

Tech Mahindra (TECHM)

HOLD

Demand to remain subdued in H1FY24E

Summary

Tech Mahindra (TechM) reported subdued revenue growth in Q4FY23 mainly due to slowdown in demand. Going forward, we expect H1FY24E to remain subdued due to delay in decision making, delay in deal conversion and slowdown in demand due to macro uncertainty. The company's deal wins are also down 26% QoQ & 41% YoY to US\$592 mn. Hence, we have revised our revenue estimates downwards by 1.8% in FY24E. In addition, we believe company's aspiration of 14-15% margins seems difficult in near term due to demand pangs. Hence, we have lowered our EPS estimates for FY23E & FY24E by 10.7% & 6%. As a result, we maintain our HOLD rating on the stock with a revised target price of Rs 1110 (15x FY25E EPS).

Key Highlights and Investment Rationale

- **Macro headwinds could dent near term growth:** The company will focus on client expansion, large deals, portfolio synergies and business transformation to drive growth. However, uncertain macros has slowed down deal decisions which has led to decline in deal wins down 26% QoQ & 41% YoY to US\$592 mn. In addition, we believe the company's communication will underperform due to delay in 5G capex (given the high interest rates). Further, lower discretionary spends will impact company's revenue growth trajectory. Hence we now expect the company to register 4.2% YoY in FY24E and 9% in FY25E.
- **EBIT margins to improve:** There are multiple margin levers in terms of utilization, sub con, pruning of low margin portfolio, fixed price contracts, tail accounts, offshoring & pyramid. However, demand pangs are expected to slow the pace of expansion. Hence we now expect FY24E & FY25E margins to improve by 38 bps & 98 bps to 11.8% & 12.8%.

TP	Rs1,110
CMP	Rs1,004
Potential upside/downside	11%
Previous Rating	HOLD

Price Performance (%)			
	-1m	-3m	-12m
Absolute	(8.9)	(2.5)	(20.4)
Rel to Sensex	(14.1)	(4.7)	(27.1)

V/s Consensus		
EPS (Rs)	FY24E	FY25E
IDBI Capital	64	74
Consensus	67	77
% difference	(4.4)	(3.6)

Key Stock Data	
Bloomberg/Reuters	TECHM IN/TEML.BO
Sector	IT Services
Shares o/s (mn)	974
Market cap. (Rs mn)	978,254
3-m daily average value (Rs mn)	128.4
52-week high / low	Rs1,297 / 944
Sensex / Nifty	60,649 / 17,915

Shareholding Pattern (%)	
Promoters	35.2
FII	26.9
DII	24.5
Public	13.4

Financial snapshot

(Rs mn)

Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	378,551	446,460	532,902	565,645	616,603
Change (yoy, %)	3	18	19	6	9
EBITDA	68,471	80,200	80,288	87,306	99,348
Change (yoy, %)	20	17	0	9	14
EBITDA Margin(%)	18.1	18.0	15.1	15.4	16.1
Adj.PAT	44,788	55,661	50,683	55,974	65,126
EPS (Rs)	51	63	58	64	74
Change (yoy, %)	5	24	(9)	10	16
PE(x)	20	16	17	16	14
Dividend Yield (%)	4	4	5	5	6
EV/EBITDA (x)	11	10	10	9	8
RoE (%)	19.2	21.5	18.6	20.0	22.5
RoCE (%)	19	22	19	21	24

Source: IDBI Capital Research;

