

Macro, client specific issues likely to impact near term growth

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)

Q3FY23 Results: TechM reported weak revenue numbers in Q3FY23.

- Revenue grew 0.2% QoQ in CC terms
- EBIT margins increased ~60 bps QoQ at 12%
- Won new deal TCV of US\$795 mn, up 11% QoQ & 13% YoY

What should investors do? TechM's share price has grown by ~1.7x over the past five years (from ~₹ 613 in January 2018 to ~₹ 1,004 levels in January 2023).

- We change our rating from BUY to **HOLD** on the stock

Target Price and Valuation: We value TechM at ₹ 1100 i.e., 13x P/E on FY25E 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
- Restructuring of low margin portfolios, acceleration in Europe and improving demand from lift & shift deals to drive 11.6% CAGR in FY22-25E
- Margins are expected to improve due to pyramid optimisation, exit of low margin business, 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 ₹ 1,730

Tech Mahindra

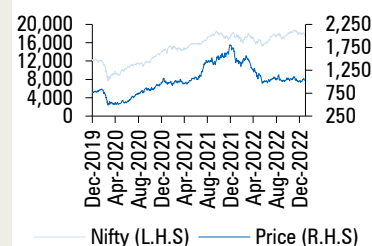
Particulars

Particular	Amount
Market Cap (₹ Crore)	97,017
Total Debt (₹ Crore)	1,582
Cash and Invest (₹ Crore)	8,949
EV (₹ Crore)	89,473
52 week H/L	1838 / 944
Equity capital	439
Face value	₹ 5

Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoters	35	35	35	35
FII	34	30	28	28
DII	18	21	24	24
Public	13	14	13	13

Price Chart



Recent event & key risks

- Won new deal TCV of US\$795 in Q3, up 11% QoQ
- **Key Risk:** (i) Lower-than-expected revenue, (ii) Better-than-expected margins

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Key Financial Summary

Key Financials	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 years CAGR (FY22-25E)
Net sales	37,855	44,646	8.9	53,341	57,544	62,007	11.6
EBITDA	6,847	8,020	13.9	8,214	9,207	10,231	8.5
EBITDA Margin (%)	18.1	18.0		15.4	16.0	16.5	
Net Profit	4,428	5,566	14.6	5,558	6,662	7,426	10.1
EPS (₹)	50.2	63.1		63.0	75.5	83.9	
P/E	20.0	15.9		15.9	13.3	12.0	
RoNW (%)	17.8	20.7		18.6	19.8	19.7	
RoCE (%)	19.8	22.5		20.9	22.2	22.4	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- The company in dollar terms reported revenue growth of 1.8% QoQ to US\$1,668 million (mn) while CC growth came in at 0.2% QoQ. In rupee terms, TechM reported growth of 4.6% QoQ to ₹ 13,735 crore. The company indicated that during the quarter its Enterprise segment reported a quarterly revenue of US\$1billion+ (bn) for the first time and also mentioned that Enterprise vertical grew 1.8% QoQ while CME vertical grew 1.9% QoQ
- Vertical wise, CME (39.8% of mix), technology (10.3% of mix) & retail (8.5% of mix) reported growth of 2%, 3.4% & 6.4% QoQ, respectively while manufacturing & BFSI were laggards declining 0.1% & 0.7% QoQ, respectively. Geography wise RoW (25.9% of mix) led the growth with 6.7% QoQ growth while US (49.7% of mix) declined 0.4% QoQ and Europe reported muted growth of 1.6% QoQ
- EBIT margins for the quarter increased ~60 bps QoQ to 12%. The company indicated that margins improved largely due to the tailwinds of currency benefits while improved operational efficiency was largely mitigated by higher SG&A expenses
- TechM indicated that the demand scenario has changed compared to what it had witnessed in H1 as decision making on the client side has seen some slowdown. The company also indicated it had also witnessed budget squeezing on the client side especially on medium to small deals, which is where revenue conversion takes place much faster compared to large deals. The company also indicated it is seeing some market and industry specific nuisances, which are also impacting the growth for them. TechM mentioned that long term growth drivers in terms of client spending on cloud transformation are intact but near term outlook may remain challenging due to macro uncertainties
- The company also indicated it is looking to remain close to customers and likely to align its investments depending on the change in business environment. TechM also indicated it is now monitoring its clients and their spending on a monthly basis compared to earlier practise of doing it on quarterly basis. Industry wise, as per management, Retail, BFSI & Manufacturing should do well in subsequent quarters while the Hi-tech vertical is witnessing softness where execution has been delayed. The company also indicated it has been rationalising some active client accounts where it does not have visibility in terms of benefits of scale as well as accounts, which are margin dilutive. As a result, the pace of client addition has slowed down in the last couple of quarters. The company also indicated that client rationalisation will continue, going forward
- The company's top five/10 client's revenue contribution declined 4.6% & 1.4% QoQ, respectively. TechM indicated that revenue decline from Top five clients was on account of a couple of customers going through restructuring of their business. The company mentioned that it is in active dialogue with clients to make sure their investments are protected. As per the company, the issue is likely to be sorted out in Q4. TechM also mentioned it is planning to recoup the loss of business in forthcoming quarters
- The company indicated it is not seeing any pricing pressure in the top clients. TechM indicated that RoW market growth for the quarter was strong due to broad based growth in the India and Middle East region. The company indicated it has been very selective in India as far as deals are concerned where it follows a margin focused strategy. The company indicated that Middle East has seen good momentum there. It is witnessing significantly large digital transformation deals there, which will likely keep the growth momentum continuing in coming quarters. TechM also indicated it is expecting pressure in the US and UK, Germany despite large amount of incremental pipeline coming from these regions. The company also indicated that client restructuring is impacting it more compared to other vendors in the deal

