

**HOLD**

TP: Rs 1,130 | ▲ 13%

**TECH MAHINDRA**

Technology & Internet

28 April 2023

**Weak performance; near-term outlook cloudy**

- Q4 revenue flattish at US\$ 1.7bn (+0.3% QoQ CC) with 10% growth in FY23 to US\$ 6.6bn
- EBIT margin disappoints at 11.2% (-80bps QoQ); net new deal wins modest at US\$ 592mn
- Maintain HOLD with a revised TP of Rs 1,130 (vs. Rs 1,160), set at 12.2x FY25E EPS (vs. 12.5x)

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**Flattish quarter:** TECHM reported Q4FY23 revenue of US\$ 1.7bn (+0.3% QoQ CC), marginally lower than our estimates. Exposure to engineering, research & development (ER&D), customer experience (CX) and network services dampened performance as spends in these areas are largely discretionary in nature and have been adversely impacted in a recessionary climate. The communications, media & entertainment (CME) vertical delivered a resilient performance on account of continued strength in 5G and network services which was offset by a sequential decline in the enterprise segment (retail and transport).

**Delayed decision-making leads to modest deal TCV:** TECHM reported net new deal TCV at US\$ 592mn in Q4 vs. an average of US\$ 830mn for the past eight quarters, reflecting a cautious client approach in light of macroeconomic uncertainty. Management stated that prevalent macro uncertainty has resulted in elongated decision-making cycles/spending cuts for discretionary/transformational deals. Revenue from the top 5 clients declined for the fourth consecutive quarter, dipping 5% QoQ.

**Margins contract:** EBIT margin fell 80bps QoQ to 11.2% due to currency headwinds (-60bps impact) and higher SG&A expenses (-90bps), partly offset by operating efficiencies and lower subcontracting costs (+70bps). EBIT margin for FY23 was 11.4% vs. 14.6% in FY22, owing to supply-side challenges in H1 and deal ramp-up cost. With abating supply-side concerns, TECHM has room to improve margins backed by improvement in SG&A and levers of subcontracting, offshoring and business mix. Q4 net profit stood at Rs 11.2bn, down 14% QoQ. Headcount declined for the second consecutive quarter, falling by 4,668 to 152,400. Utilisation at 86% was flat QoQ.

**Maintain HOLD:** The stock is trading at 13.3x/11.2x FY24E/FY25E EPS. Macro uncertainty led to the miss on margins in Q4 and we anticipate back-ended growth recovery in FY24. Given a subdued revenue and margin outlook, we revise our target P/E from 12.5x to 12.2x FY25E EPS (~20% discount to WPRO), translating to a lower TP of Rs 1,130 (vs. Rs 1,160), and retain our HOLD rating. Higher payout (dividend yield >5%) and >4% FCF yield should lend some support to valuations.

**Key changes**

Target	Rating
▼	◀ ▶

Ticker/Price	TECHM IN/Rs 1,003
Market cap	US\$ 10.7bn
Free float	64%
3M ADV	US\$ 38.7mn
52wk high/low	Rs 1,299/Rs 944
Promoter/FPI/DII	36%/39%/25%

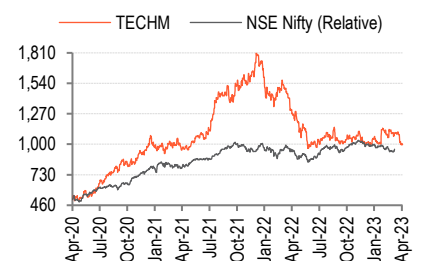
Source: NSE | Price as of 27 Apr 2023

**Key financials**

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	5,37,442	6,07,222	6,79,583
EBITDA (Rs mn)	82,605	99,771	1,18,617
Adj. net profit (Rs mn)	53,171	68,487	81,638
Adj. EPS (Rs)	60.5	77.9	92.8
Consensus EPS (Rs)	60.5	80.9	93.6
Adj. ROAE (%)	18.4	21.4	22.7
Adj. P/E (x)	16.6	12.9	10.8
EV/EBITDA (x)	10.3	8.3	6.8
Adj. EPS growth (%)	(5.4)	28.8	19.2