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Con-call Highlights

- Revenue grew 0.3% in CC terms & flat in USD. In terms of verticals, manufacturing was up 1.5% QoQ, CME was up 0.7% QoQ and retail & transport was down 10.4% QoQ.
- In terms of geographies, while Europe recorded 3.5% sequential growth, America and RoW declined by 0.3% and 2.9% respectively. Growth was impacted due to broad based demand softness amidst challenging macro-economic conditions. According to the management, Japan and Middle East regions provide good growth opportunities and will hence focus on these regions.
- New deal TCV stood at USD 592 mn v/s 795 mn in previous quarter, down 26% QoQ. New deal TCV for FY23 was USD 2.9 bn, down 11% YoY.
- EBIT margin declined by 83 bps QoQ to 11.2% on account of -60 bps impact by currency movement, -90 bps impact due to increased SGA spends and +70 bps uplift due to reduction in sub-contractors cost. Going forward, management will continue to invest in SG&A.
- Demand outlook – management informed that the demand environment continues to remain unstable and is expected to impact the growth in H1FY24E as well. However, TechM is optimistic of strong H2FY24E as the pipeline is robust and conversations with clients are positive. In addition, company stated that cloud, 5G and AI are providing future growth opportunities. Also, the telecommunication network business is expected to reach USD 1bn in revenue by the end of FY24E on the back of increased 5G traction.
- Margin outlook – though the company did not provide any margin guidance, it believes there are many margin levers in the form of ramping up of large deals, flat pyramid, reduction in sub con cost, 4%-5% improvement in offshore and divesting from low margin business which it can capitalise on in order to improve the margin profile.
- Management informed that the client specific issues in top 5 clients are bottoming out and is expected to stabilize in the near term.
- Total headcount stood at 152,400, down 3% QoQ. LTM attrition in IT business declined by 200 bps to 15%. Utilization remained stable sequentially at 86%.
- DSO days declined by 2 days sequentially to 96 and FCF as a percentage of PAT stood at 104.4%.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q4FY23	Q3FY23	QoQ (%)	Q4FY22	YoY (%)
Revenues (US\$ mn)	1,668	1,668	(0.0)	1,608	3.7
Revenues	137,182	137,346	(0.1)	121,163	13.2
COGS	97,482	97,937	(0.5)	85,603	13.9
Gross profit	39,700	39,409	0.7	35,560	11.6
SG&A	19,493	17,969	8.5	14,676	32.8
EBITDA	20,207	21,440	(5.8)	20,884	(3.2)
Depreciation & amortization	4,902	4,981	(1.6)	4,842	1.2
EBIT	15,305	16,459	(7.0)	16,042	(4.6)
Other income	2,121	1,343	57.9	2,646	(19.8)
PBT	17,426	17,802	(2.1)	18,688	(6.8)
Tax	3,999	4,859	(17.7)	3,280	21.9
Adjusted net profit	(123)	23	n.m.	(351)	n.m.
Minority interest	13,304	12,966	2.6	15,056	(11.6)
Exceptional items	2,126	0	n.m.	0	n.m.
Reported net profit	11,178	12,966	(13.8)	15,056	(25.8)
Diluted EPS (Rs)	15.2	14.6	3.5	17.1	(11.3)
As % of net revenue					
Gross profit	28.9	28.7		29.3	
SG&A	14.2	13.1		12.1	
EBITDA	14.7	15.6		17.2	
EBIT	11.2	12.0		13.2	
Reported net profit	8.1	9.4		12.4	
Tax rate	22.9	27.3		17.6	

Source: Company; IDBI Capital Research

Exhibit 2: Actual vs. estimates

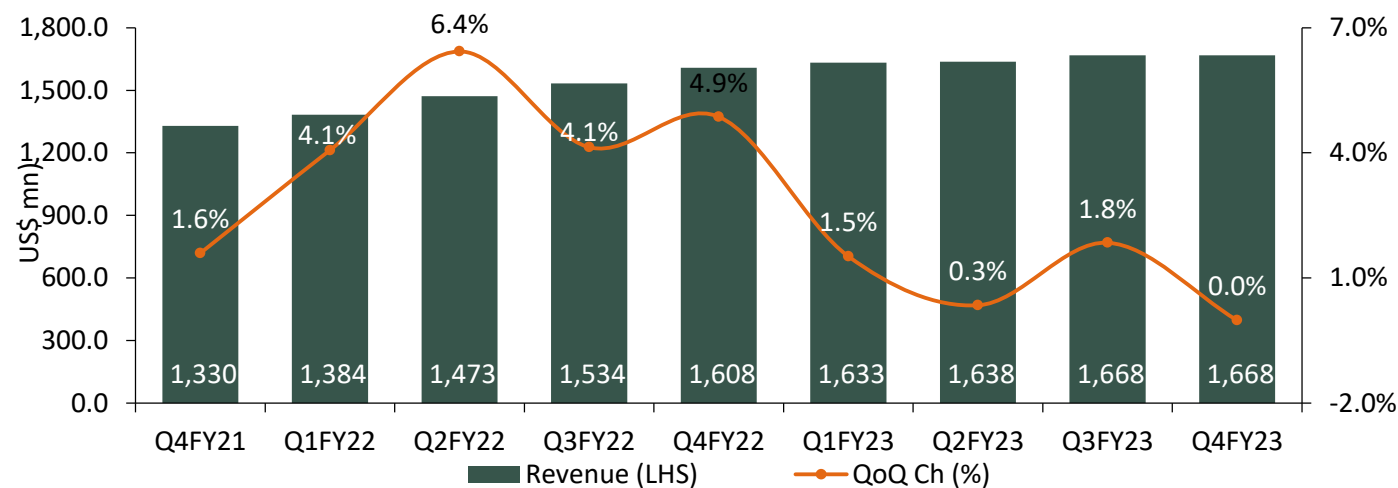
Year to March	Q4FY23	Q4FY23E	Variance (%)
Revenue (US\$ mn)	1,668	1,685	-1.0%
Revenue (Rs mn)	137,182	138,590	-1.0%
EBIT (Rs mn)	15,305	16,944	-9.7%
EBIT margin (%)	11.2%	12.2%	(107) bps
Recurring PAT (Rs mn)	13,304	13,540	-1.7%
Recurring PAT margin (%)	9.70%	9.77%	(07) bps
Recurring EPS (Rs)	15.2	15.3	-0.8%

