

Margins bottom out in Q1

About the stock: Tech Mahindra (TechM) has over 1.2 lakh employees across 90 countries serving 1000+ clients with higher exposure to telecom (40% of revenues).

- Apart from telecom, the company caters to BFSI, manufacturing & retail
- TechM has grown organically & inorganically (dollar revenue CAGR of 6.6% over the past five years)

Q1FY23 Results: TechM reported weak margins for Q1FY23

- Dollar revenues increased 1.5% QoQ, while it was up 3.5% QoQ in CC
- EBIT margins dipped 220 bps QoQ at 11.0%
- New deal TCV at US\$802 million (mn), down 20.7% QoQ & 1.6% YoY

What should investors do? TechM's share price has grown by ~2.6x over the past five years (from ~₹ 389 in July 2017 to ~₹ 1,000 levels in July 2022).

- We maintain our **BUY** rating on the stock

Target Price and Valuation: We value TechM at ₹ 1170 i.e. 15x P/E on FY24E EPS

Key triggers for future price performance:

- Healthy deal wins, traction in communication segment led by legacy modernisation, 5G, customer care, automation, network and cloud to drive revenues
- Pruning of low return geographies, acceleration in Europe and improving demand from lift & shift deals to drive 11.8% CAGR growth in FY22-24E
- Margins are expected to recover on pricing, lower subcontractor costs and utilisation improvement

Alternate Stock Idea: Apart from TechM, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 1,760

Tech Mahindra

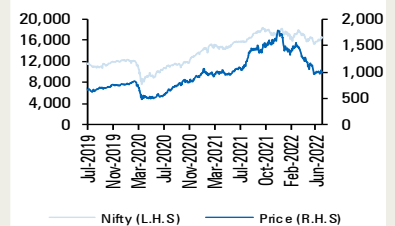
Particulars

| Particular | Amount |
|---------------------------|------------|
| Market Cap (₹ Crore) | 96,630 |
| Total Debt (₹ Crore) | 1,582 |
| Cash and Invest (₹ Crore) | 8,949 |
| EV (₹ Crore) | 89,086 |
| 52 week H/L | 1837 / 944 |
| Equity capital | 439 |
| Face value | ₹ 5 |

Shareholding pattern

| | Sep-21 | Dec-21 | Mar-22 | Jun-22 |
|-----------|--------|--------|--------|--------|
| Promoters | 36 | 36 | 35 | 35 |
| FII | 36 | 35 | 34 | 30 |
| DII | 17 | 17 | 18 | 21 |
| Public | 12 | 12 | 13 | 14 |

Price Chart



Recent event & key risks

- Tech M did 11 acquisitions in FY22
- **Key Risk:** (i) Deceleration in deal pipeline, (ii) Lower than expected margins.

Research Analyst

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Key Financial Summary

| Key Financials | FY20 | FY21 | FY22 | 5 Year CAGR (FY17-22) | FY23E | FY24E | 2 years CAGR (FY22-24E) |
|-------------------|--------|--------|--------|-----------------------|--------|--------|-------------------------|
| Net sales | 36,868 | 37,855 | 44,646 | 8.9 | 51,357 | 55,803 | 11.8 |
| EBITDA | 5,726 | 6,847 | 8,020 | 13.9 | 8,371 | 9,431 | 8.4 |
| EBITDA Margin (%) | 15.5 | 18.1 | 18.0 | | 16.3 | 16.9 | |
| Net Profit | 3,816 | 4,428 | 5,566 | 14.6 | 5,842 | 6,875 | 11.1 |
| EPS (₹) | 59.5 | 50 | 63.1 | | 66 | 78 | |
| P/E | 16.8 | 19.9 | 15.9 | | 15.1 | 12.8 | |
| RoNW (%) | 17.5 | 18 | 20.7 | | 19 | 20 | |
| RoCE (%) | 18.3 | 20 | 22.5 | | 22 | 23 | |

