Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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		↔	

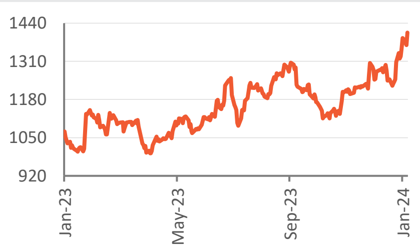
Company details

Market cap:	Rs. 1,37444 cr
52-week high/low:	Rs. 1,416 / 983
NSE volume: (No of shares)	24 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	63.35 cr

Shareholding (%)

Promoters	35.1
FII	24.6
DII	28.9
Others	11.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.5	21.9	22.0	31.5
Relative to Sensex	11.6	11.8	14.9	14.9

Sharekhan Research, Bloomberg

Stock Update

Result Update

Tech Mahindra Ltd

Weak Quarter; maintain Reduce

IT & ITeS	Sharekhan code: TECHM
Reco/View: Reduce ↔	CMP: Rs. 1,408
	Price Target: Rs. 1,300 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q3FY24 revenue stood at $1,573 million, up 1.1% q-o-q/ down 5.4% y-o-y beating our estimates of 0.8% q-o-q decline in CC terms, aided by the manufacturing, retail and Others verticals; this was partially offset by weakness in BFSI and Technology verticals.
- EBIT margin rose 65 bps q-o-q to 5.4% on account of lower cost of sales yet lagged our estimate of 5.6%. Net new deal win TCV stood at $381 million, down 42%/52% on q-o-q and y-o-y basis respectively.
- Management stated that though the market environment is slightly more positive currently than it was two quarters ago but said it's still too early to call it green shoots.
- We believe that continuing challenges in the telecom sector may continue to impact Tech Mahindra's earnings outlook. Hence, we maintain Reduce on Tech Mahindra with revised PT of Rs 1300 (the increase in PT reflects increase in target multiple to factor anticipated recovery from restructuring efforts). At CMP the stock traded at 24.4/20.5x its FY25/26E EPS.

Tech Mahindra reported Q3FY24 revenue of $1,573 million, up 1.1% q-o-q/ down 5.4% y-o-y beating our estimates of degrowth of 0.8% q-o-q in constant currency (CC) terms. Rupee revenues stood at 13,101 crore, up 1.8% q-o-q/ down 4.6% y-o-y. Growth was led by the manufacturing, retail and others verticals, but partially offset by weakness in the BFSI and technology verticals. The key Communication, Entertainment and Media vertical (CME) vertical was flat q-o-q. EBIT margin rose 65 bps q-o-q to 5.4% but was lower than our estimate of 5.6% on account of lower cost of sales.Net profit stood at Rs 510.4 crore, down 20.7% q-o-q/60.6% y-o-y owing to higher interest expense and lower other income. Net new deal win TCV stood at $381 million, down 42%/52% on q-o-q and y-o-y basis respectively. Revenue from Top5 and Top 10 Clients declined 4.8%/2.6% q-o-q, respectively while revenue from Top20 Clients grew 1.1% q-o-q. LTM Attrition moderated 100 bps q-o-q to10%. Utilisation improved 200 bps q-o-q to 88%. Net headcount additions fell by 4,354 taking the total to 1,46,250. We believe that organisational restructuring and other measures taken by the new CEO would aid in a gradual turnaround. However, with headwinds still persisting for key telecom vertical we believe Tech Mahindra earnings outlook remains at risk. Hence, we maintain Reduce on Tech Mahindra with revised price target (PT) of Rs 1300 (the increase in PT reflects the increase in target multiple to factor anticipated recovery from restructuring efforts). At CMP the stock traded at 24.4/20.5x its FY25/26E EPS.

Key positives

- LTM attrition moderated 100 bps q-o-q to 10%
- IT improved to 88%, up 200 bps q-o-q.

Key negatives

- Net new deal wins (TCV) stood at $381 million, down 42%/52% on q-o-q and y-o-y basis respectively.
- Net headcount declined by 4,354 taking the total headcount to 1,46,250.