Source: Company, IDBI Capital Research

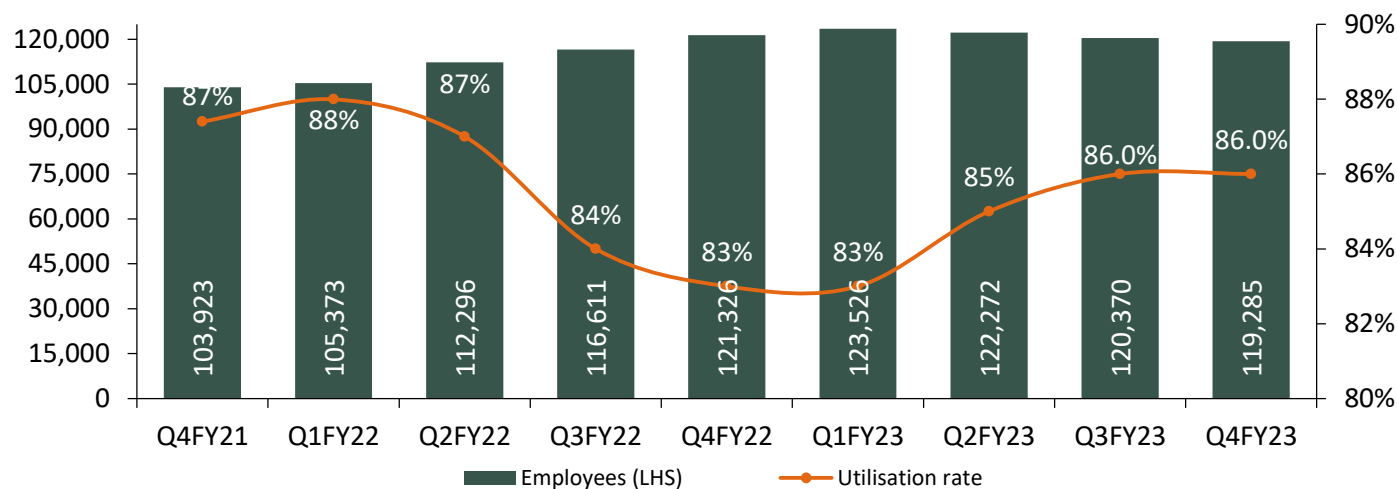
Exhibit 3: Earnings Revision

Year-end: March	FY24E			FY25E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	6,881	7,006	-1.8%	7,501	7545	-0.6%
Revenue (Rs bn)	565.6	575.9	-1.8%	616.6	620	-0.6%
EBIT margin (%)	11.8%	13.0%	(121) bps	12.8%	13.6%	(80) bps
EPS (Rs/sh)	63.8	71.4	-10.7%	74.2	79	-6.4%