- The company indicated that CME & 5G for enterprise will continue to be the growth driver in the medium to long term. TechM announced a partnership with a telco for 5G rollout for a client and full tech stack is being developed at the Chakan factory of the group where telco, client and TechM are working on it. The company also mentioned that its large deal pipeline is robust and the large deal team is working on a few deals. It expects large deals to return in two to three quarters from now. The company also mentioned it will continue with its investments to protect its wallet share with telcos and believes vendor consolidation and large deal momentum will be growth drivers in the medium term
- The company indicated it called out various levers for margin expansion in the past. Some of them continue to drive margin expansion for it which are
 - i) Utilisation improvement: The company indicated it is at 88% of utilisation compared to pre-Covid levels and it has scope to improve the utilisation from the current level
 - ii) Exit of low margin portfolio: The company indicated it did a good chunk of exits in Q2 where it benefited from 20 bps on margin. TechM earlier guided for US\$100-120 mn impact of portfolio exit in FY23. TechM indicated that this exercise will continue in FY24 as well. The company is also looking for right partners in these portfolios if it is planning to divest some stake while it also mentioned that a complete exit also cannot be ruled out
 - iii) Pyramid rationalisation: The company also mentioned it is expecting more freshers to become billable while it is filling many vacant positions internally
 - iv) Lower subcontractor costs The company mentioned it is trying to reduce sub-contractor's costs but some specific projects may require subcontractors. Hence, it is not seeing meaningful reduction of the same in the near term and it may remain elevated
- The company reported a TCV of US\$795 mn, up 11% QoQ and 13% QoQ during the quarter bringing its 9MFY23 TCV to US\$2.3 bn. The TCV continues to be in the guided range of US\$700 mn to US\$1 bn
- LTM attrition during the quarter declined 230 bps QoQ to 17.3%. The company indicated that although attrition has moderated from its peak; supply side challenges still persist for certain niche skills. The company indicated it will address the challenges here by internal rotation of employees. The utilisation of the company during the quarter improved by 150 bps QoQ to 86.4%
- The company's total headcount during the quarter declined by 6,844 to 157,068 with BPO employees declining by 4,820 while software employee declined by 1,902. TechM indicated that in the current volatile environment the linearity between headcount and revenue growth is reducing. Hence, a decline in employees should not be seen from a demand point of view. The company further indicated that though the demand pipeline and TCV wins remain robust it will be prudent in its hiring plans as the decision making has slowed down. Regarding the decline in BPO employees the company indicated it had ramped up the hirings in Q2 due to seasonality

Exhibit 1: Variance Analysis

	Q3FY23	Q3FY23E	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
Revenue	13,735	13,509	11,451	19.9	13,129	4.6	Revenue grew by 0.2% QoQ in CC terms & 1.8% QoQ in dollar terms due with currency tailwinds benefits
Employee expenses	9,794	9,686	8,009	22.3	9,461	3.5	
Gross Margin	3,941	3,823	3,442	14.5	3,668	7.4	
Gross margin (%)	28.7	28.3	30.1	-137 bps	27.9	76 bps	
SG&A expenses	1,797	1,743	1,382	30.0	1,684	6.7	
EBITDA	2,144	2,080	2,060	4.1	1,984	8.1	
EBITDA Margin (%)	15.6	15.4	18	-237 bps	15	50 bps	
Depreciation & amortisation	498.1	500	362.1	37.6	491.7	1.3	
EBIT	1,646	1,581	1,698	(3.1)	1,492	10.3	
EBIT Margin (%)	12.0	11.7	15	-284 bps	11.4	62 bps	EBIT margin improved largely due to currency benefits as operating leverages benefits mitigated by higher SG&A expenses
Other income (less interest)	134	180	189	(29.0)	211	(36.4)	
PBT	1,780	1,761	1,887	(5.7)	1,704	4.5	
Tax paid	486	387	508	(4.4)	365	33.2	
PAT	1,297	1,344	1,369	(5.3)	1,285	0.9	
Adjusted PAT	1,297	1,344	1,369	(5.3)	1,285	0.9	