Management Commentary

- Management does not see telecom vertical having bottomed out and still sees a significant amount of volatility at least for the next couple of quarters.
- The management expects the 7.0% level to be the bottom for EBIT margin and expects improvement going forward.
- The management stated that though the market environment is slightly more positive currently than it was two quarters ago but indicated it's still too early to call it green shoots.
- The company is undergoing organizational restructuring and above normal investments would be required to turnaround.

Revision in estimates – We have revised our estimates to factor in Q3FY24 performance.

Our Call

Valuation – Maintain Reduce with PT of Rs. 1300: Although Tech Mahindra reported healthy revenue growth for the quarter the overall performance continues to remain sluggish owing to headwinds on Telecom vertical and on account of business rationalisation. We believe that the organizational restructuring and other measures taken by New CEO would aid in a gradual turnaround. However, with headwinds persisting for key telecom vertical we believe Tech Mahindra earnings outlook continues to remain at risk. Hence, we maintain Reduce on Tech Mahindra with revised PT of Rs. 1300 (the increase in PT reflects the increase in target multiple to factor anticipated recovery from restructuring efforts). At CMP the stock traded at 24.4/20.5x its FY25/26E EPS.

Key Risks

Faster-than-expected 5G roll-outs globally, Successful execution of re prioritization plans, Tailwinds from margin levers aiding faster normalization of EBIT margins.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	44,646.0	53,290.2	52,512.5	57,046.7	63,399.6
OPM (%)	18.0	15.1	10.2	14.3	15.4
Adjusted PAT	5,566.1	5,249.3	3,187.7	5,086.7	6,049.7
% YoY growth	24.3	-5.7	-39.3	59.6	18.9
Adjusted EPS (Rs.)	62.8	59.7	36.2	57.8	68.7
P/E (x)	22.4	23.6	38.9	24.4	20.5
P/B (x)	4.6	4.4	4.1	3.8	3.5
EV/EBITDA (x)	16.1	16.2	22.9	14.7	11.9
RoNW (%)	21.5	19.2	11.1	16.5	18.0
RoCE (%)	23.3	20.5	12.1	18.4	20.3

Source: Company; Sharekhan estimates

Key result highlights

- **Revenue growth:** Company reported revenues of $1,573 million, up 1.1% q-o-q/ down 5.4% y-o-y beating our estimates of degrowth of 0.8% q-o-q in constant currency. Rupee revenue stood at 13,101 crore, up 1.8% q-o-q/ down 4.6% y-o-y. Growth was led by Manufacturing. Retail and Others partially offset by weakness in BFSI and Technology. CME vertical was flat q-o-q. IT service revenues stood at 11,183.4 crore, up 2.3% q-o-q/ down 5.2% y-o-y while BPO revenues stood at Rs. 1917.9 crore, down 0.7%/0.9% q-o-q and y-o-y, respectively.
- **EBIT margin:** It improved 65 bps q-o-q to 5.4% but was lower than our estimate of 5.6% on account of lower cost of sales.Net Profit stood at Rs 510.4 crore down 20.7% q-o-q/60.6% y-o-y owing to higher interest expense and lower other income.
- **Verticals & geography-wise:** Manufacturing, Retail and Others grew 2.8%/6.1% and 9.2% q-o-q respectively while BFSI, Technology and CME declined by 2.6%/3.5% and 0.2% q-o-q respectively. In terms of geography Europe/ROW grew 2%/5.9% q-o-q while Americas revenue declined 1.5% q-o-q.
- **SG&A expenses and subcontracting costs:** SG&A expenses rose by 9.6% sequentially to Rs. 1990 crore. Sub-contracting costs moderated further to 1509.4 crore at 11.5% of its revenues.
- **Deal wins:** Net new deal win TCV stood at $381 million, down 42%/52% on q-o-q and y-o-y basis respectively. Revenue from Top 5 and Top 10 Clients declined 4.8%/2.6% q-o-q respectively while revenue from Top 20 Clients grew 1.1% q-o-q.
- **Attrition and utilisation:** LTM attrition moderated 100 bps q-o-q to10%. Utilisation improved 200 bps q-o-q to 88%. Net headcount additions fell by 4,354 taking total headcount to 1,46,250.
- **Top accounts:** Revenue from Top5 and Top 10 Clients declined 4.8%/2.6% q-o-q respectively while revenue from Top20 Clients grew 1.1% q-o-q.
- **Cash generation:** Free cash flow (FCF) stood at $228 million with FCF to net income ratio at 373%. Net Cash stood at $843 million versus $784 million in Q2FY24.