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- The company reported 1.5% QoQ growth in revenues at US\$1,632 mn. In CC terms revenue grew 3.5% QoQ implying cross currency impact of 200 bps. In rupee terms, revenue grew 4.9% QoQ to ₹ 12,708 crore
- Vertical wise the revenue growth was led by Manufacturing (15.3% of mix) which grew by 4.2% QoQ. Retail & Technology vertical grew by 5.5% & 5.9% QoQ respectively while Communications & BFSI were laggards with +1% & -2.6% QoQ growth respectively. The company indicated that in CC terms communications segment grew by 3.9% QoQ and enterprise grew by 3.2% QoQ
- EBIT margins for the quarter were down 220 bps QoQ to 11%. Margins for the quarter was impacted by the following factors: i) -100 bps due to higher salary, sub-contractor cost & large deal transition cost, ii) -80 bps due to visa cost and seasonality impact iii) -100bps on normalization of SGA expenses mitigated by +50 bps due to increased pricing
- The company indicated that it will roll out its annual wage hike in Q2 & it will impact margins by 100 bps. However, the company also indicated that the margins are bottomed out in Q1FY23 implying improvement in margins from Q2 onwards. The company indicated that EBIT margins will improve by 100-150 bps every quarter from Q2 & it aims to be back to at least 14% margin exit by Q4FY23.
- The company has indicated the following levers for margin improvement, going forward:
 - i) Pricing: The company indicated that it had negotiations on pricing with customers in Q4FY22 & have started getting some positive impact as tailwind for margin in Q1 was +50 bps of impact on margins in the next quarter on margins
 - ii) Expenses: The company indicated it had booked all annual visa expenses in Q1 while large deal transition expenses were also booked in Q1. The company indicated that it also had incurred some additional expenses in this quarter due to shutdown of its Belarus facility (Russia-Ukraine war impact) and have shifted its employees to other European location. This expenses are one-time and not recurring in nature.
 - iii) Utilization: The company indicated its utilization level dropped to 82.8% as it had ramped up fresher hiring in FY22 (it added 10,000 freshers in FY22). The company indicated that utilization levels are expected from Q2 onwards as the new recruits will be deployed on projects in the subsequent quarters
- Off shoring: The company indicates that offshoring is also one of the leavers going forward to improve margins.
- The company indicates that it is now focusing on integration of acquisitions done by it in FY22 and will take a pause on it for few quarters
- The company won net new deals TCV of US\$ 802 mn in the quarter, down by 20.7% QoQ & 1.6% YoY. The company indicated that deal TCV is in its guided range of US\$700m to US\$ 1bn. The company indicated that demand continue to be robust which is visible as far as pipeline is concerned and it has not seen any evidence of tech spend reduction from clients so far. The company mentioned that it is seeing traction in the areas of communications, digital transformation on cloud, data & customer experience however did not rule out any prioritisation of tech spends from the clients.
- The company indicated that LTM attrition declined by 130 bps QoQ to 22%. It added 6,862 net new employees in the quarter

- The company indicated spending in communication vertical may not have some direct co-relation to the paying end users as the focus area of communication service provider continue to be on network capacity additions, network modernisation etc.

Exhibit 1: Variance Analysis

| | Q1FY23 | Q1FY23E | Q1FY22 | YoY (%) | Q4FY22 | QoQ (%) | Comments |
|------------------------------|--------|---------|--------|----------|--------|----------|--|
| Revenue | 12,708 | 12,502 | 10,198 | 24.6 | 12,116 | 4.9 | Revenue grew by 3.5% QoQ CC growth |
| Employee expenses | 9,116 | 9,001 | 6,968 | 30.8 | 8,560 | 6.5 | |
| Gross Margin | 3,592 | 3,500 | 3,229 | 11.2 | 3,556 | 1.0 | |
| Gross margin (%) | 28.3 | 28.0 | 31.7 | -340 bps | 29.3 | -108 bps | |
| SG&A expenses | 1,712 | 1,625 | 1,353 | 26.5 | 1,468 | 16.6 | |
| EBITDA | 1,880 | 1,875 | 1,876 | 0.2 | 2,088 | (10.0) | |
| EBITDA Margin (%) | 14.8 | 15.0 | 18 | -360 bps | 17 | -244 bps | |
| Depreciation & amortisation | 476.7 | 500 | 331.1 | 44.0 | 484.2 | (1.6) | |
| EBIT | 1,403 | 1,375 | 1,545 | (9.2) | 1,604 | (12.5) | |
| EBIT Margin (%) | 11.0 | 11.0 | 15 | -411 bps | 13.2 | -220 bps | EBIT margins impacted by: i) -100 bps due to higher salary, sub-contractor cost & large deal transition cost, ii) -80 bps due to visa cost, iii) -100bps normalization of SGA expenses mitigated by +50 bps due to increased pricing |
| Other income (less interest) | 82 | 320 | 249 | (67.2) | 265 | (69.1) | |
| PBT | 1,485 | 1,695 | 1,795 | (17.2) | 1,869 | (20.5) | |
| Tax paid | 338 | 424 | 429 | (21.1) | 328 | 3.0 | |
| PAT | 1,132 | 1,236 | 1,353 | (16.4) | 1,506 | (24.8) | PAT was impacted by lower other income due to losses in some of its investments |
| Adjusted PAT | 1,132 | 1,236 | 1,353 | (16.4) | 1,506 | (24.8) | |

