

BUY Tech Mahindra

Your success is our success

Weak performance; all eyes on future strategy

Information Technology ▶ Result Update ▶ October 25, 2023

TARGET PRICE (Rs): 1,330

Tech Mahindra posted another weak set of results—revenue declined 2.8% QoQ (2.4%, CC terms) to USD1.55bn, below our estimate. Reported EBITM declined by 210bps QoQ to 4.7% and adj. EBITM fell by 140bps QoQ, also missing our estimates. Weakness persisted in CME (down 4.9% QoQ), which is unlikely to see any near-term material recovery, with 5G spends not picking up. Deal wins improved QoQ to USD640mn, but stayed lower YoY due to weak discretionary spending and elongated sales cycle. Management has announced organizational restructuring, to simplify & streamline the business into six strategic units, for fostering deeper client relationships. It plans to share its detailed business plan and growth strategy with investors in Apr-24. We cut FY24E EPS by a sharp ~28%, factoring-in the Q2 miss and near-term weakness, while lowering our FY25-26 estimates by under 3%, anticipating recovery in performance as the new management's strategy & execution starts showing results. We maintain BUY with revised TP of Rs1,330/share (from Rs1,360) at 18x Sep-25E EPS.

Tech Mahindra: Financial Snapshot (Consolidated)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	4,46,460	5,32,902	5,19,527	5,61,592	6,22,506
EBITDA	80,200	80,288	55,402	95,607	1,06,661
Adj. PAT	55,660	48,313	29,060	59,444	68,343
Adj. EPS (Rs)	63.4	54.9	33.0	67.5	77.6
EBITDA margin (%)	18.0	15.1	10.7	17.0	17.1
EBITDA growth (%)	17.1	0.1	(31.0)	72.6	11.6
Adj. EPS growth (%)	25.2	(13.4)	(39.9)	104.6	15.0
RoE (%)	21.5	18.5	10.8	19.9	21.0
RoIC (%)	30.3	22.8	13.4	28.0	31.8
P/E (x)	18.0	20.8	34.6	16.9	14.7
EV/EBITDA (x)	11.6	11.8	16.8	9.4	8.3
P/B (x)	3.7	3.6	3.5	3.2	3.0
FCFF yield (%)	4.4	4.6	3.3	6.7	5.9

Source: Company, Emkay Research

Results Summary

Revenue declined 2.8% QoQ (2.4% in CC terms) to USD1.55bn in Q2, below our estimate of USD1.59bn. CME declined 4.9% QoQ (after a 9.4% fall in Q1). Technology, BFSI, and Others declined 0.5%, 3%, and 8.4% QoQ, while Manufacturing and RTL grew 2.2% and 0.7%, respectively. Among geographies, The Americas grew 0.7% QoQ, while Europe and ROW declined 6.8% and 6.4%, respectively. Reported EBITM fell by another 210bps QoQ to 4.7%, while adjusted EBITM declined by 140bps QoQ to 7.3%. Net new-deal wins improved to USD640mn, post the weak performance in Q1. Total headcount increased 1.6% QoQ to 150,604 due to net addition of 2,906 employees in BPO. Utilization declined to 86%, from 87% in Q1. The company has declared an interim dividend of Rs12 per share. **What we like:** Healthy deal wins, moderation in attrition to 11.4% (from 12.8% in Q1) and healthy cash generation (OCF/ EBITDA of ~184%). **What we did not like:** Weak operating performance.

Earnings Call KTAs

i) Revenue in Q2 was impacted by the tougher macro environment, weak discretionary spending, elongated sales cycle, and business rationalization actions. Management has taken actions to exit/divest businesses that are not strategically suitable; this impacted revenue and margins in Q2. Management expects portfolio rationalization actions to continue in Q3. ii) Large deal intake was USD640mn in Q2 across fintech, digital transformation, and the modernizing legacy network. Deal pipeline for H2 looks healthy, however deal conversion may take slightly longer. iii) Company has announced organizational restructuring effective Jan 1, 2024, to simplify and streamline the business under 6 strategic units, for fostering deeper client relationships. In The Americas, business is organized across 3 industry units (Communications, Tech & Media, and Diverse industries). In the EMEA and APJ, the units will continue to be based region-wise, with verticals coming together for better synergy benefits. TechM has carved out India from APJ as a separate unit, as the Indian market needs a different strategy. From a delivery perspective, Company has 'verticalized' delivery with a total of 8 service lines, to bring-in efficiencies, agility, and better customer experience. iv) Pyramid rationalization, service line mix, profitability of acquired entities, productivity in fixed price portfolio through automation, and sub-contracting cost optimization remain the margin levers for the medium-to-long term. v) Decline in the top-5 clients revenue continued due to portfolio rationalization actions (USD15mn impact on a quarterly basis), cut in spending in top communications customer, and weak discretionary spending.