Results (Consolidated) Rs cr

Particulars	Q3FY24	Q3FY23	Y-o-Y (%)	Q2FY24	Q-o-Q (%)
Revenues In USD (mn)	**1,573.0**	**1,668.0**	**-5.7**	**1,555.2**	**1.1**
Revenues In INR	**13,101.3**	**13,734.6**	**-4.6**	**12,863.9**	**1.8**
Cost of Services	9,964.9	9,793.7	1.7	9,975.2	-0.1
Gross profit	**3,136.4**	**3,940.9**	**-20.4**	**2,888.7**	**8.6**
SG&A	1,990.0	1,796.9	10.7	1,816.4	9.6
EBITDA	**1,146.4**	**2,144.0**	**-46.5**	**1,072.3**	**6.9**
Depreciation	443.4	498.1	-11.0	465.7	-4.8
EBIT	**703.0**	**1,645.9**	**-57.3**	**606.6**	**15.9**
Other Income	87.5	247.2	-64.6	264.2	-66.9
PBT	**674.0**	**1,780.2**	**-62.1**	**773.3**	**-12.8**
Provision for taxes	155.1	485.9	-68.1	110.0	41.0
Adjusted net profit	**510.4**	**1,296.6**	**-60.6**	**643.4**	**-20.7**
Non Recurring / Exceptional Items	0.0	0.0	-	149.5	-
Reported net profit	**510.4**	**1,296.6**	**-60.6**	**493.9**	**3.3**
EPS (Rs) Excl Treasury Shares	5.8	14.6	-60.4	5.6	4.1
Margin (%)			**BPS**		**BPS**
EBITDA Margins	8.8	15.6	-686	8.3	41
EBIT Margin	5.4	12.0	-662	4.7	65
PAT Margin	3.9	9.4	-554	5.0	-111
Tax rate	23.0	27.3	-428	14.2	879