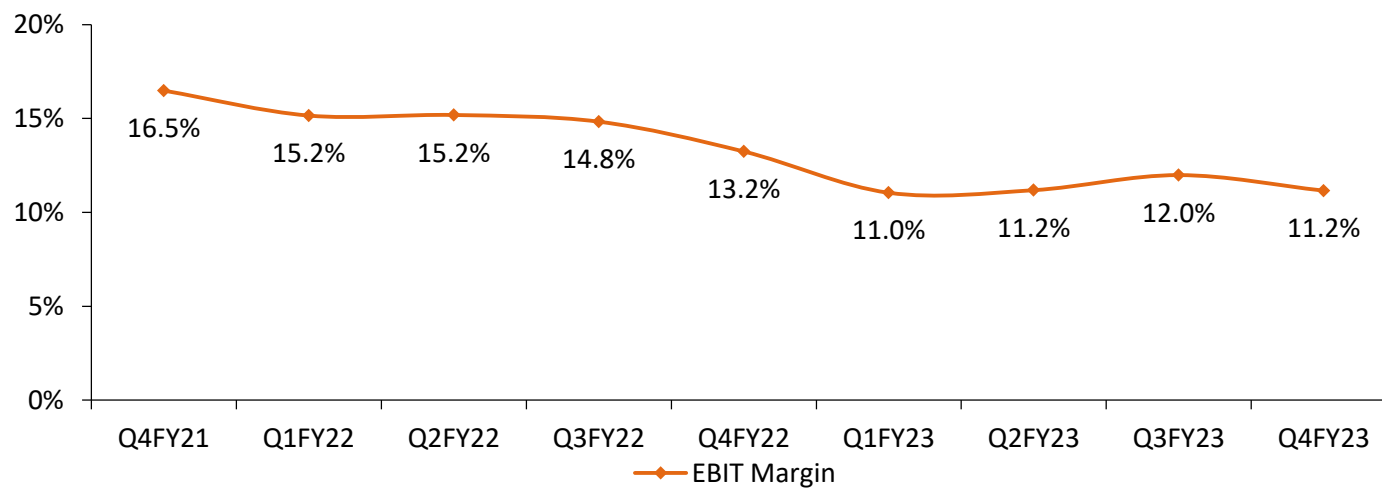
Source: Company; IDBI Capital Research

Exhibit 4: Q4FY23 revenue growth was flat QoQ

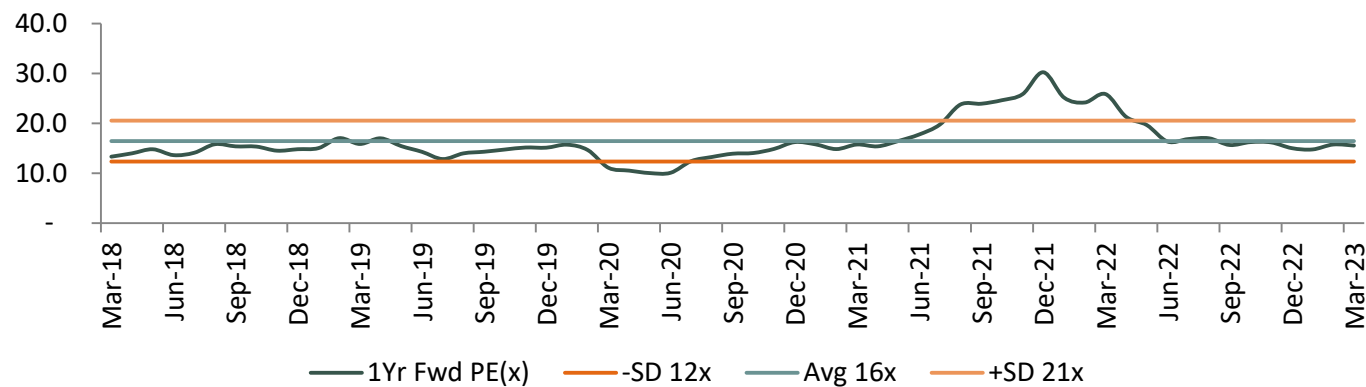
Source: Company; IDBI Capital Research

Exhibit 5: Utilisation rate remained stable at 86%

Source: Company; IDBI Capital Research

Exhibit 6: EBIT Margin declined QoQ

Source: Company; IDBI Capital Research

Exhibit 7: One-year forward PER trend

Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Net sales	368,677	378,551	446,460	532,902	565,645	616,603
<i>Change (yoy, %)</i>	6	3	18	19	6	9
Operating expenses	(311,416)	(310,080)	(366,261)	(452,614)	(478,339)	(517,255)
EBITDA	57,261	68,471	80,200	80,288	87,306	99,348
<i>Change (yoy, %)</i>	-10	20	17	0	9	14
<i>Margin (%)</i>	15.5	18.1	18.0	15.1	15.4	16.1
Depreciation	(14,458)	(14,577)	(15,204)	(19,567)	(20,708)	(20,708)
EBIT	42,803	53,894	64,996	60,721	66,599	78,641
Interest paid	(1,919)	(1,740)	(1,626)	(3,256)	(2,680)	(2,680)
Other income	11,924	7,871	11,123	9,650	10,452	10,452
Pre-tax profit	52,808	60,025	74,493	64,745	74,371	86,413
Tax	(11,604)	(15,999)	(18,220)	(15,885)	(17,849)	(20,739)
<i>Effective tax rate (%)</i>	22.0	26.7	24.5	24.5	24.0	24.0
Minority Interest	(874.0)	255.0	(612.0)	(547.0)	(548.0)	(548.0)
Net profit	40,330	44,281	55,661	48,313	55,974	65,126
Exceptional items	(2,175)	(507)	-	(2,370)	-	-
Adjusted net profit	42,505	44,788	55,661	50,683	55,974	65,126
<i>Change (yoy, %)</i>	(1)	5	24	(9)	10	16
EPS	49	51	63	58	64	74
Dividend per sh	15.0	45.0	45.0	50.0	53.0	63.0
<i>Dividend Payout %</i>	37	88	71	87	83	85

