IDBI capital

Tech Mahindra (TECHM) HOLD

Weakness in comms to impact growth

Summary

Tech Mahindra (TechM) reported subdued revenue growth in Q1FY24 (down 4% QoQ) due bankruptcy of one client (0.4%), decline in communication business and seasonality (Comviva). Going forward, we expect the company to report subdued revenue growth in FY24E mainly led by softness in communication, delay in decision making & deal conversion and backended growth assumptions. This coupled poor margin performance in Q1 (led by one off provision of ~32 mn & wage hikes) prompt us to revise our EPS estimates downwards by 26% for FY24E and 8% for FY25E. Despite this considering the credential of new CEO and expectation of turnaround has prompted us to maintain HOLD rating on the stock with a revised target price of Rs 1,095 (16x FY25E EPS).

Key Highlights and Investment Rationale

- **Communication to remain a drag:** As highlighted in our earlier report we believe the company's communication (40% of revenues) will underperform due to delay in 5G capex (given the high interest rates). Further, lower discretionary spends, delay in decision making and decline in deal wins (down 39% QoQ & 55% YoY to US$359 mn) will impact company's revenue growth trajectory. Hence we expect the company's revenue to decline by 0.6% (in dollar terms) in FY24E. We are expecting a turnaround in FY25E and have assumed 8.8% YoY growth for the year.

- **EBIT margins to improve:** We believe that in FY24E the company will report a margin decline of 192 bps to 9.5% mainly due to subdued Q1FY24 and soft revenue growth. However, we expect margins to expand by 331 bps to 12.8% in FY25E mainly led by subcon (from 14% to 10%) & pyramid rationalisation, divestment of non-strategic portfolio and offshoring (down by 3-4%).

TP	**Rs1,095**
CMP	**Rs1,144**
Potential upside/downside	-4%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	2.8	14.8	14.5
Rel to Sensex	(3.1)	4.2	(6.2)

V/s Consensus

EPS (Rs)	FY24E	FY25E
IDBI Capital	47	68
Consensus	61	72
% difference	*(23.4)*	*(5.6)*

Key Stock Data

Bloomberg/Reuters	TECHM IN/TEML.BO
Sector	IT Services
Shares o/s (mn)	975
Market cap. (Rs mn)	1,115,159
3-m daily average value (Rs mn)	--
52-week high / low	Rs1,270 / 983
Sensex / Nifty	66,707 / 19,778

Shareholding Pattern (%)

Promoters	35.2
FII	25.7
DII	25.6
Public	13.5

Financial snapshot (Rs mn)

Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	378,551	446,460	532,902	539,881	587,288
Change (yoy, %)	*3*	*18*	*19*	*1*	*9*
EBITDA	68,471	80,200	80,286	69,603	93,510
Change (yoy, %)	*20*	*17*	*0*	*(13)*	*34*
EBITDA Margin(%)	*18.1*	*18.0*	*15.1*	*12.9*	*15.9*
Adj.PAT	44,788	55,661	50,681	41,277	60,085
EPS (Rs)	51	63	58	47	68
Change (yoy, %)	*5*	*24*	*(9)*	*(19)*	*46*
PE(x)	22	18	20	24	17
Dividend Yield (%)	4	4	4	3	5
EV/EBITDA (x)	13	12	12	13	10
RoE (%)	19.2	21.5	18.6	14.8	20.9
RoCE (%)	19	22	19	16	23

Source: IDBI Capital Research;