Source: Company, Bloomberg, BOBCAPS Research | P - Provisional

**Stock performance**



Source: NSE

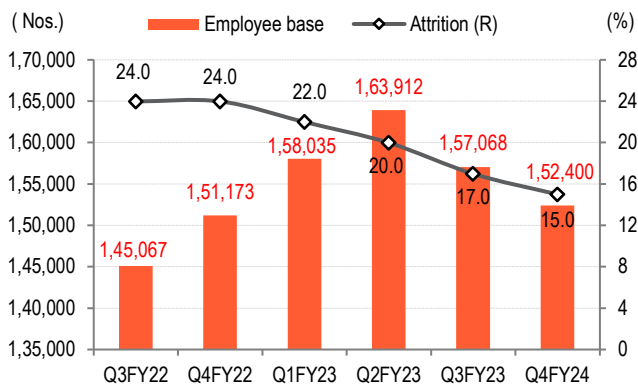


**Fig 1 – Quarterly performance**

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue	1,668	1,668	1,608	0.0	3.7	1,675	(0.4)
INR Revenue	1,37,182	1,37,346	1,21,163	(0.1)	13.2	1,38,523	(1.0)
EBIT	15,303	16,459	16,042	(7.0)	(4.6)	16,623	(7.9)
PAT	11,176	12,966	15,056	(13.8)	(25.8)	12,883	(13.3)
EBIT Margin (%)	11.2	12.0	13.2	(82bps)	(208bps)	12.0	(84bps)
PAT Margin (%)	8.1	9.4	12.4	(129bps)	(427bps)	9.3	(115bps)