Source: Company, ICICI Direct Research

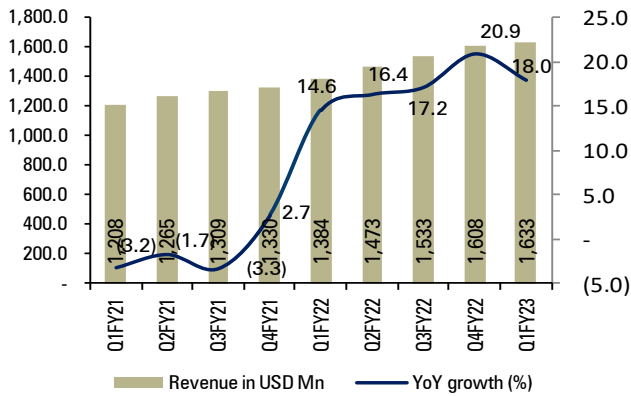
Exhibit 2: Change in estimates

| (₹ Crore) | FY23E | | | FY24E | | | Comments |
|-----------------|--------|--------|----------|--------|--------|----------|--|
| | Old | New | % Change | Old | New | % Change | |
| Revenue | 50,307 | 51,357 | 2.1 | 55,883 | 55,803 | -0.1 | Some tweaking on Q1 performance as well as Rupee Dollar rate |
| EBIT | 6,889 | 6,622 | -3.9 | 7,824 | 7,645 | -2.3 | |
| EBIT Margin (%) | 13.7 | 12.9 | -80 bps | 14.0 | 13.7 | -30 bps | As per management guidance |
| PAT | 6,042 | 5,842 | -3.3 | 7,010 | 6,875 | -1.9 | |
| EPS (₹) | 68.5 | 66.2 | -3.3 | 79.5 | 77.9 | -1.9 | |