Source: Company, ICICI Direct Research

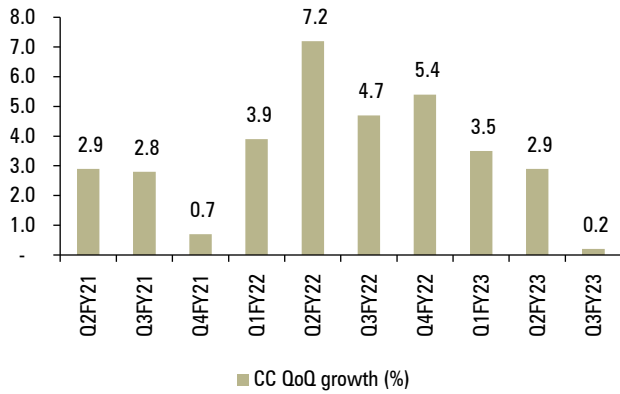
Exhibit 2: Change in estimates

	FY23E			FY24E			FY25E			Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change	
(₹ Crore)										
Revenue	52,007	53,341	2.6	57,544	57,544	0.0	62,007	62,007	0.0	
EBIT	6,501	6,241	-4.0	7,883	7,366	-6.6	8,929	8,371	-6.3	
EBIT Margin (%)	12.5	11.7	-80 bps	13.7	12.8	-90 bps	14.4	13.5	-90 bps	Margin expansion not panning out as per guidance
PAT	5,752	5,558	-3.4	7,056	6,662	-5.6	7,850	7,426	-5.4	
EPS (₹)	65.2	63.0	-3.4	80.0	75.5	-5.6	88.7	83.9	-5.4	