Devang Bhatt
devang.bhatt@idbicapital.com
+91-22-2217 1846

Dhawal Doshi
dhawal.doshi@idbicapital.com
+91-22-2217 1841

Con-call Highlights

- Revenue declined by 0.9%/4.2% QoQ/YoY and stood at $1.6bn. Decline in revenue was predominantly due to 1) softness in CME vertical as clients cut discretionary spend and project closures in network space, 2) digital transformation projects coming to an end, 3) bankruptcy of one client (revenue impact of $6-7mn) and 4) seasonality in Comviva business.
- All the geographies observed sequential revenue decline. RoW declined by 8.2% due to closure of few projects and seasonality in Comviva business. Europe contracted by 6.7% on the back of cut in discretionary spends by telecommunication clients. Americas de grew by 0.5%. In terms of verticals sequential revenue decline was led by CME (-9.4%), followed by BFSI (-3.2%). Manufacturing was the only vertical which recorded growth (+1.8%).
- EBIT margin came in at 6.8% recording a contraction of 438bps QoQ. Fall in margin was due to 1) revenue contraction, 2) one time provision due to customer bankruptcy (-200bps impact), 3) seasonality in Comviva business (-50bps impact) and 4) wage hikes (-130bps impact). No further provision for client bankruptcy.
- TCV of net new deal wins stood at $359mn (-39%/-55% QoQ/YoY) taking TCV of deals won during last 4 quarters to $2.5bn. Company informed that digital transformation deals and enterprise part of major telecom companies have observed deals being pushed out which impacted the deal win TCV. Company expects deal closures to pick up in H2FY24E.
- Demand outlook – management informed that the demand environment continues to remain challenging. In terms of verticals, 1) CME continued to remain soft as clients put discretionary spends on hold. Demand softness under the telecom sub segment is expected to continue for H1FY24E. 2) Manufacturing vertical is experiencing robust demand led by sub verticals like automobile and aero. Management will continue to focus on this vertical to drive growth in the near term. 3) In terms of BFSI vertical, TechM will focus on America to drive growth in this vertical as the market opportunity in this region is huge.
- Margin outlook – though the company did not provide any margin guidance, it believes there are many margin levers in the form of flat pyramid, reduction in sub con cost, improvement in offshore and divesting from low margin business which it can capitalise on in order to improve the margin profile.
- Total headcount at 148,297 down 2.7% QoQ, down 4,103 QoQ (BPO - 2,023 and Software -2,268)

Exhibit 1: Financial snapshot (Rs mn)

Year-end: March	Q1FY24	Q4FY23	QoQ (%)	Q1FY23	YoY (%)
Revenues (US$ mn)	**1,601**	**1,668**	***(4.0)***	**1,633**	***(1.9)***
Revenues	**131,590**	**137,182**	***(4.1)***	**127,079**	***3.5***
COGS	97,805	97,484	*0.3*	91,162	*7.3*
Gross profit	33,785	39,698	*(14.9)*	35,917	*(5.9)*
SG&A	20,405	19,493	*4.7*	17,116	*19.2*
EBITDA	**13,380**	**20,205**	***(33.8)***	**18,801**	***(28.8)***
Depreciation & amortization	4,466	4,902	*(8.9)*	4,767	*(6.3)*
EBIT	**8,914**	**15,303**	***(41.7)***	**14,034**	***(36.5)***
Other income	720	2,121	*(66.1)*	818	*(12.0)*
PBT	9,634	17,424	*(44.7)*	14,852	*(35.1)*
Tax	2,676	3,999	*(33.1)*	3,380	*(20.8)*
Adjusted net profit	(33)	(123)	*n.m.*	(156)	*n.m.*
Minority interest	6,925	13,302	*(47.9)*	11,316	*(38.8)*
Exceptional items	0	2,126	*n.m.*	0	*n.m.*
Reported net profit	**6,925**	**11,176**	***(38.0)***	**11,316**	***(38.8)***
Diluted EPS (Rs)	**7.8**	**15.0**	***(47.9)***	**12.8**	***(38.8)***
As % of net revenue					
Gross profit	25.7	28.9		28.3	
SG&A	15.5	14.2		13.5	
EBITDA	10.2	14.7		14.8	
EBIT	6.8	11.2		11.0	
Reported net profit	5.3	8.1		8.9	
Tax rate	27.8	23.0		22.8	

Source: Company; IDBI Capital Research

Exhibit 2: Actual vs. estimates

Year to March	Q1FY24	Q1FY24E	*Variance (%)*
Revenue (US$ mn)	1,601	1,641	*-2.5%*
Revenue (Rs mn)	131,590	134,935	*-2.5%*
EBIT (Rs mn)	8,914	13,461	*-33.8%*
EBIT margin (%)	*6.8%*	*10.0%*	*(320) bps*
Recurring PAT (Rs mn)	6,925	11,570	*-40.1%*
Recurring PAT margin (%)	*5.26%*	*8.57%*	*(331) bps*
Recurring EPS (Rs)	7.8	13.2	*-40.7%*