Source: Company, ICICI Direct Research

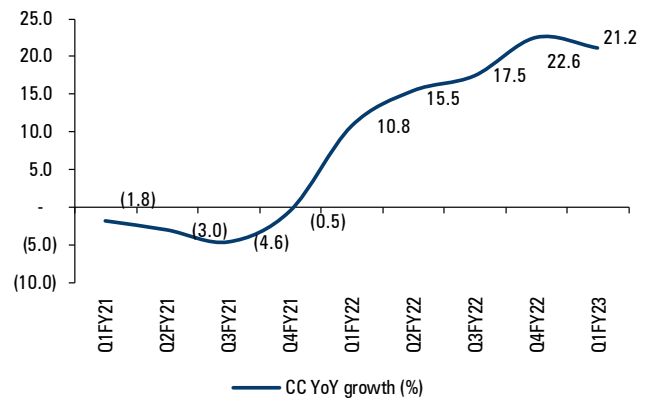
Key Metrics

Exhibit 3: Dollar revenue with YoY growth



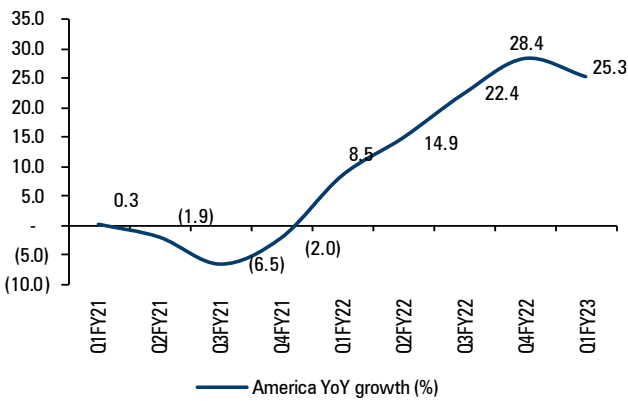
Source: Company, ICICI Direct Research

Exhibit 4: YoY CC growth



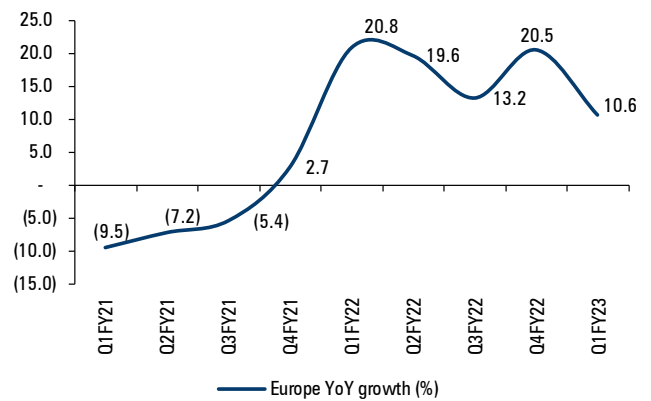
Source: Company, ICICI Direct Research

Exhibit 5: Americas region YoY growth



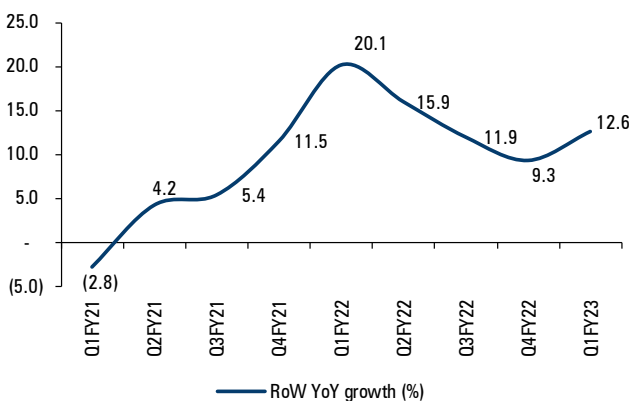
Source: Company, ICICI Direct Research

Exhibit 6: Europe region YoY growth



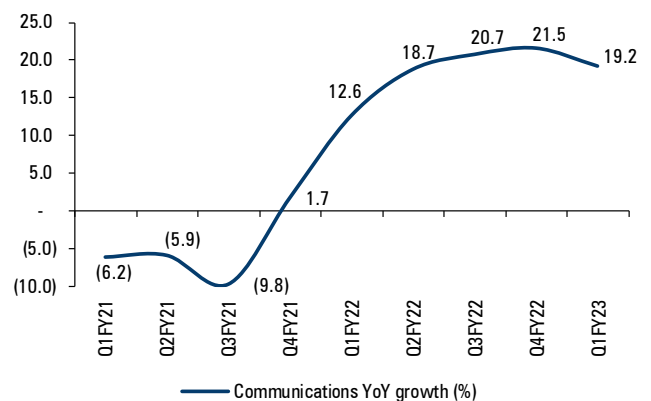
Source: Company, ICICI Direct Research

Exhibit 7: RoW region YoY growth



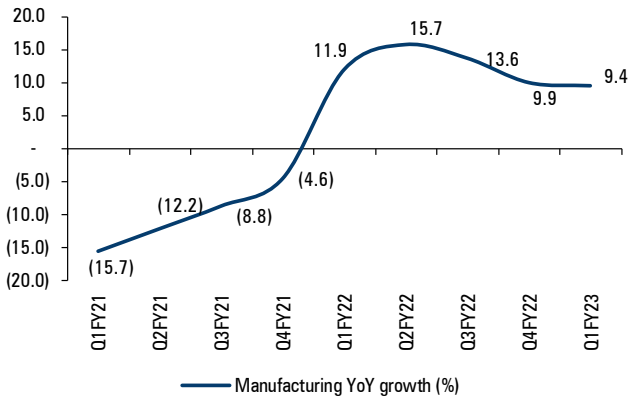
Source: Company, ICICI Direct Research

Exhibit 8: Communications YoY growth



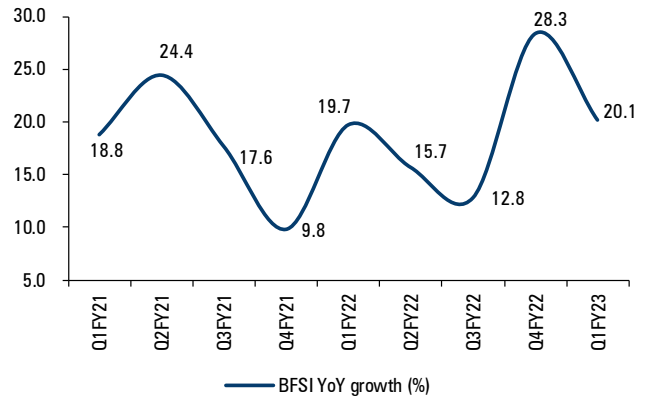
Source: Company, ICICI Direct Research

Exhibit 9: Manufacturing YoY growth



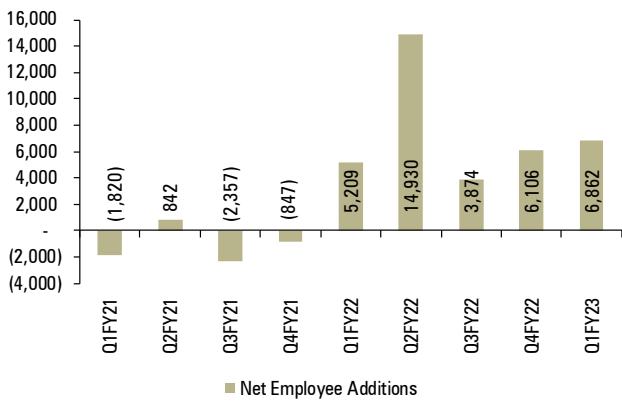
Source: Company, ICICI Direct Research

Exhibit 10: BFSI YoY growth



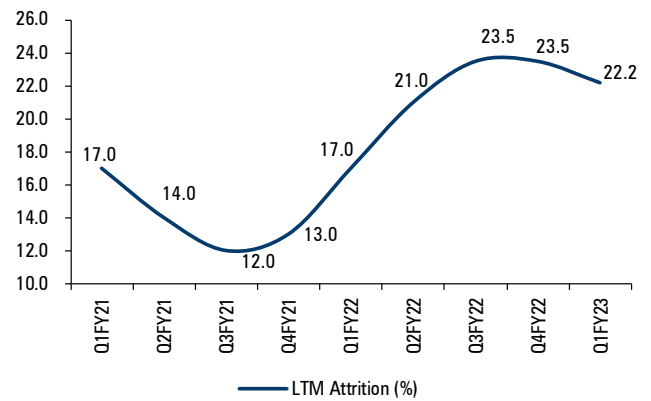
Source: Company, ICICI Direct Research

Exhibit 11: Net Employee addition trend



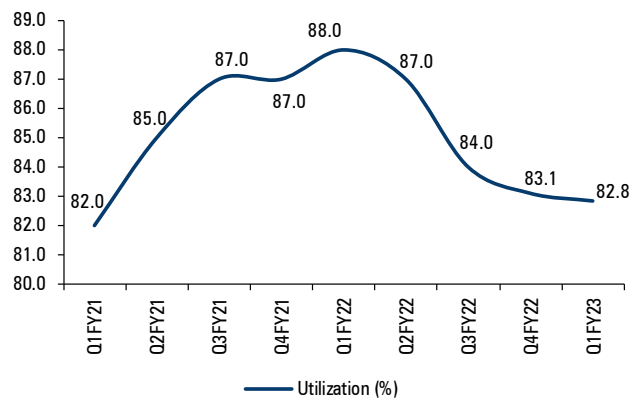
Source: Company, ICICI Direct Research

Exhibit 12: LTM Attrition trend



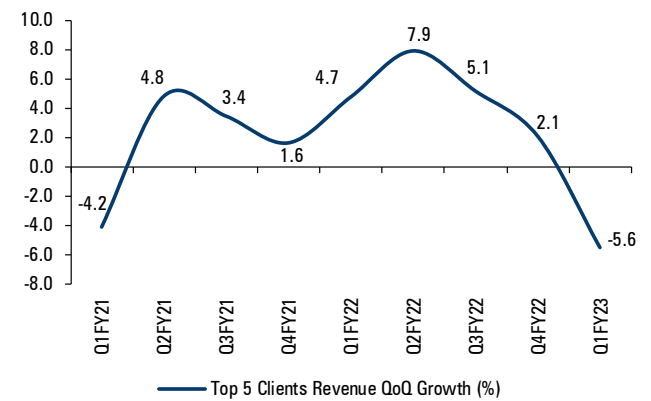
Source: Company, ICICI Direct Research

Exhibit 13: Utilization Trend



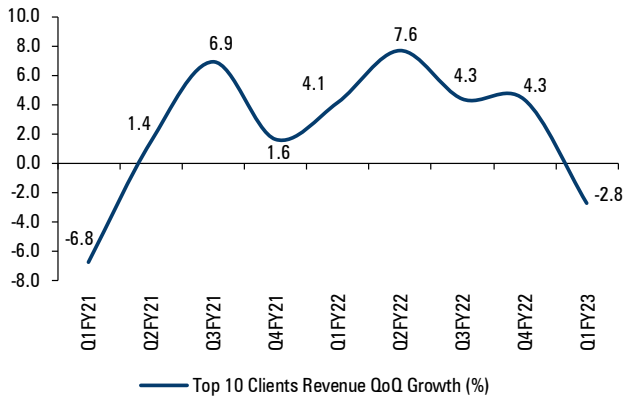
Source: Company, ICICI Direct Research

Exhibit 14: Top 5 clients QoQ growth



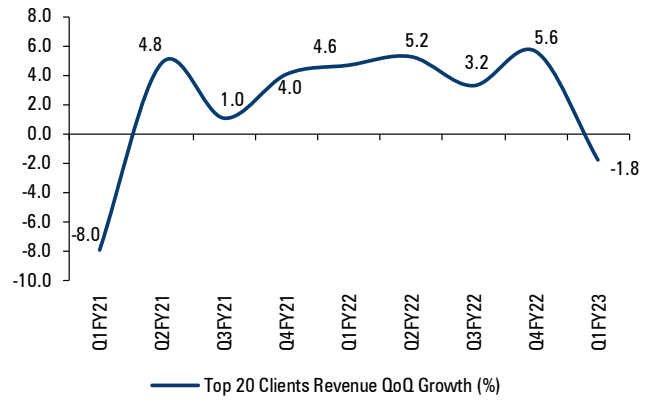
Source: Company, ICICI Direct Research

Exhibit 15: Top 10 clients QoQ growth



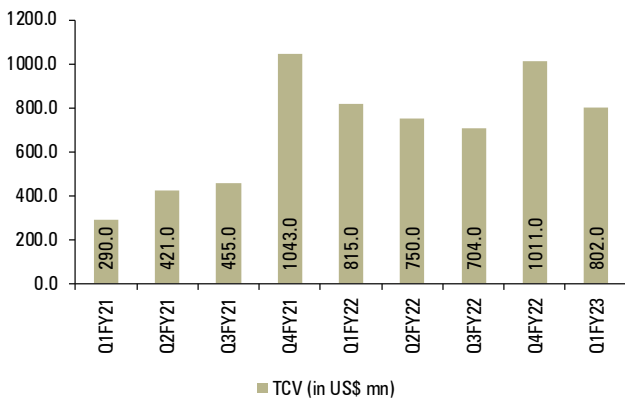