Target Price – 12M	Sep-24
Change in TP (%)	(2.2)
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	16.4
CMP (25-Oct-23) (Rs)	1,142.2

Stock Data	Ticker
52-week High (Rs)	1,320
52-week Low (Rs)	981
Shares outstanding (mn)	975.6
Market-cap (Rs bn)	1,114
Market-cap (USD mn)	13,394
Net-debt, FY24E (Rs mn)	-73,098
ADTV-3M (mn shares)	3
ADTV-3M (Rs mn)	3,344.4
ADTV-3M (USD mn)	40.2
Free float (%)	64.0
Nifty-50	19,122
INR/USD	83.2
Shareholding, Sep-23	
Promoters (%)	35.1
FPIs/MFs (%)	26.2/27.1

Price Performance

(%)	1M	3M	12M
Absolute	(12.1)	(1.2)	7.3
Rel. to Nifty	(9.6)	1.6	(0.5)

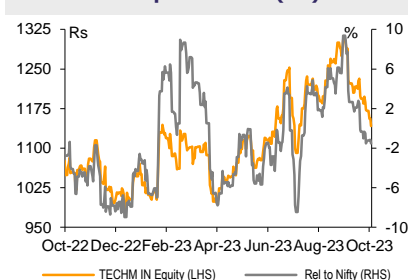
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Exhibit 1: Quarterly snapshot

(Rs mn)	Q2FY24	Q1FY24	QoQ (%)	Q2FY23	YoY (%)
Revenue (USD mn)	1,555	1,601	-2.8	1,638	-5.1
Net sales	1,28,639	1,31,590	-2.2	1,31,295	-2.0
Total Income	1,28,639	1,31,590	-2.2	1,31,295	
Operating expenses	1,17,916	1,18,210		1,11,453	
EBITDA	10,723	13,380	-19.9	19,841	-46.0
EBITDA margin (%)	8.3	10.2	-180	15.1	-680
Depreciation	4,657	4,466		4,917	
EBIT	6,066	8,914	-31.9	14,924	-59.4
EBIT margin (%)	4.7	6.8	-210	11.4	-670
Interest	(975)	(1,197)		(790)	
Other income	2,642	1,917		2,902	
Pre-tax profit	7,733	9,634	-19.7	17,036	-54.6
Tax provided	1,100	2,676		3,647	
Profit after tax	6,633	6,958	-4.7	13,389	-50.5
MI	(199)	(33)		(291)	
Reported Profit After tax	4,939	6,925	-28.7	12,854	-61.6
Emkay Net Profit	6,434	6,925	-7.1	13,098	-50.9
EPS (Rs)	7.3	7.9	-7.2	14.9	-51.0

Source: Company, Emkay Research

Exhibit 2: Actuals vs estimates

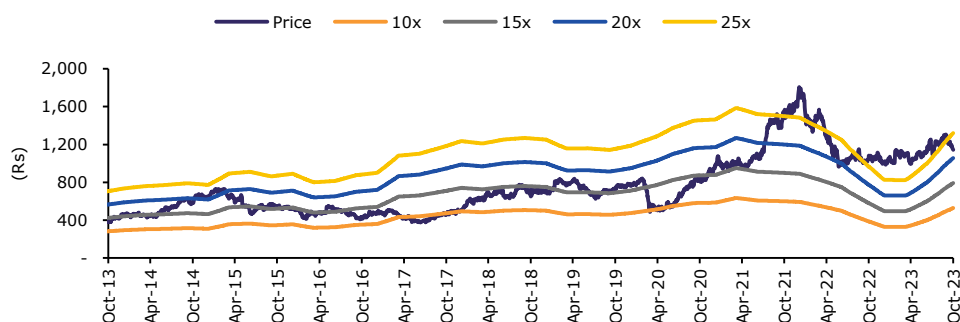
(Rs mn)	Actual	Estimate		Variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenues (USD mn)	1,555	1,593	1,585	-2.4%	-1.9%	USD revenue growth was below our expectations.
Sales	1,28,639	1,31,560	1,31,054	-2.2%	-1.8%	
EBIT	6,066	12,485	7,601	-51.4%	-20.2%	Adjusted EBITM declined by 140bps sequentially and came below expectations.
EBIT margin	4.7%	9.5%	5.8%	-480 bps	-110 bps	
Profit	6,434	9,749	6,422	-34.0%	0.2%	Profit missed expectations due to operating performance miss and impairment of goodwill.