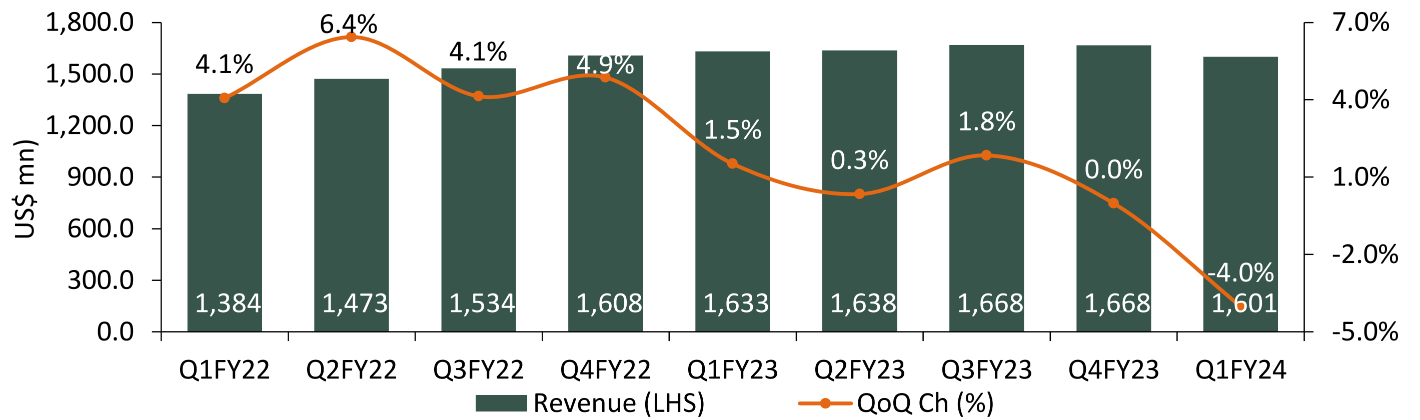
Source: Company, IDBI Capital Research

Exhibit 3: Earnings Revision

		FY24E			FY25E	
Year-end: March	New	Old	*Chg (%)*	New	Old	*Chg (%)*
Revenue (US$ mn)	6,568	6,881	*-4.5%*	7,145	7501	*-4.8%*
Revenue (Rs bn)	539.9	565.6	*-4.5%*	587.3	617	*-4.8%*
EBIT margin (%)	*9.5%*	*11.8%*	*(233) bps*	*12.8%*	*12.8%*	*(0) bps*
EPS (Rs/sh)	47.0	63.8	*-26.3%*	68.5	74	*-7.7%*