Source: Company, ICICI Direct Research

Exhibit 16: Top 20 clients QoQ growth



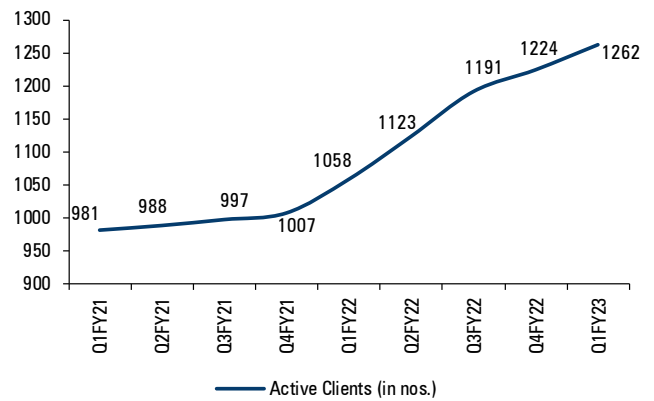
Source: Company, ICICI Direct Research

Exhibit 17: TCV Trend



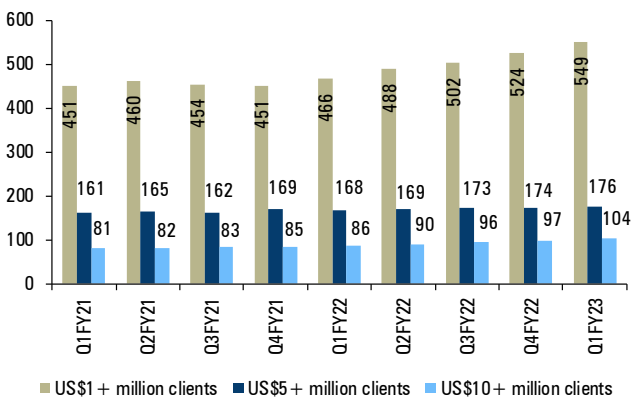
Source: Company, ICICI Direct Research

Exhibit 18: Active clients



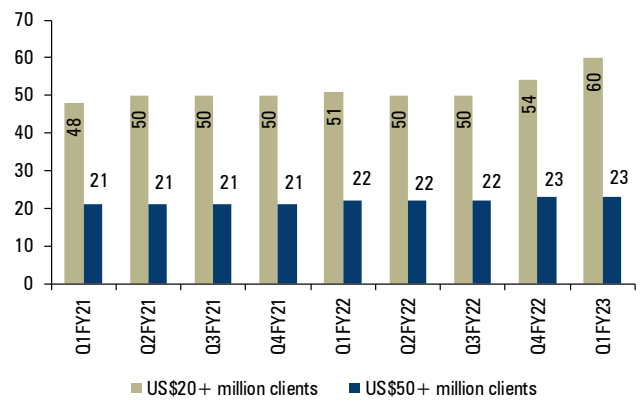
Source: Company, ICICI Direct Research

Exhibit 19: Client Mix



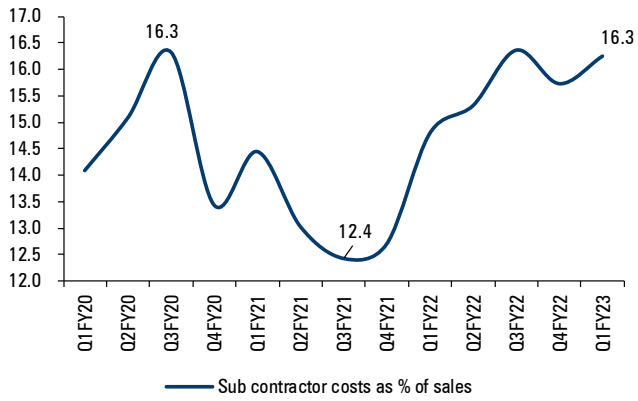
Source: Company, ICICI Direct Research

Exhibit 20: Client Mix



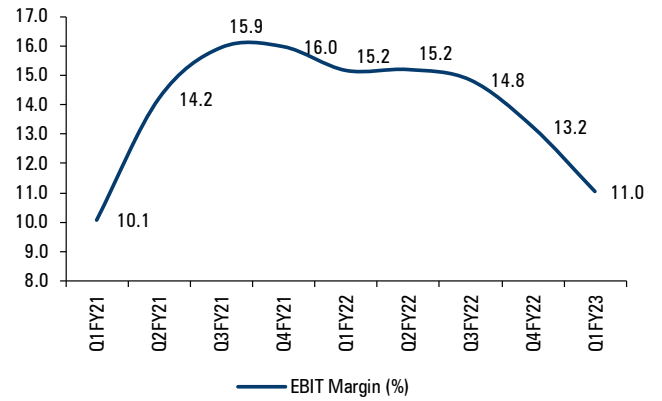
Source: Company, ICICI Direct Research

Exhibit 21: Sub-contractor cost trend



Source: Company, ICICI Direct Research

Exhibit 22: EBIT Margin Trend



Source: Company, ICICI Direct Research

Financial summary

| Exhibit 23: Profit and loss statement | | | | | ₹ crore |
|---------------------------------------|---------------|---------------|---------------|---------------|---------|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Net sales | 37,855 | 44,646 | 51,357 | 55,803 | |
| Growth (%) | 3 | 18 | 15 | 9 | |
| COGS (employee expenses) | 25,856 | 30,972 | 36,361 | 39,062 | |
| Gross profit | 12,000 | 13,674 | 14,996 | 16,741 | |
| S,G&A expenses | 5,153 | 5,654 | 6,625 | 7,310 | |
| Total Operating Expenditure | 31,008 | 36,626 | 42,986 | 46,372 | |
| EBITDA | 6,847 | 8,020 | 8,371 | 9,431 | |
| Growth (%) | 20 | 17 | 4 | 13 | |
| Depreciation | 1,508 | 1,520 | 1,749 | 1,786 | |
| Interest | 174 | 163 | 163 | 163 | |
| Other Income | 787 | 1,112 | 1,465 | 1,644 | |
| PBT | 5,952 | 7,449 | 7,924 | 9,126 | |
| Total Tax | 1,600 | 1,822 | 2,021 | 2,190 | |