Source: Company, ICICI Direct Research

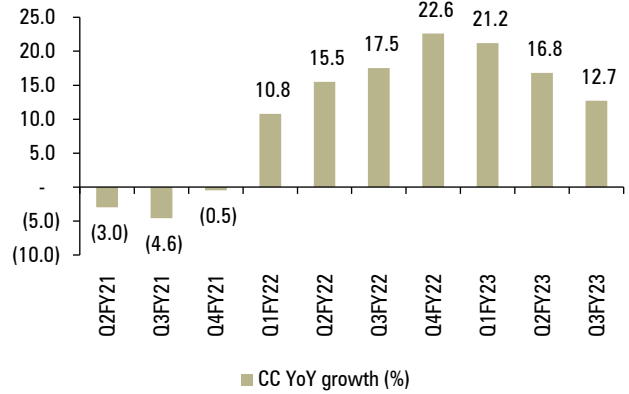
Key Metrics

Exhibit 3: CC growth impacted by furloughs



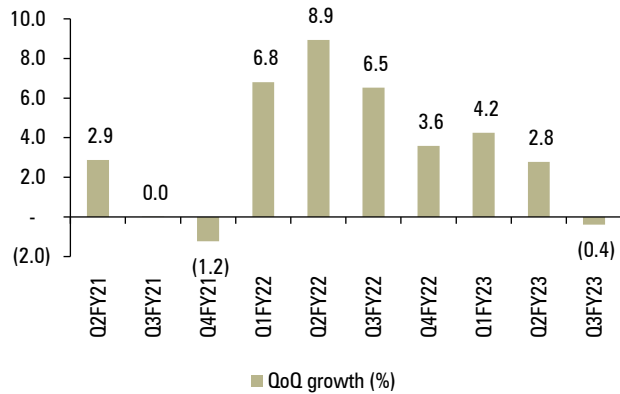
Source: Company, ICICI Direct Research

Exhibit 4: While YoY growth moderates to 12.7% in Q3



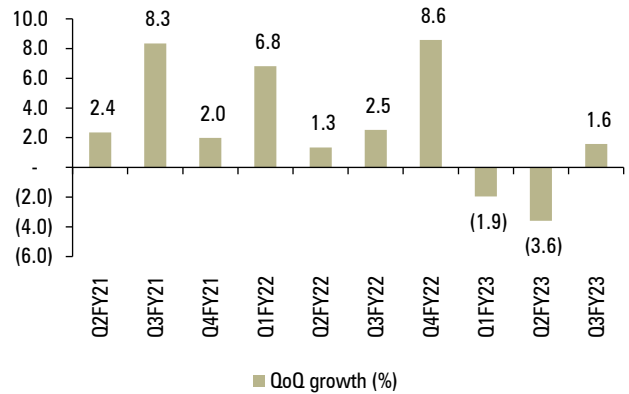
Source: Company, ICICI Direct Research

Exhibit 5: Americas region declines in Q3



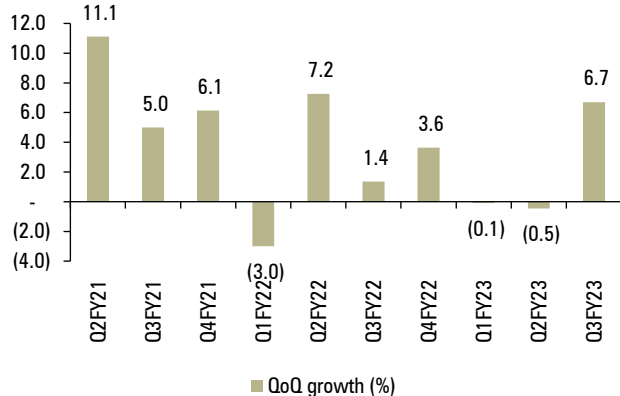
Source: Company, ICICI Direct Research

Exhibit 6: While Europe region reports growth of 1.6%



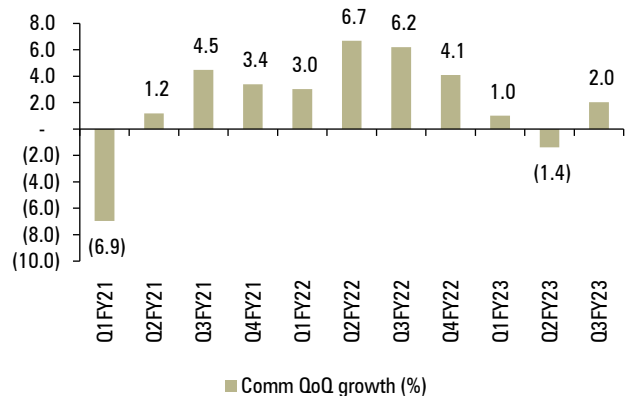
Source: Company, ICICI Direct Research

Exhibit 7: RoW region reports strong recovery



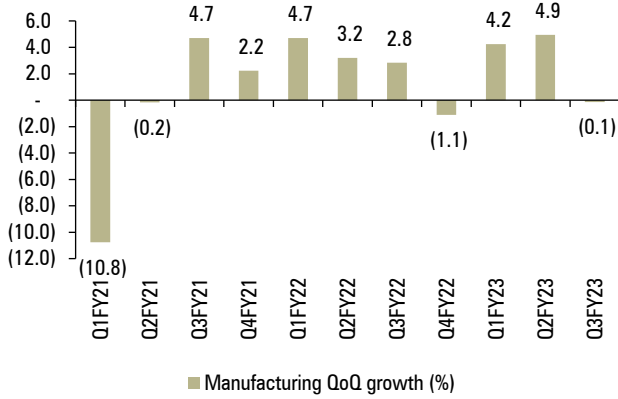
Source: Company, ICICI Direct Research

Exhibit 8: Communications rebounds in Q3



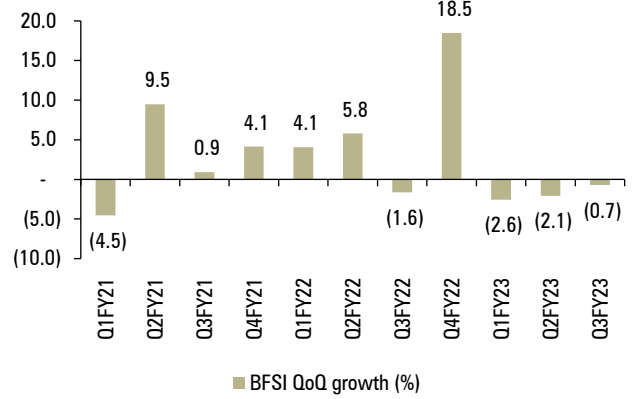
Source: Company, ICICI Direct Research

Exhibit 9: Manufacturing laggard in Q3



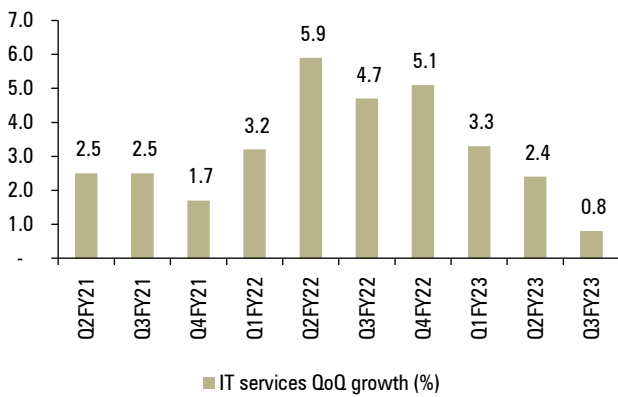
Source: Company, ICICI Direct Research

Exhibit 10: As is BFSI



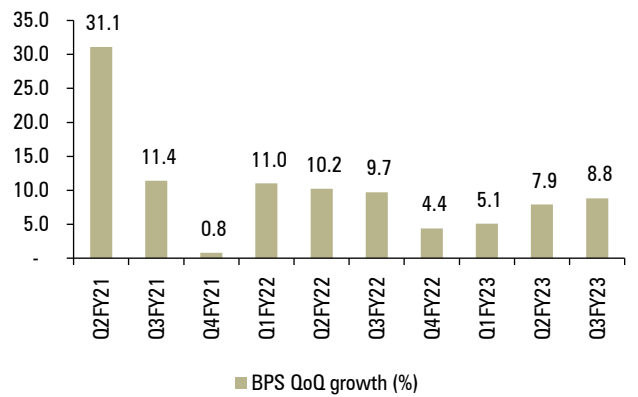