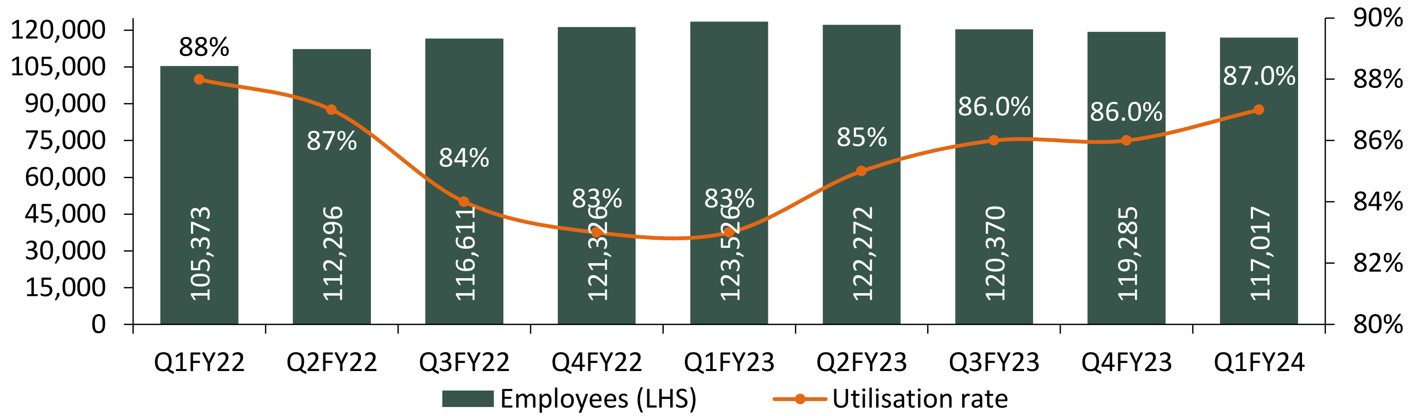
Source: Company; IDBI Capital Research

Exhibit 4: Q1FY24 revenue growth was below our estimates



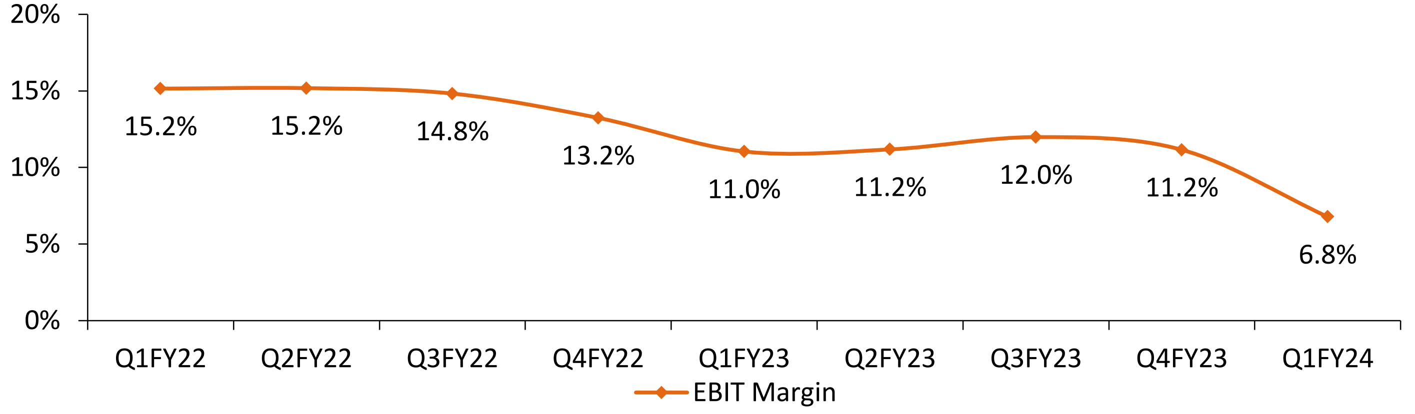
Source: Company; IDBI Capital Research

Exhibit 5: Utilisation rate improved to 87%



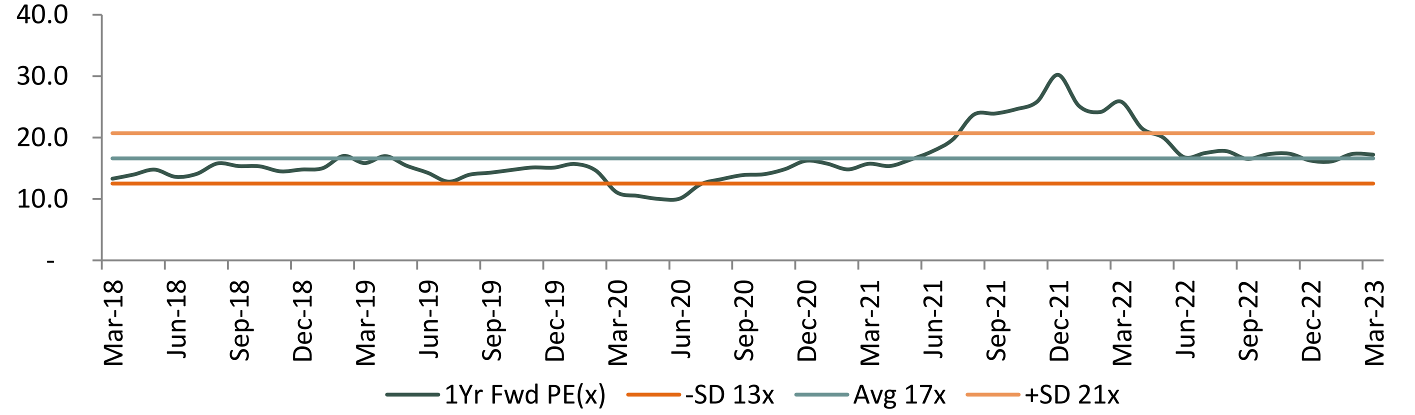
Source: Company; IDBI Capital Research

Exhibit 6: EBIT Margin declined QoQ by ~440bps



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**	**539,881**	**587,288**
Change (yoy, %)	*6*	*3*	*18*	*19*	*1*	*9*
Operating expenses	(311,416)	(310,080)	(366,261)	(452,616)	(470,279)	(493,778)
EBITDA	**57,261**	**68,471**	**80,200**	**80,286**	**69,603**	**93,510**
Change (yoy, %)	*-10*	*20*	*17*	*0*	*-13*	*34*
Margin (%)	*15.5*	*18.1*	*18.0*	*15.1*	*12.9*	*15.9*
Depreciation	(14,458)	(14,577)	(15,204)	(19,567)	(18,473)	(18,430)
EBIT	**42,803**	**53,894**	**64,996**	**60,719**	**51,130**	**75,080**
Interest paid	(1,919)	(1,740)	(1,626)	(3,256)	(4,788)	(4,788)
Other income	11,924	7,871	11,123	9,650	9,033	9,488
Pre-tax profit	**52,808**	**60,025**	**74,493**	**64,743**	**55,375**	**79,780**
Tax	(11,604)	(15,999)	(18,220)	(15,885)	(13,654)	(19,147)
Effective tax rate (%)	*22.0*	*26.7*	*24.5*	*24.5*	*24.7*	*24.0*
Minority Interest	(874.0)	255.0	(612.0)	(547.0)	(444.0)	(548.0)
Net profit	**40,330**	**44,281**	**55,661**	**48,311**	**41,277**	**60,085**
Exceptional items	(2,175)	(507)	-	(2,370)	-	-
Adjusted net profit	**42,505**	**44,788**	**55,661**	**50,681**	**41,277**	**60,085**
Change (yoy, %)	*(1)*	*5*	*24*	*(9)*	*(19)*	*46*
EPS	49	51	63	58	47	68
Dividend per sh	15.0	45.0	45.0	50.0	40.0	55.0
Dividend Payout %	*37*	*88*	*71*	*87*	*85*	*80*

