	63	57	68	80	80	75	93
As a percentage of Net Sales	15.3	18.2	15.5	18.1	18.0	15.1	14.0	15.6
Depreciation	11	11	14	15	15	20	19	20
Other Income	12	3	10	6	10	6	3	3
Adj. PBT	49	55	53	60	75	67	60	75
Tax	11	13	12	15	18	16	15	19
Rate (%)	22.4	22.6	22.0	25.3	24.4	23.7	24.3	25.0
Adj. PAT	38	43	41	45	56	51	45	57
Minority interest	0	0	-1	-1	1	1	0	0
Share from associates	0	0	0	0	0	0	0	0
PAT before EO	38	43	43	46	56	51	45	56
Change (%)	33.9	13.1	-1.1	7.2	22.1	-8.9	-11.1	25.2
Extraordinary Items (EO)	0	0	-2	-1	0	-2	-3	-3
Reported PAT	38	43	40	44	56	48	42	54
Change (%)	33.9	13.1	-6.2	9.8	25.7	-13.2	-12.1	26.7

Balance Sheet								(INR b)
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Share Capital	4	4	4	4	4	4	4	4
Reserves	184	198	214	244	264	275	282	291
Net Worth	188	203	218	249	269	279	286	295
Minority Interest	5	5	4	4	5	5	5	5
Loans	17	14	24	17	16	16	16	16
Other long-term liabilities	12	9	28	28	36	31	30	33
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	235	243	287	309	338	343	350	361
Applications								
Assets	79	73	89	91	149	149	146	145
Investments	15	12	2	6	4	6	6	6
Other non-current assets	30	33	50	47	50	62	62	69
Curr. Assets	181	216	232	253	245	244	253	270
Debtors	65	70	76	65	75	81	83	92
Cash and Bank Balance	20	20	30	27	38	41	33	18
Investments	75	98	57	98	46	30	55	80
Other Current Assets	22	28	68	63	86	93	83	79
Current Liab. and Prov.	70	91	87	88	111	119	118	128
Net Current Assets	111	124	145	165	134	126	135	141
Application of Funds	235	243	287	309	338	343	350	361

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)								
EPS	43.0	48.5	48.7	52.1	63.2	57.6	51.0	63.9
Diluted EPS	42.7	47.7	48.3	51.7	62.6	57.3	50.9	63.7
Cash EPS	54.8	60.3	62.3	66.7	79.7	76.7	68.8	83.5
Book Value	213.4	228.7	249.9	284.4	305.2	317.3	324.1	334.0
DPS	14.0	14.0	15.0	45.0	45.0	50.0	43.3	54.1
Payout (%)	32.8	29.3	31.0	87.1	71.9	87.3	85.0	85.0
Valuation (x)								
P/E ratio	26.6	23.6	23.5	21.9	18.1	19.9	22.4	17.9
Cash P/E ratio	20.9	19.0	18.4	17.1	14.3	14.9	16.6	13.7
EV/EBITDA ratio	21.4	15.9	17.3	14.5	12.3	12.2	13.2	10.9
EV/Sales ratio	3.3	2.9	2.7	2.6	2.2	1.8	1.8	1.7
Price/Book Value	5.4	5.0	4.6	4.0	3.7	3.6	3.5	3.4
Dividend Yield (%)	1.2	1.2	1.3	3.9	3.9	4.4	3.8	4.7
Profitability Ratios (%)								
RoE	21.5	22.0	20.2	19.5	21.5	18.5	15.9	19.4
RoCE	17.2	22.8	17.3	19.3	21.0	18.6	17.1	21.3
Turnover Ratios								
Debtors (Days)	77	73	75	62	61	56	56	56
Fixed Asset Turnover (x)	3.9	4.7	4.1	4.1	3.0	3.6	3.7	4.1
Leverage Ratio								
Debt/Equity Ratio (x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Cash Flow Statement

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
(INR b)								
CF from Operations	43	55	49	65	67	74	64	77
Change in Working Capital	-8	-11	-5	16	-14	-18	7	0
Net Operating CF	36	44	44	81	53	56	71	77
Net Purchase of FA	-8	-8	-8	-6	-8	-10	-15	-19
Free Cash Flow	28	37	35	75	45	46	56	58
Net Purchase of Invest.	-26	-13	19	-49	13	7	-25	-25
Net Cash from Invest.	-34	-21	10	-55	5	-3	-40	-44
Inc./ (Dec.) in Equity	0	0	0	1	1	0	0	0
Proceeds from LTB/STB	6	-6	-20	-13	-8	-9	0	0
Dividend Payments	-9	-17	-25	-18	-40	-43	-38	-48
Cash Flow from Fin.	-3	-23	-45	-30	-47	-51	-38	-48
Other adjustments	0	0	1	0	0	1	0	0
Net Cash Flow	0	1	10	-3	11	3	-7	-15
Opening Cash Balance	20	20	20	30	27	38	41	33
Add: Net Cash	0	1	10	-3	11	3	-7	-15
Closing Cash Balance	20	20	30	27	38	41	33	18

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