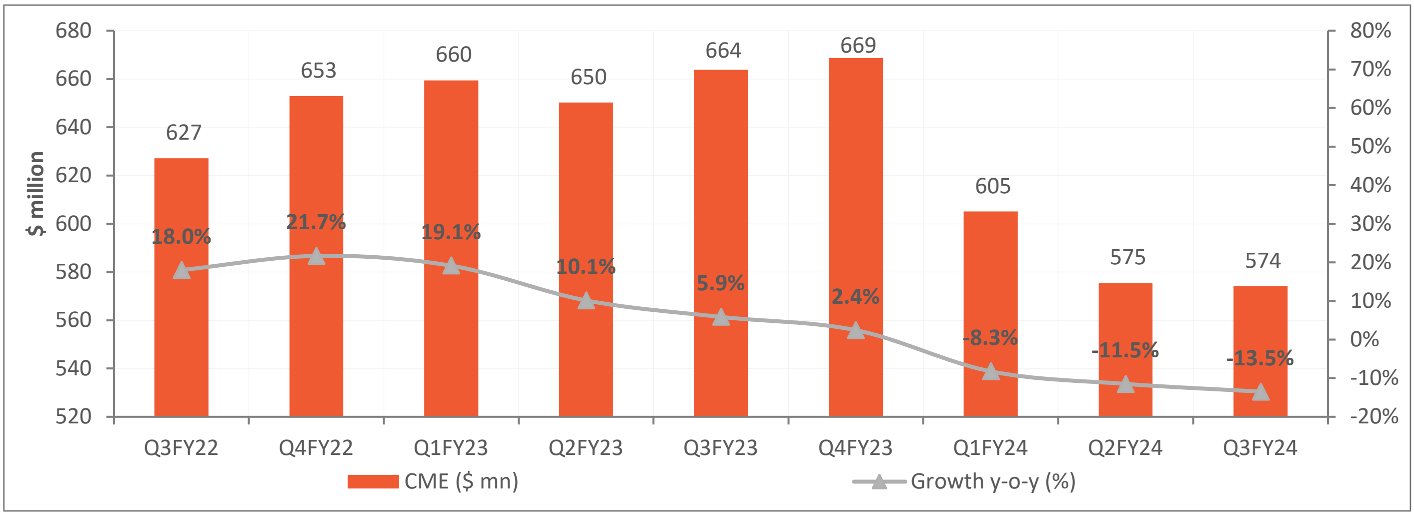
Source: Company; Sharekhan Research

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

Particulars	Revenues	Contribution	$ Growth (%)	
	($ mn)	(%)	Q-o-Q (%)	Y-o-Y (%)
Revenues ($ mn)	1,573	100	1.1	-5.7
Geographic mix				
America	816	51.9	-1.5	-1.5
Europe	374	23.8	2.0	-8.0
RoW	382	24.3	5.9	-11.5
Industry verticals				
CME	574	36.5	-0.2	-13.5
Manufacturing	285	18.1	2.8	8.7
Technology	165	10.5	-3.5	-3.9
BFSI	244	15.5	-2.6	-8.1
Retail, transpost and logistics	135	8.6	6.1	-4.6
Others	170	10.8	9.2	2.9
Clients contribution				
Top 5	252	16.0	-4.8	-16.2
Top 10	409	26.0	-2.6	-9.2
Top 20	613	39.0	1.1	-8.1
Revenue by services		(%)	q-o-q	y-o-y
IT	1,343	85.4	1.6	-6.3
BPO	230	14.6	-1.4	-2.0