Source: Company, ICICI Direct Research

Exhibit 11: IT services growth moderating



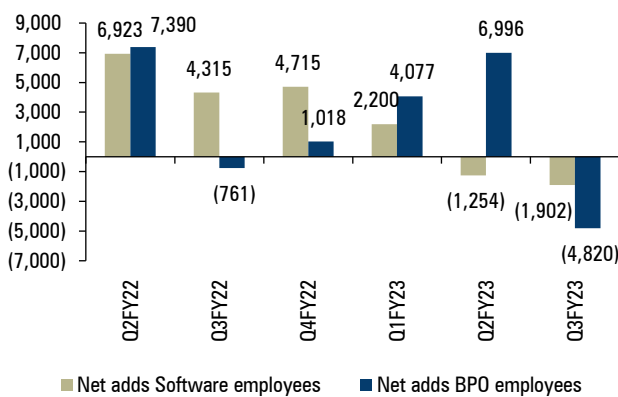
Source: Company, ICICI Direct Research

Exhibit 12: While BPS business continues to grow robustly



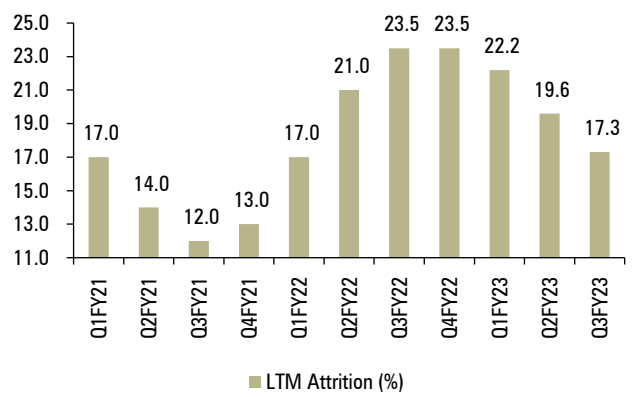
Source: Company, ICICI Direct Research

Exhibit 13: Net decline for IT aligned as per demand



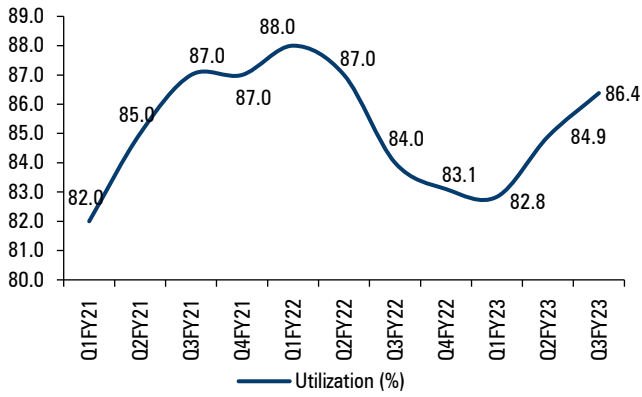
Source: Company, ICICI Direct Research

Exhibit 14: LTM attrition continues to decline



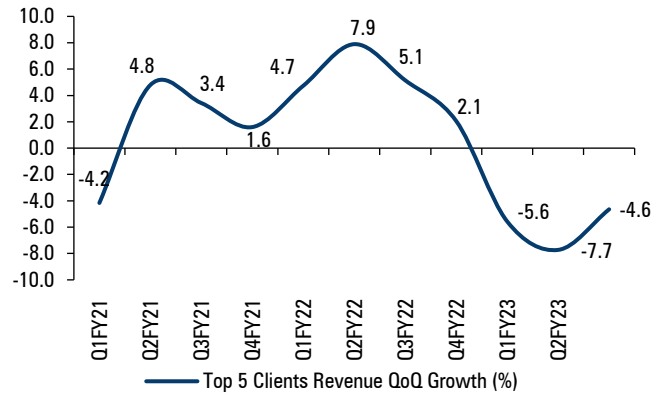
Source: Company, ICICI Direct Research

Exhibit 15: Utilisation continues to improve



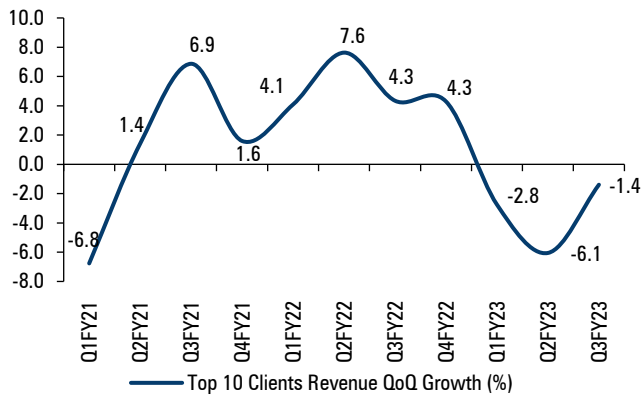
Source: Company, ICICI Direct Research

Exhibit 16: Top clients impacted by internal restructuring



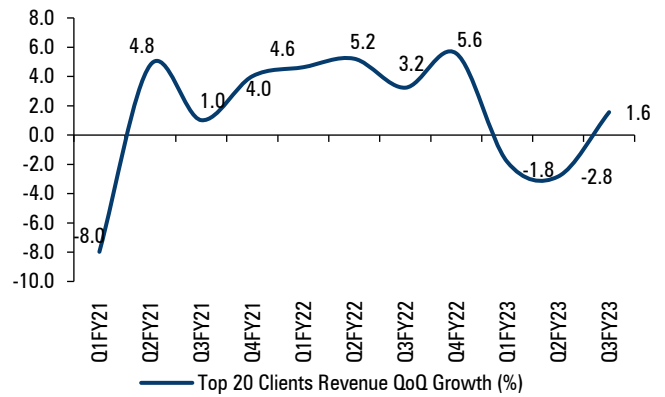
Source: Company, ICICI Direct Research

Exhibit 17: Top 10 clients QoQ growth trend



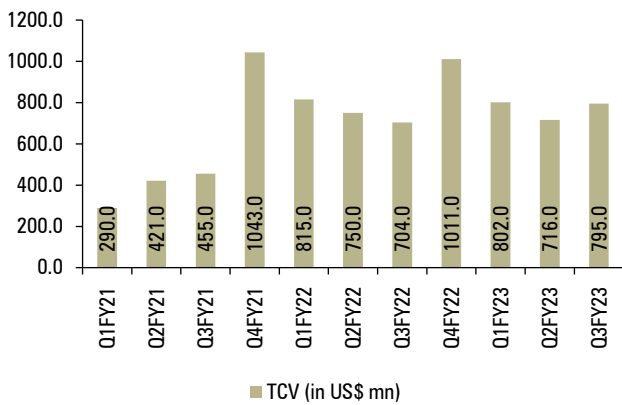
Source: Company, ICICI Direct Research

Exhibit 18: Top 20 clients QoQ growth trend



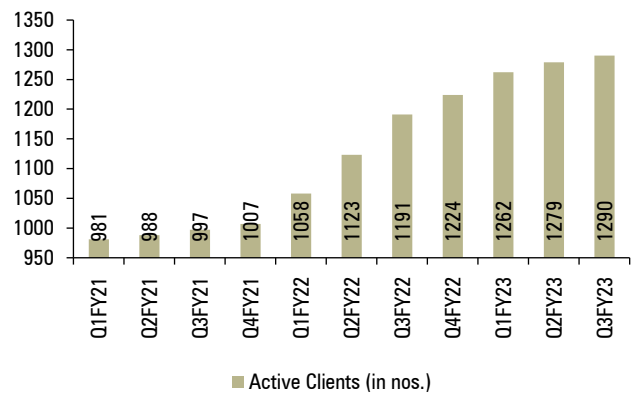
Source: Company, ICICI Direct Research