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E*	FY24E	FY25E
Shareholders' funds	218,131	248,650	268,857	275,660	285,121	294,958
Share capital	4,359	4,370	4,388	4,388	4,388	4,388
Reserves & surplus	213,772	244,280	264,469	271,272	280,733	290,570
Total Debt	24,282	16,928	15,817	13,817	11,817	9,817
Other liabilities	21,076	19,027	22,761	22,761	22,761	22,761
Curr Liab & prov	105,757	107,619	131,766	158,658	168,211	183,080
Current liabilities	72,193	71,051	93,494	107,557	113,972	123,954
Provisions	33,564	36,568	38,272	51,100	54,240	59,126
Total liabilities	151,115	143,574	170,344	195,236	202,789	215,658
Total equity & liabilities	373,179	396,019	444,155	476,397	493,959	517,213
Net fixed assets	76,047	80,405	139,318	132,751	127,043	121,336
Investments	3,804	6,648	5,276	5,276	5,276	5,276
Other non-curr assets	61,605	56,367	55,004	55,004	55,004	55,004
Current assets	231,723	252,599	244,557	283,366	306,636	335,597
Inventories	358	242	405	483	513	559
Sundry Debtors	75,772	90,317	119,334	143,081	151,872	165,554
Cash and Bank	87,606	124,971	84,104	90,865	102,307	112,860
Loans and advances	30,632	29,331	33,964	40,880	43,392	47,301
Total assets	373,179	396,019	444,155	476,397	493,959	517,213

*Awaiting annual report

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E*	FY24E	FY25E
Pre-tax profit	52,808	60,025	74,493	64,745	74,371	86,413
Depreciation	9,343	14,577	15,204	19,567	20,708	20,708
Tax paid	(13,611)	(16,284)	(13,487)	(15,885)	(17,849)	(20,739)
Chg in working capital	(13,353)	(11,266)	(9,666)	(3,850)	(1,779)	(2,769)
Other operating activities	(50,579)	58,648	5,372	1,063	(495)	(770)
Cash flow from operations (a)	(15,392)	105,700	71,916	65,640	74,955	82,843
Capital expenditure	(13,723)	(18,935)	(74,117)	(13,000)	(15,000)	(15,000)
Chg in investments	5,424	(2,844)	1,372	-	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(8,299)	(21,779)	(72,745)	(13,000)	(15,000)	(15,000)
Equity raised/(repaid)	(78)	11	18	-	-	-
Debt raised/(repaid)	10,235	(7,354)	(1,111)	(2,000)	(2,000)	(2,000)
Dividend (incl. tax)	(15,692)	(39,330)	(39,492)	(43,880)	(46,513)	(55,289)
Chg in minorities	(1,718)	117	547	-	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(7,253)	(46,556)	(40,038)	(45,880)	(48,513)	(57,289)
Net chg in cash (a+b+c)	(30,944)	37,365	(40,867)	6,760	11,443	10,554

*Awaiting annual report

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Book Value (Rs)	250	284	306	314	325	336
Adj EPS (Rs)	49	51	63	58	64	74
Adj EPS growth (%)	1	5	24	-9	10	16
EBITDA margin (%)	16	18	18	15	15	16
Pre-tax margin (%)	14	16	17	12	13	14
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	17	19	22	19	21	24
ROE (%)	20.2	19.2	21.5	18.6	20.0	22.5
DuPont Analysis						
Asset turnover (x)	1.0	1.0	1.1	1.2	1.2	1.2
Leverage factor (x)	1.7	1.6	1.6	1.7	1.7	1.7
Net margin (%)	11.5	11.8	12.5	9.5	9.9	10.6
Working Capital & Liquidity ratio						
Inventory days	0	0	0	0	0	0
Receivable days	75	87	98	98	98	98
Payable days	38	33	41	39	40	40

Valuations

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
PER (x)	20.6	19.6	15.8	17.4	15.7	13.5
Price/Book value (x)	4.0	3.5	3.3	3.2	3.1	3.0
EV/Net sales (x)	2.2	2.0	1.8	1.5	1.4	1.3
EV/EBITDA (x)	14	11	10	10	9	8
Dividend Yield (%)	1	4	4	5	5	6

Source: Company; IDBI Capital Research



Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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