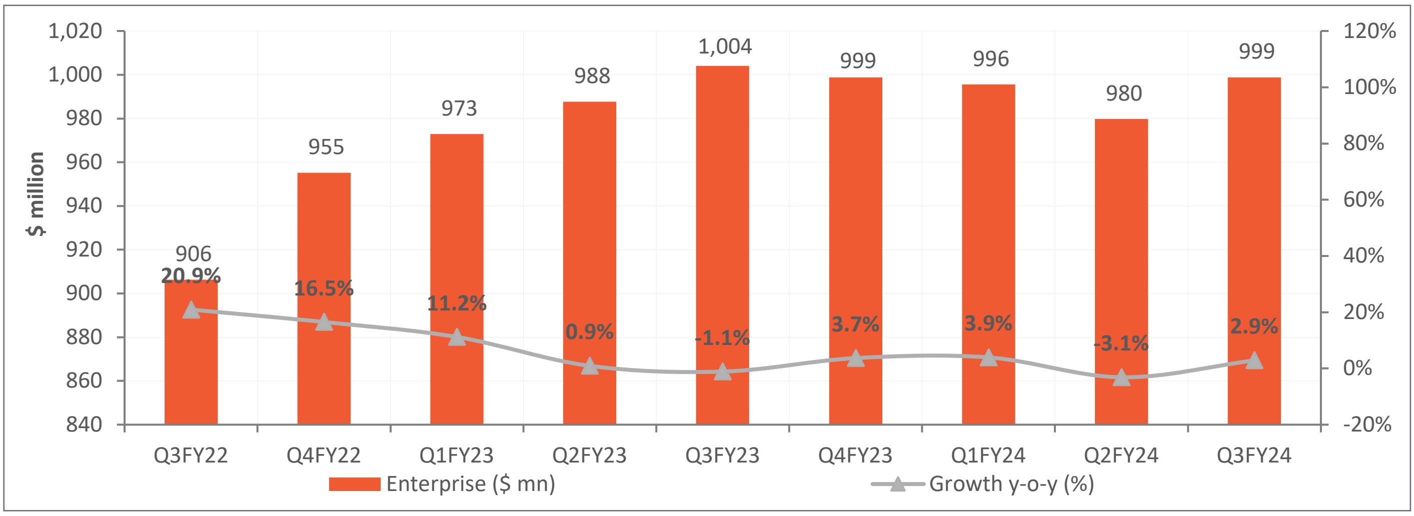
Source: Company; Sharekhan Research

CME vertical revenue growth trend



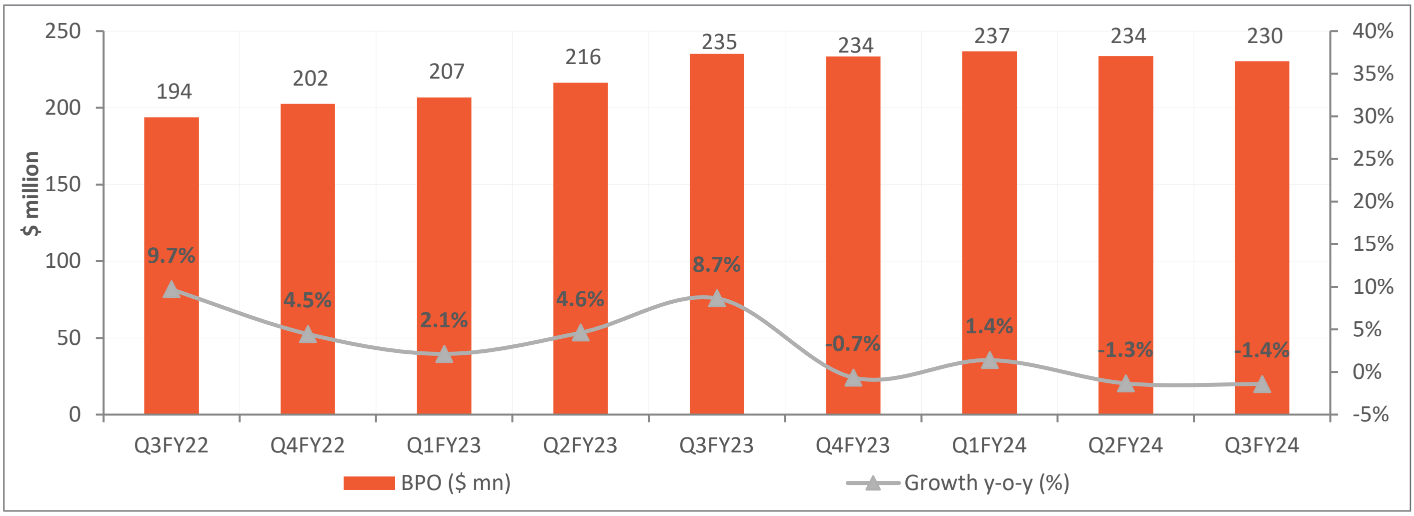
Source: Sharekhan Research

Enterprise vertical revenue growth trend



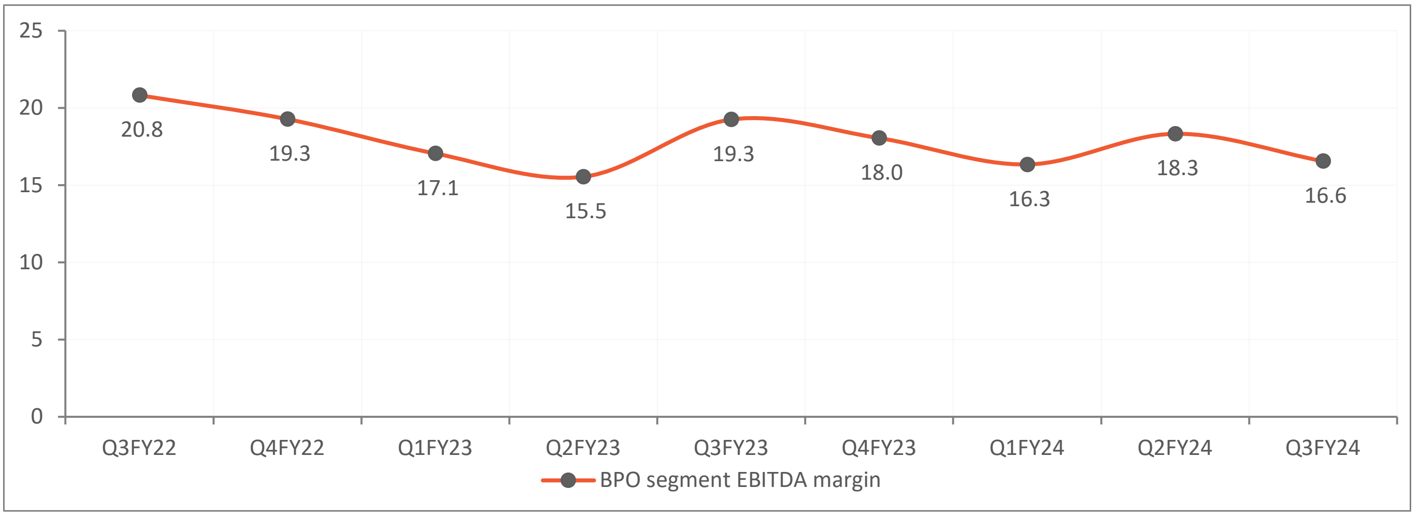
Source: Sharekhan Research

BPO revenue growth trend



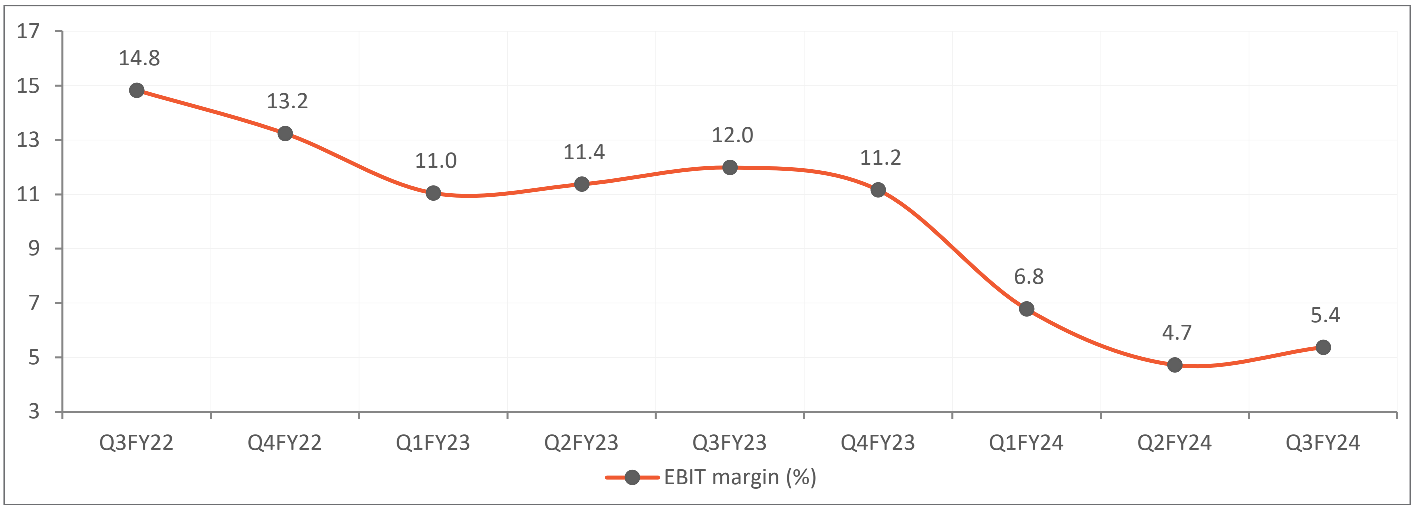
Source: Sharekhan Research

BPO segment's EBITDA margin trend



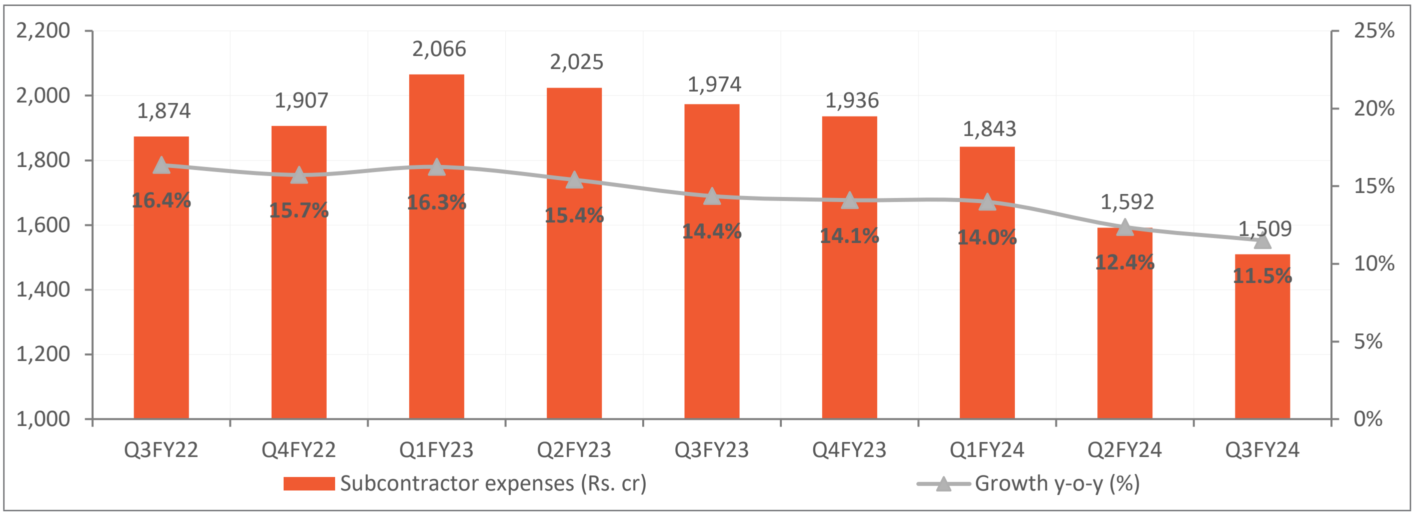
Source: Sharekhan Research

Tech M's EBIT margin trend



Source: Sharekhan Research

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



Source: Sharekhan Research

Outlook and Valuation

■ Sector View – Macro headwinds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25 aided by lower base coupled with easing sector headwinds. Though, IT sector has already outperformed Nifty last year, we expect overall outperformance in CY24 as well driven by receding headwinds and better earnings visibility.