Exhibit 19: TCV in guided range of US\$700 mn-1 bn



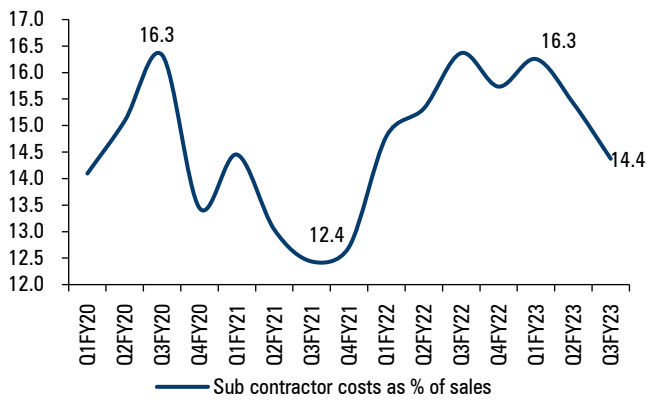
Source: Company, ICICI Direct Research

Exhibit 20: Rationalisation impacts pace of addition



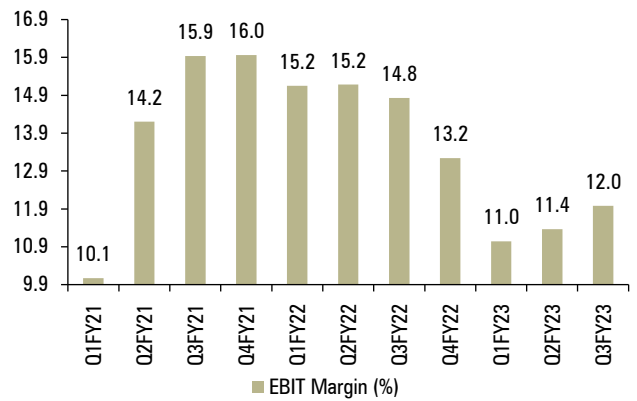
Source: Company, ICICI Direct Research

Exhibit 21: Sub-contractor cost declining but still elevated



Source: Company, ICICI Direct Research

Exhibit 22: Helping margin improvement



Source: Company, ICICI Direct Research

Financial summary

Exhibit 23: Profit and loss statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Net sales	44,646	53,341	57,544	62,007
Growth (%)	18	19	8	8
COGS (employee expenses)	30,972	38,139	40,568	43,653
Gross profit	13,674	15,202	16,975	18,354
S,G&A expenses	5,654	6,988	7,768	8,123
Total Operating Expenditure	36,626	45,126	48,337	51,775
EBITDA	8,020	8,214	9,207	10,231
Growth (%)	17	2	12	11
Depreciation	1,520	1,974	1,841	1,860
Interest	163	163	163	163
Other Income	1,112	1,465	1,644	1,644
PBT	7,449	7,543	8,847	9,852
Total Tax	1,822	1,923	2,123	2,364
Exceptional item	-	-	-	-