| Exceptional item | - | - | - | - | |
| PAT | 4,428 | 5,566 | 5,842 | 6,875 | |
| Growth (%) | 16 | 26 | 5 | 18 | |
| EPS (₹) | 50.2 | 63.1 | 66.2 | 77.9 | |

Source: Company, ICICI Direct Research

| Exhibit 24: Cash flow statement | | | | | ₹ crore |
|-------------------------------------|----------------|----------------|----------------|----------------|---------|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Profit before Tax | 5,953 | 7,452 | 7,924 | 9,126 | |
| Add: Depreciation | 1,508 | 1,520 | 1,749 | 1,786 | |
| (Inc)/dec in Current Assets | 1,646 | (3,362) | (2,399) | (1,594) | |
| Inc/(dec) in CL and Provisions | (83) | 1,928 | 1,663 | 1,102 | |
| Taxes paid | (1,415) | (2,314) | (2,021) | (2,190) | |
| CF from operating activities | 8,094 | 5,285 | 6,179 | 7,312 | |
| (Inc)/dec in Investments | (5,149) | 1,188 | - | - | |
| (Inc)/dec in Fixed Assets | (573) | (835) | (1,284) | (1,395) | |
| Others | 221 | 108 | 901 | 1,079 | |
| CF from investing activities | (5,450) | 482 | (383) | (316) | |
| Issue/(Buy back) of Equity | 57 | 87 | - | - | |
| Inc/(dec) in loan funds | (795) | (163) | - | - | |
| Dividend paid & dividend tax | (1,759) | (3,981) | (2,629) | (3,094) | |
| Inc/(dec) in debentures | - | - | - | - | |
| Finance charges | (558) | (123) | (163) | (163) | |
| CF from financing activities | (2,987) | (4,667) | (3,142) | (3,606) | |
| Net Cash flow | (343) | 1,100 | 2,654 | 3,390 | |
| Cash by acquisition | - | - | - | - | |
| Opening Cash | 3,017 | 2,835 | 3,975 | 6,629 | |
| Cash carried to B/S | 2,835 | 3,975 | 6,629 | 10,019 | |