Source: Company, Emkay Research

Exhibit 3: Changes in estimates

(Rs mn)	FY24E			FY25E			FY26E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue (USD mn)	6,443	6,280	-2.5%	6,927	6,686	-3.5%	7,585	7,324	-3.4%
YoY growth	-2.5%	-4.9%		7.5%	6.5%		9.5%	9.5%	
Revenue	5,32,857	5,19,527	-2.5%	5,81,904	5,61,592	-3.5%	6,44,744	6,22,506	-3.4%
EBIT	51,727	36,857	-28.7%	79,177	76,469	-3.4%	90,161	86,840	-3.7%
EBITM (%)	9.7	7.1		13.6	13.6		14.0	14.0	
Net Profit	40,163	29,060	-27.6%	61,132	59,444	-2.8%	70,092	68,343	-2.5%
EPS (Rs)	45.6	33.0	-27.7%	69.4	67.5	-2.8%	79.6	77.6	-2.6%

Source: Company, Bloomberg, 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	4,46,460	5,32,902	5,19,527	5,61,592	6,22,506
Revenue growth (%)	17.9	19.4	(2.5)	8.1	10.8
EBITDA	80,200	80,288	55,402	95,607	1,06,661
EBITDA growth (%)	17.1	0.1	(31.0)	72.6	11.6
Depreciation & Amortization	15,204	19,567	18,545	19,137	19,821
EBIT	64,996	60,721	36,857	76,469	86,840
EBIT growth (%)	21.7	(6.6)	(39.3)	107.5	13.6
Other operating income	0	0	0	0	0
Other income	11,123	9,650	7,626	7,059	8,634
Financial expense	1,626	3,256	3,767	3,201	3,201
PBT	74,493	67,115	40,717	80,327	92,273
Extraordinary items	0	(2,370)	(1,495)	0	0
Taxes	18,220	15,885	9,730	20,483	23,530
Minority interest	(613)	(547)	(432)	(400)	(400)
Income from JV/Associates	0	0	0	0	0
Reported PAT	55,660	48,313	29,060	59,444	68,343
PAT growth (%)	25.7	(13.2)	(39.9)	104.6	15.0
Adjusted PAT	55,660	48,313	29,060	59,444	68,343
Diluted EPS (Rs)	63.4	54.9	33.0	67.5	77.6
Diluted EPS growth (%)	25.2	(13.4)	(39.9)	104.6	15.0
DPS (Rs)	45.0	50.0	24.5	40.0	45.0
Dividend payout (%)	70.9	91.0	74.3	59.3	58.0
EBITDA margin (%)	18.0	15.1	10.7	17.0	17.1
EBIT margin (%)	14.6	11.4	7.1	13.6	14.0
Effective tax rate (%)	24.5	23.7	23.9	25.5	25.5
NOPLAT (pre-IndAS)	49,098	46,349	28,049	56,970	64,696
Shares outstanding (mn)	877.6	879.9	881.3	881.3	881.3

Source: Company, Emkay Research

Cash flows					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	74,493	67,115	40,717	80,327	92,273
Others (non-cash items)	15,812	29,647	18,113	18,737	19,421
Taxes paid	(23,137)	(19,931)	(9,730)	(20,483)	(23,530)
Change in NWC	(14,343)	(18,451)	(8,059)	(415)	(15,667)
Operating cash flow	52,853	55,720	41,041	78,166	72,497
Capital expenditure	(8,353)	(9,692)	(7,928)	(10,430)	(12,830)
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)	(25,096)	(10,430)	(12,830)
Equity raised/(repaid)	1,175	442	6	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)	(21,591)	(35,251)	(39,657)
Others	0	0	0	0	0
Financing cash flow	(46,666)	(50,781)	(21,468)	(35,251)	(39,657)
Net chg in Cash	11,002	2,154	(5,523)	32,486	20,010
OCF	52,853	55,720	41,041	78,166	72,497
Adj. OCF (w/o NWC chg.)	67,196	74,171	49,099	78,581	88,164
FCFF	44,500	46,028	33,113	67,736	59,667
FCFE	43,958	44,220	29,346	64,535	56,466
OCF/EBITDA (%)	65.9	69.4	74.1	81.8	68.0
FCFE/PAT (%)	79.0	91.5	101.0	108.6	82.6
FCFF/NOPLAT (%)	90.6	99.3	118.1	118.9	92.2