PAT	5,566	5,558	6,662	7,426
Growth (%)	26	(0)	20	11
EPS (₹)	63.1	63.0	75.5	83.9

Source: Company, ICICI Direct Research

Exhibit 24: Cash flow statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Profit before Tax	7,452	7,543	8,847	9,852
Add: Depreciation	1,520	1,974	1,841	1,860
(Inc)/dec in Current Assets	(3,362)	(3,110)	(1,507)	(1,601)
Inc/(dec) in CL and Provisions	1,928	2,155	1,042	1,106
Taxes paid	(2,314)	(1,923)	(2,123)	(2,364)
CF from operating activities	5,285	5,900	7,182	7,936
(Inc)/dec in Investments	1,188	-	-	-
(Inc)/dec in Fixed Assets	(835)	(1,334)	(1,439)	(1,550)
Others	108	901	1,079	1,079
CF from investing activities	482	(433)	(359)	(471)
Issue/(Buy back) of Equity	87	-	-	-
Inc/(dec) in loan funds	(163)	-	-	-
Dividend paid & dividend tax	(3,981)	(2,501)	(2,998)	(3,342)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(123)	(163)	(163)	(163)
CF from financing activities	(4,667)	(3,014)	(3,511)	(3,854)
Net Cash flow	1,100	2,453	3,313	3,611
Cash by acquisition	-	-	-	-
Opening Cash	2,835	3,975	6,428	9,740
Cash carried to B/S	3,975	6,428	9,740	13,352