Source: Company, ICICI Direct Research

| Exhibit 25: Balance sheet | | | | | ₹ crore |
|-----------------------------|---------------|---------------|---------------|---------------|---------|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Liabilities | | | | | |
| Equity Capital | 437 | 439 | 439 | 439 | |
| Share application money | - | - | - | - | |
| Reserve and Surplus | 24,428 | 26,447 | 29,660 | 33,441 | |
| Total Shareholders funds | 24,865 | 26,886 | 30,099 | 33,880 | |
| Minority Interest | 380 | 495 | 559 | 623 | |
| Total Debt | 1,662 | 1,582 | 1,582 | 1,582 | |
| Other long term liabilities | 3,990 | 4,843 | 4,843 | 4,843 | |
| Total Liabilities | 30,897 | 33,806 | 37,083 | 40,928 | |
| Assets | | | | | |
| Net Block | 3,470 | 3,620 | 3,311 | 3,270 | |
| Capital WIP | 118 | 165 | 165 | 165 | |
| Investments | 10,238 | 4,884 | 4,887 | 4,889 | |
| Deferred tax assets | 913 | 819 | 819 | 819 | |
| Goodwill on consolidation | 4,008 | 7,426 | 7,426 | 7,426 | |
| Debtors | 6,475 | 11,934 | 13,728 | 14,917 | |
| Loans and Advances (short) | - | - | - | - | |
| Other non-current assets | 3,794 | 4,198 | 4,191 | 4,192 | |
| Cash | 2,835 | 3,975 | 6,629 | 10,019 | |
| Other current assets | 6,261 | 4,071 | 4,683 | 5,089 | |
| Total Current Assets | 25,258 | 24,457 | 29,517 | 34,501 | |
| Trade payables | 2,785 | 4,095 | 4,710 | 5,118 | |
| Current liabilities | 5,465 | 6,299 | 7,246 | 7,873 | |
| Provisions | 531 | 672 | 773 | 839 | |
| Total Current Liabilities | 8,782 | 11,065 | 12,728 | 13,830 | |
| Application of Funds | 30,897 | 33,806 | 37,083 | 40,928 | |