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Shareholders' funds	**218,131**	**248,650**	**268,857**	**275,658**	**281,831**	**293,648**
Share capital	4,359	4,370	4,388	4,388	4,388	4,388
Reserves & surplus	213,772	244,280	264,469	271,270	277,443	289,260
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**	**160,694**	**174,526**
Current liabilities	72,193	71,051	93,494	107,557	108,925	118,211
Provisions	33,564	36,568	38,272	51,100	51,769	56,315
Total liabilities	**151,115**	**143,574**	**170,344**	**195,236**	**195,272**	**207,104**
Total equity & liabilities	**373,179**	**396,019**	**444,155**	**476,395**	**483,048**	**507,245**
Net fixed assets	76,047	80,405	139,318	132,751	129,278	125,848
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**	**283,364**	**293,490**	**321,117**
Inventories	358	242	405	483	490	533
Sundry Debtors	75,772	90,317	119,334	143,081	144,954	157,683
Cash and Bank	87,606	124,971	84,104	90,863	98,468	108,970
Loans and advances	30,632	29,331	33,964	40,880	41,416	45,052
Total assets	**373,179**	**396,019**	**444,155**	**476,395**	**483,048**	**507,245**

Cash Flow Statement (Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Pre-tax profit	52,808	60,025	74,493	64,743	55,375	79,780
Depreciation	9,343	14,577	15,204	19,567	18,473	18,430
Tax paid	(13,611)	(16,284)	(13,487)	(15,885)	(13,654)	(19,147)
Chg in working capital	(13,353)	(11,266)	(9,666)	(3,850)	(379)	(2,576)
Other operating activities	(50,579)	58,648	5,372	1,063	(106)	(717)
Cash flow from operations (a)	**(15,392)**	**105,700**	**71,916**	**65,638**	**59,709**	**75,770**
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)	(35,104)	(48,268)
Chg in monorities	(1,718)	117	547	-	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	**(7,253)**	**(46,556)**	**(40,038)**	**(45,880)**	**(37,104)**	**(50,268)**
Net chg in cash (a+b+c)	**(30,944)**	**37,365**	**(40,867)**	**6,758**	**7,605**	**10,502**

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	250	284	306	314	321	335
Adj EPS (Rs)	*49*	*51*	*63*	*58*	*47*	*68*
Adj EPS growth (%)	*1*	*5*	*24*	*-9*	*-19*	*46*
EBITDA margin (%)	*16*	*18*	*18*	*15*	*13*	*16*
Pre-tax margin (%)	*14*	*16*	*17*	*12*	*10*	*14*
Net Debt/Equity (x)	*0*	*0*	*0*	*0*	*0*	*0*
ROCE (%)	*17*	*19*	*22*	*19*	*16*	*23*
ROE (%)	*20.2*	*19.2*	*21.5*	*18.6*	*14.8*	*20.9*
DuPont Analysis						
Asset turnover (x)	1.0	1.0	1.1	1.2	1.1	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*	*7.6*	*10.2*
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	38	40

Valuations

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
PER (x)	23.5	22.3	18.0	19.8	24.3	16.7
Price/Book value (x)	4.6	4.0	3.7	3.6	3.6	3.4
EV/Net sales (x)	2.5	2.4	2.1	1.7	1.7	1.5
EV/EBITDA (x)	16	13	12	12	13	10
Dividend Yield (%)	*1*	*4*	*4*	*4*	*3*	*5*

Source: Company; IDBI Capital Research

Notes

Dealing	(91-22) 6836 1111	dealing@idbicapital.com

Key to Ratings Stocks:

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

IDBI Capital Markets & Securities Ltd.

Equity Research Desk

6th Floor, IDBI Tower, WTC Complex, Cuffe Parade, Colaba, Mumbai – 400 005. Phones: (91-22) 2217 1700; Fax: (91-22) 2215 1787; Email: info@idbicapital.com

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Compliance Officer: Christina D'souza; Email: compliance@idbicapital.com; Telephone: (91-22) 2217 1907

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