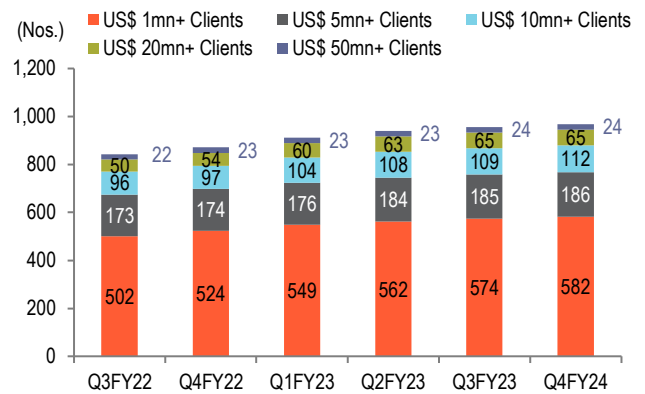
Source: Company, BOBCAPS Research

**Fig 2 – Employee base and Attrition**



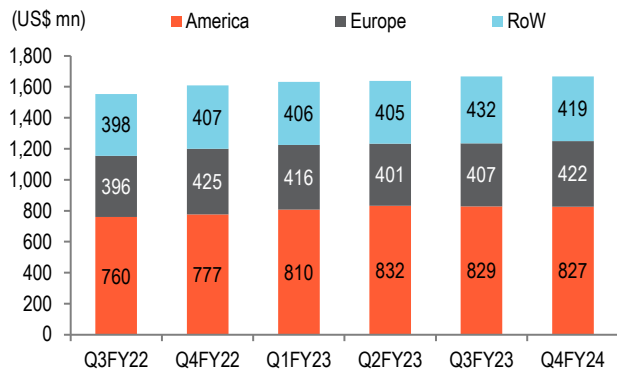
Source: Company, BOBCAPS Research

**Fig 3 – Client concentration**



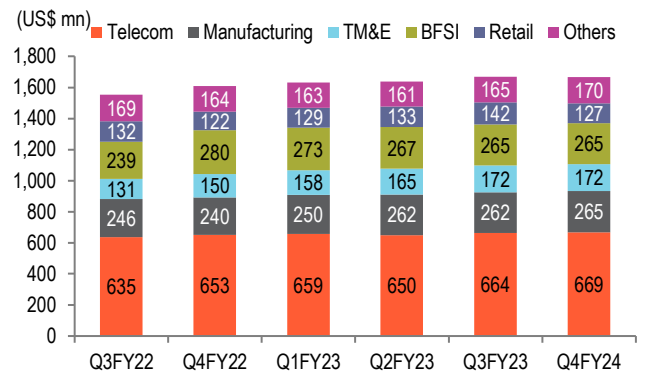
Source: Company, BOBCAPS Research

**Fig 4 – Revenue by geography**



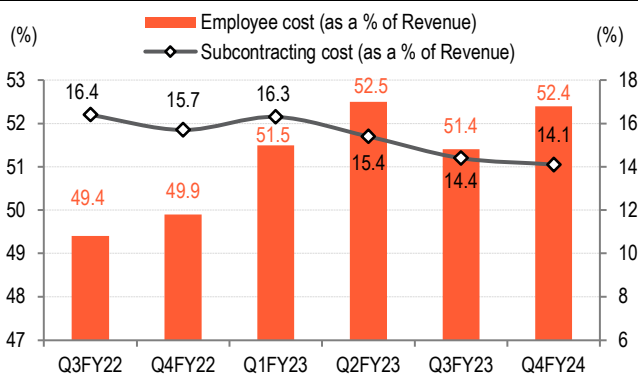
Source: Company, BOBCAPS Research

**Fig 5 – Revenue by vertical**



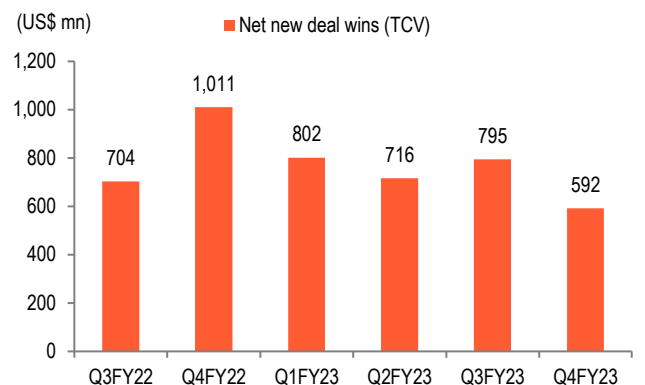
Source: Company, BOBCAPS Research

**Fig 6 – Employee and Subcontracting costs**



Source: Company, BOBCAPS Research

**Fig 7 – Net new deal TCV**



Source: Company, BOBCAPS Research

## Earnings call highlights

- TECHM expects a better revenue growth and margin trajectory in H2FY24 vs. H1FY24 which is likely to be soft. Factors that could have a positive impact on margins include an offshore shift, exits from low-margin business, automation, a better business and geographical mix, and optimisation of subcontracting costs.
- Management expects SG&A cost to normalise as the company is likely to focus on organic growth over the next few quarters.
- Reported PAT saw a one-off impact of Rs 2.1bn from impairment of goodwill pertaining to a prior acquisition (Europe mortgage) in the last quarter.
- Management stated that prevalent macro uncertainty has resulted in elongated decision-making cycles and spending cuts by clients for discretionary and transformational deals. The pipeline is skewed towards cost takeout deals.
- 5G spends remain robust and the focus on capacity building and carrier additions continues. Post conversations with clients, TECHM is optimistic about deal pipelines in the medium term.
- Management expects some carry-forward of price hike benefits in FY24, but these will be limited compared to FY23.
- Wage hikes are guided to be spread across quarters.
- LTM attrition trended downwards to 15% for Q4 vs. 17.0% for Q3.
- Days sales outstanding (DSO) stood at 96 days and the hedge book was at US\$ 2.3bn as at end-Q4.

## Valuation methodology

The stock is trading at 13.3x/11.2x FY24E/FY25E EPS. The stock is trading at 13.3x/11.2x FY24E/FY25E EPS. Macro uncertainty led to the miss on margins in Q4 and we anticipate back-ended growth recovery in FY24. Given a subdued revenue and margin outlook, we revise our target P/E from 12.5x to 12.2x FY25E EPS (~20% discount to WPRO), translating to a lower TP of Rs 1,130 (vs. Rs 1,160), and retain our HOLD rating. Higher payout (dividend yield >5%) and >4% FCF yield should lend some support to valuations