■ 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 – Maintain Reduce with PT of Rs. 1300

Although Tech Mahindra reported healthy revenue growth for the quarter the overall performance continues to remain sluggish owing to headwinds on Telecom vertical and on account of business rationalisation. We believe that the organizational restructuring and other measures taken by New CEO would aid in a gradual turnaround. However, with headwinds persisting for key telecom vertical we believe Tech Mahindra earnings outlook continues to remain at risk. Hence, we maintain Reduce on Tech Mahindra with revised PT of Rs. 1300 (the increase in PT reflects the increase in target multiple to factor anticipated recovery from restructuring efforts). At CMP the stock traded at 24.4/20.5x its FY25/26E 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)Faster-than-expected 5G roll-outs globally 2) Successful execution of re prioritization plans 3)Tailwinds from margin levers aiding faster normalization of EBIT margins

Additional Data

Key management personnel

Mr. Anand Mahindra	Chairman
Mohit Joshi	Managing Director and Chief Executive Officer
Rohit Anand	Chief Financial Officer
Manish Vyas	President, Communications, Media & Entertainment Business
Vivek Agarwal	President – BFSI, HLS and Corporate Development
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	9.64
2	SBI Funds Management Ltd	3.44
3	First State Investments ICVC	2.96
4	ICICI Prudential Asset Management	2.67
5	Vanguard Group Inc	2.55
6	BlackRock Inc	2.12
7	Mitsubishi UFJ Financial Group Inc	2.02
8	Norges Bank	2.01
9	HDFC Asset Management Co Ltd	1.26
10	UTI Asset Management Co Ltd	1.18

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

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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.

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