Source: Company, ICICI Direct Research

Exhibit 25: Balance sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity Capital	439	439	439	439
Share application money	-	-	-	-
Reserve and Surplus	26,447	29,504	33,168	37,253
Total Shareholders funds	26,886	29,943	33,607	37,691
Minority Interest	495	559	623	687
Total Debt	1,582	1,582	1,582	1,582
Other long term liabilities	4,843	4,843	4,843	4,843
Total Liabilities	33,806	36,927	40,655	44,803
Assets				
Net Block	3,620	3,136	3,083	3,123
Capital WIP	165	165	165	165
Investments	4,884	4,887	4,889	4,892
Deferred tax assets	819	819	819	819
Goodwill on consolidation	7,426	7,426	7,426	7,426
Debtors	11,934	14,258	15,382	16,575
Loans and Advances (short)	-	-	-	-
Other non-current assets	4,198	4,191	4,192	4,192
Cash	3,975	6,428	9,740	13,352
Other current assets	4,071	4,864	5,248	5,655
Total Current Assets	24,457	30,027	34,846	40,058
Trade payables	4,095	4,892	5,278	5,687
Current liabilities	6,299	7,525	8,118	8,748
Provisions	672	802	866	933
Total Current Liabilities	11,065	13,220	14,262	15,368
Application of Funds	33,806	36,927	40,655	44,803

Source: Company, ICICI Direct Research

Exhibit 26: Key ratios				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
EPS	63.1	63.0	75.5	83.9
Cash EPS	80.3	85.4	96.4	104.9
BV	304.7	339.4	380.9	425.8
DPS	28.4	28.4	34.0	37.9
Cash Per Share	45.0	72.9	110.4	150.8
Operating Ratios (%)				
EBITDA Margin	18.0	15.4	16.0	16.5
PAT Margin	12.5	10.4	11.6	12.0
Return Ratios (%)				
RoE	20.7	18.6	19.8	19.7
RoCE	22.5	20.9	22.2	22.4
RoIC	25.8	24.3	28.2	31.4
Valuation Ratios (x)				
P/E	15.9	15.9	13.3	12.0
EV / EBITDA	11.2	10.7	9.2	7.9
EV / Net Sales	2.0	1.6	1.5	1.3
Market Cap / Sales	2.2	1.8	1.7	1.6
Price to Book Value	3.3	3.0	2.6	2.4
Solvency Ratios				
Debt/EBITDA	0.2	0.2	0.2	0.2
Debt/Equity	0.1	0.1	0.0	0.0
Current Ratio	1.5	1.4	1.4	1.4
Quick Ratio	1.4	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)	1,135	1,220	BUY	3,08,001	49.8	53.6	59.2	22.8	21.2	19.2	24.2	26.2	27.7	21.8	22.2	23.3
Infosys (INFTEC)	1,539	1,730	BUY	6,47,553	52.1	60.7	70.8	29.5	25.3	21.7	36.0	36.2	39.1	29.2	30.1	32.3
TCS (TCS)	3,435	3,780	BUY	12,56,884	104.7	118.5	133.4	32.8	29.0	25.7	51.4	50.1	49.3	43.0	42.6	41.5
Tech M (TECMAH)	1,004	1,100	HOLD	97,671	63.1	63.0	75.5	15.9	15.9	13.3	22.5	20.9	22.2	20.7	18.6	19.8
Wipro (WIPRO)	402	455	BUY	2,20,348	23.5	23.3	26.4	17.1	17.2	15.2	18.8	18.9	20.5	19.6	18.7	20.3
LTIM (LTINFO)	4,449	4,940	BUY	1,31,600	133.4	153.9	176.8	33.4	28.9	25.2	34.1	33.2	33.1	27.6	27.2	27.1
Coforge (NIITEC)	4,415	4,870	BUY	26,889	106.5	148.9	172.7	41.4	29.7	25.6	25.6	31.8	31.5	24.2	28.5	28.0
TeamLease (TEASER)	2,252	2,335	HOLD	3,850	22.5	73.7	77.5	100.2	30.6	29.1	15.4	15.5	14.3	(4.7)	15.3	14.0
Infoedge (INFEDG)	3,727	4,590	HOLD	46,838	35.8	45.5	51.7	104.2	82.0	72.1	4.2	5.4	6.0	3.2	4.1	4.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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