## Key risks

- Multiple digital deal wins, including in the domestic market, represent an upside risk to our estimates.
- A further rise in interest rate would be a key downside risk.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	35.5	1,071	1,240	BUY
Infosys	INFO IN	64.0	1,246	1,760	BUY
Persistent Systems	PSYS IN	4.5	4,583	5,330	BUY
Tata Consultancy Services	TCS IN	142.5	3,188	3,580	HOLD
Tech Mahindra	TECHM IN	10.7	1,003	1,130	HOLD
Wipro	WPRO IN	25.1	374	420	HOLD

Source: BOBCAPS Research, NSE | Price as of 27 Apr 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Total revenue</b>	<b>3,78,551</b>	<b>4,46,460</b>	<b>5,37,442</b>	<b>6,07,222</b>	<b>6,79,583</b>
EBITDA	68,471	80,201	82,605	99,771	1,18,617
Depreciation	14,577	15,204	19,730	20,184	22,078
EBIT	53,894	64,997	62,875	79,587	96,539
Net interest inc./(exp.)	(1,740)	(1,626)	(1,853)	(1,320)	(1,320)
Other inc./(exp.)	7,871	11,123	7,153	8,585	9,510
Exceptional items	0	0	0	0	0
EBT	59,530	74,522	68,045	86,913	1,04,788
Income taxes	15,999	18,220	15,377	20,426	25,150
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	762	(612)	373	2,060	2,060
<b>Reported net profit</b>	<b>44,281</b>	<b>55,662</b>	<b>53,171</b>	<b>68,487</b>	<b>81,638</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>44,281</b>	<b>55,662</b>	<b>53,171</b>	<b>68,487</b>	<b>81,638</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	1,02,292	1,45,645	1,44,299	1,49,726	1,58,259
Provisions	13,121	15,527	14,724	16,636	18,619
Debt funds	16,618	1,420	1,420	1,420	1,420
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,370	4,388	4,388	4,388	4,388
Reserves & surplus	2,48,075	2,69,423	2,98,405	3,34,382	3,77,652
Shareholders' fund	2,52,445	2,73,811	3,02,793	3,38,770	3,82,040
<b>Total liab. and equities</b>	<b>3,96,780</b>	<b>4,48,707</b>	<b>4,75,541</b>	<b>5,18,856</b>	<b>5,72,642</b>
Cash and cash eq.	26,904	37,889	51,456	83,599	1,23,322
Accounts receivables	64,728	74,676	80,984	83,181	83,784
Inventories	242	405	405	405	405
Other current assets	1,10,932	1,38,706	1,41,210	1,43,045	1,48,001
Investments	1,04,436	49,522	49,522	49,522	49,522
Net fixed assets	80,405	1,39,318	1,43,772	1,50,914	1,59,417
CWIP	1,183	1,651	1,651	1,651	1,651
Intangible assets	40,082	74,258	74,258	74,258	74,258
Deferred tax assets, net	9,133	8,191	8,191	8,191	8,191
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>3,96,780</b>	<b>4,48,707</b>	<b>4,75,541</b>	<b>5,18,856</b>	<b>5,72,642</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Cash flow from operations</b>	<b>64,824</b>	<b>52,836</b>	<b>52,432</b>	<b>80,072</b>	<b>95,843</b>
Capital expenditures	(12,048)	(8,353)	(24,185)	(27,325)	(30,581)
Change in investments	43,390	57,765	0	0	0
Other investing cash flows	(64,787)	(44,597)	9,006	9,905	10,830
<b>Cash flow from investing</b>	<b>(33,445)</b>	<b>4,815</b>	<b>(15,179)</b>	<b>(17,420)</b>	<b>(19,752)</b>
Equities issued/Others	(569)	(1,238)	0	0	0
Debt raised/repaid	(13,624)	(1,625)	0	0	0
Interest expenses	(1,789)	(3,995)	0	0	0
Dividends paid	(18,660)	(39,808)	(23,687)	(30,510)	(36,368)
Other financing cash flows	0	0	0	0	1
<b>Cash flow from financing</b>	<b>(34,642)</b>	<b>(46,666)</b>	<b>(23,687)</b>	<b>(30,510)</b>	<b>(36,367)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(3,263)</b>	<b>10,985</b>	<b>13,567</b>	<b>32,143</b>	<b>39,724</b>
<b>Closing cash &amp; cash eq.</b>	<b>26,904</b>	<b>37,889</b>	<b>51,456</b>	<b>83,599</b>	<b>1,23,322</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	50.4	63.9	60.5	77.9	92.8
Adjusted EPS	50.4	63.9	60.5	77.9	92.8
Dividend per share	17.6	23.4	22.4	28.8	34.3
Book value per share	287.1	311.3	344.3	385.2	434.4