Source: Company, ICICI Direct Research

| Exhibit 26: Key ratios | | | | | ₹ crore |
|-----------------------------|-------|-------|-------|-------|---------|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Per share data (₹) | | | | | |
| EPS | 50.2 | 63.1 | 66.2 | 77.9 | |
| Cash EPS | 67.3 | 80.3 | 86.0 | 98.2 | |
| BV | 281.8 | 304.7 | 341.2 | 384.0 | |
| DPS | 45.0 | 28.4 | 29.8 | 28.4 | |
| Cash Per Share | 32.1 | 45.0 | 75.1 | 113.6 | |
| Operating Ratios (%) | | | | | |
| EBITDA Margin | 18.1 | 18.0 | 16.3 | 16.9 | |
| PAT Margin | 11.7 | 12.5 | 11.4 | 12.3 | |
| Return Ratios (%) | | | | | |
| RoE | 17.8 | 20.7 | 19.4 | 20.3 | |
| RoCE | 19.8 | 22.5 | 21.8 | 22.7 | |
| RoIC | 29.2 | 25.8 | 25.8 | 29.3 | |
| Valuation Ratios (x) | | | | | |
| P/E | 19.9 | 15.9 | 15.1 | 12.8 | |
| EV / EBITDA | 12.5 | 11.2 | 10.4 | 8.9 | |
| EV / Net Sales | 2.3 | 2.0 | 1.7 | 1.5 | |
| Market Cap / Sales | 2.6 | 2.2 | 1.9 | 1.7 | |
| Price to Book Value | 3.5 | 3.3 | 2.9 | 2.6 | |
| Solvency Ratios | | | | | |
| Debt/EBITDA | 0.2 | 0.2 | 0.2 | 0.2 | |
| Debt/Equity | 0.1 | 0.1 | 0.1 | 0.0 | |
| Current Ratio | 1.5 | 1.5 | 1.4 | 1.4 | |
| Quick Ratio | 1.5 | 1.4 | 1.4 | 1.4 | |

Source: Company, ICICI Direct Research

Exhibit 27: ICICI Direct coverage universe (IT)

| Company Name | CMP | TP (₹) | Rating | Mcap (₹) | EPS (₹) | | | P/E | | | RoCE (x) | | | RoE(x) | | |
|--------------------|-------|--------|--------|-----------|---------|-------|-------|-------|-------|-------|----------|-------|-------|--------|-------|-------|
| | | | | | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E |
| HCL Tech (HCLTEC) | 913 | 1,050 | HOLD | 2,47,880 | 49.8 | 50.5 | 55.2 | 18.3 | 18.1 | 16.6 | 24.2 | 24.8 | 26.0 | 21.8 | 21.0 | 21.9 |
| Infosys (INFTEC) | 1,452 | 1,760 | BUY | 6,10,862 | 52.1 | 58.2 | 67.1 | 27.9 | 24.9 | 21.6 | 36.0 | 35.2 | 37.7 | 29.2 | 29.2 | 31.2 |
| TCS (TCS) | 3,116 | 3,785 | BUY | 11,40,106 | 104.7 | 115.1 | 130.4 | 29.7 | 27.1 | 23.9 | 51.4 | 49.2 | 48.7 | 43.0 | 41.9 | 41.0 |
| Tech M (TECMAH) | 1,000 | 1,170 | BUY | 97,193 | 63.1 | 66.2 | 77.9 | 15.8 | 15.1 | 12.8 | 22.5 | 21.8 | 22.7 | 20.7 | 19.4 | 20.3 |
| Wipro (WIPRO) | 405 | 460 | HOLD | 2,22,102 | 22.3 | 23.3 | 27.1 | 18.2 | 17.4 | 15.0 | 18.8 | 18.9 | 21.0 | 19.6 | 18.7 | 20.8 |
| LTI (LTINFNC) | 4,314 | 4,480 | HOLD | 75,587 | 130.8 | 140.3 | 165.9 | 33.0 | 30.7 | 26.0 | 32.3 | 29.0 | 29.6 | 26.1 | 24.1 | 24.4 |
| Mindtree (MINCON) | 3,047 | 3,320 | BUY | 50,216 | 100.3 | 109.8 | 127.9 | 30.4 | 27.8 | 23.8 | 38.0 | 35.4 | 34.5 | 30.2 | 27.4 | 26.6 |
| Coforge (NIITEC) | 3,790 | 4,375 | BUY | 23,083 | 106.5 | 147.8 | 175.0 | 35.6 | 25.6 | 21.7 | 25.6 | 31.5 | 31.8 | 24.2 | 28.4 | 28.3 |
| TeamLease (TEASER) | 3,701 | 4,025 | BUY | 6,327 | 22.5 | 95.0 | 125.4 | 164.7 | 38.9 | 29.5 | 15.4 | 19.2 | 20.7 | (4.7) | 18.9 | 20.2 |
| Infoedge (INFEDG) | 3,867 | 4,575 | BUY | 48,603 | 35.8 | 41.6 | 45.5 | 108.1 | 92.9 | 85.0 | 4.2 | 5.0 | 5.3 | 3.2 | 3.8 | 4.0 |

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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