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	4,388	4,400	4,406	4,406	4,406
Reserves & Surplus	2,64,469	2,74,845	2,82,314	3,06,506	3,35,192
Net worth	2,68,857	2,79,245	2,86,720	3,10,913	3,39,599
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	2,85,073	2,89,101	2,96,693	3,20,886	3,49,572
Net tangible fixed assets	26,823	28,622	26,081	25,853	25,661
Net intangible assets	37,383	33,425	25,994	19,065	12,283
Net ROU assets	9,372	10,972	8,668	7,119	7,101
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	88,073	1,20,559	1,40,569
Current assets (ex-cash)	2,02,446	2,21,628	2,26,241	2,34,607	2,61,789
Current Liab. & Prov.	1,55,443	1,59,467	1,56,021	1,63,973	1,75,488
NWC (ex-cash)	47,003	62,161	70,220	70,634	86,301
Total assets	2,85,073	2,89,101	2,96,693	3,20,886	3,49,572
Net debt	(73,682)	(61,570)	(73,098)	(1,05,584)	(1,25,594)
Capital employed	2,85,073	2,89,101	2,96,693	3,20,886	3,49,572
Invested capital	1,94,839	2,11,837	2,07,620	1,99,327	2,08,003
BVPS (Rs)	306.4	317.4	325.3	352.8	385.4
Net Debt/Equity (x)	(0.3)	(0.2)	(0.3)	(0.3)	(0.4)
Net Debt/EBITDA (x)	(0.9)	(0.8)	(1.3)	(1.1)	(1.2)
Interest coverage (x)	0.0	0.0	0.1	0.0	0.0
RoCE (%)	27.9	24.5	15.2	27.1	28.5

Source: Company, Emkay Research

Valuations and key Ratios

Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	18.0	20.8	34.6	16.9	14.7
P/CE(x)	14.1	14.3	20.5	12.8	11.4
P/B (x)	3.7	3.6	3.5	3.2	3.0
EV/Sales (x)	2.1	1.8	1.8	1.6	1.4
EV/EBITDA (x)	11.6	11.8	16.8	9.4	8.3
EV/EBIT(x)	14.3	15.5	25.3	11.8	10.1
EV/IC (x)	4.8	4.5	4.5	4.5	4.2
FCFF yield (%)	4.4	4.6	3.3	6.7	5.9
FCFE yield (%)	4.4	4.4	2.9	6.4	5.6
Dividend yield (%)	3.9	4.4	2.1	3.5	3.9
DuPont-RoE split					
Net profit margin (%)	12.5	9.5	5.9	10.6	11.0
Total asset turnover (x)	1.6	1.9	1.8	1.8	1.9
Assets/Equity (x)	1.1	1.0	1.0	1.0	1.0
RoE (%)	21.5	18.5	10.8	19.9	21.0
DuPont-RoIC					
NOPLAT margin (%)	11.0	8.7	5.4	10.1	10.4
IC turnover (x)	2.8	2.6	2.5	2.8	3.1
RoIC (%)	30.3	22.8	13.4	28.0	31.8
Operating metrics					
Core NWC days	38.4	42.6	49.3	45.9	50.6
Total NWC days	38.4	42.6	49.3	45.9	50.6
Fixed asset turnover	7.8	7.1	6.8	7.3	8.1
Opex-to-revenue (%)	82.0	84.9	89.3	83.0	82.9

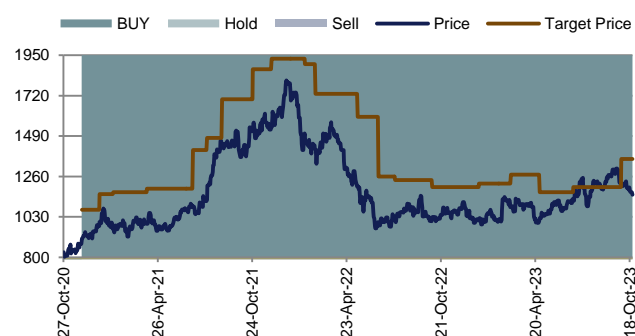
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	CMP (INR)	TP (INR)	Rating	Analyst
02-Oct-23	1,223	1,360	Buy	Dipeshkumar Mehta
26-Jul-23	1,143	1,200	Buy	Dipeshkumar Mehta
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: Company, Bloomberg, Emkay Research

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