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	2.3	1.9	1.6	1.4	1.2
EV/EBITDA	12.7	10.8	10.3	8.3	6.8
Adjusted P/E	19.9	15.7	16.6	12.9	10.8
P/BV	3.5	3.2	2.9	2.6	2.3

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	74.4	74.7	78.1	78.8	77.9
Interest burden (PBT/EBIT)	110.5	114.7	108.2	109.2	108.5
EBIT margin (EBIT/Revenue)	14.2	14.6	11.7	13.1	14.2
Asset turnover (Rev./Avg TA)	98.3	105.6	116.3	122.1	124.5
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.5	1.5
<b>Adjusted ROAE</b>	<b>18.7</b>	<b>21.2</b>	<b>18.4</b>	<b>21.4</b>	<b>22.7</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	2.7	17.9	20.4	13.0	11.9
EBITDA	19.6	17.1	3.0	20.8	18.9
Adjusted EPS	4.2	26.9	(5.4)	28.8	19.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	18.1	18.0	15.4	16.4	17.5
EBIT margin	14.2	14.6	11.7	13.1	14.2
Adjusted profit margin	11.7	12.5	9.9	11.3	12.0
Adjusted ROAE	18.7	21.2	18.4	21.4	22.7
ROCE	16.3	19.5	18.9	22.8	27.1
<b>Working capital days (days)</b>					
Receivables	68	57	53	49	45
Inventory	0	0	0	0	0
Payables	121	124	116	106	100
<b>Ratios (x)</b>					
Gross asset turnover	4.8	4.1	3.8	4.1	4.4
Current ratio	1.8	1.6	1.7	1.9	2.0
Net interest coverage ratio	(31.0)	(40.0)	(33.9)	(60.3)	(73.1)
<b>Adjusted debt/equity</b>	<b>0.0</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.3)</b>

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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**BUY** – Expected return >+15%

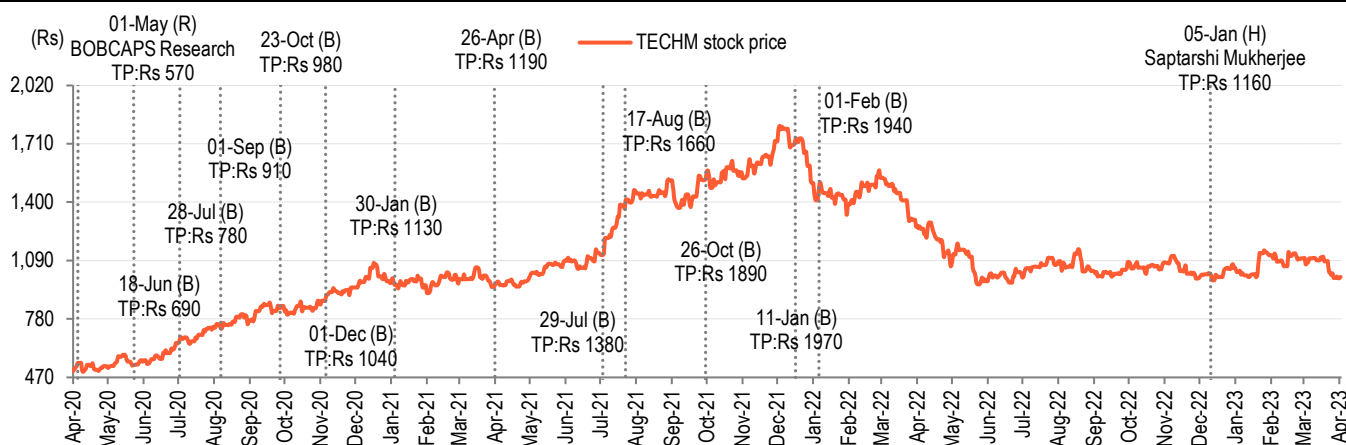
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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### Ratings and Target Price (3-year history): TECH MAHINDRA (TECHM IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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