

Expect improved growth in FY22E...

We attended the virtual analyst meet of Tech Mahindra (TechM). The company highlighted that it is expecting acceleration in growth based on a large deal pipeline (73 large deal potential), healthy pipeline (up 20% YoY in six months), acceleration in digital technologies and 5G opportunities. TechM is also aiming to reduce revenue volatility by focusing on more annuity type deals. In FY22E, the company is targeting lower than double digit growth (probably mid high single digit) in Telecom (~40% of revenues) and double digit in enterprise segment (~60% of revenues). In terms of margins, TechM expects to reach 15% by FY22E led by higher offshoring, lower subcontracting cost, reducing focus on low margin geographies, services & customers and pyramid rationalisation.

Digital acceleration, large deals, 5G to drive growth

The company expects digital technologies like customer experience, cloud, data & analytics to grow at a healthy pace in coming years. The company expects customer experience to increase at a CAGR of 11.2% to US\$219 billion in FY20-24 and expects acquisitions like Born, Mad Pow, Bio to help capture this demand. In terms of cloud, TechM expects this market to increase at a CAGR of 18% to US\$484 billion mainly led by cloud migration, application modernisation and software as a service (SAAS) implementation. The company generates US\$900 million (~17% of topline) from cloud and is growing at 22%. TechM's booked TCv in cloud is 2x over the previous year representing tremendous growth in coming years. In terms of data & analytics the company generates US\$800 million (15% of revenues) and employs 10,000 associates with 35 Fortune 500 clients and 300+ customer base. TechM expects to expand its global customer base to 1000+ customers. Apart from capturing acceleration in digital technologies, the company's focus on winning large deals will further boost revenues in coming years. In order to increase large deals, TechM is proactively chasing large deals, increasing visibility through PE experts, CXO Advisory & Industry Analyst, setting up a large deal team of business analyst, financial analyst, enterprise architect & deal director and tapping increased opportunity by right acquisition & restructuring deals via carve outs. Hence, we believe TechM would witness growth acceleration in coming years.

Valuation & Outlook

The company is expected to see acceleration in revenue growth led by large deal pipeline, digital acceleration and improving IT spend in communication. Further, in the long term, we believe TechM will be a key beneficiary of 5G opportunities. This, coupled with an improving margin trajectory led by cost rationalisation and reasonable valuation prompt us to be positive on the stock. Hence, we maintain our **BUY** recommendation on the stock with a target price of ₹ 1040/share (15x FY23E EPS).

Tech Mahindra

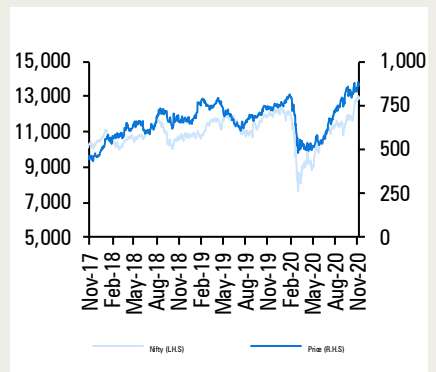
Particulars

Particular	Amount
Market Cap (₹ Crore)	86,194.0
Total Debt (₹ Crore)	2,428.2
Cash and Invest (₹ Crore)	8,760.6
EV (₹ Crore)	79,861.6
52 week H/L	909 / 470
Equity capital	435.9
Face value	₹ 5

Key Highlights

- Digital acceleration, focus on large deal wins, client mining and healthy pipeline indicate improving revenue trajectory
- Tech Mahindra aspires to expand margins to 15% by FY22E led by cost rationalisation initiatives
- Maintain BUY

Price Performance



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Key Financial Summary

Key Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net sales	34,742	36,868	37,536	40,490	44,787	6.7%
EBITDA	6,337	5,726	6,419	7,450	8,375	13.5%
EBITDA Margin (%)	18.2	15.5	17.1	18.4	18.7	
Net Profit	4,298	4,033	4,402	5,169	5,923	13.7%
EPS (₹)	47.7	45.9	50.0	58.8	67.3	
P/E	18.7	19.5	17.8	15.2	13.2	
RoNW (%)	21.2	18.5	18.3	18.9	19.0	
RoCE (%)	23.6	19.1	18.7	19.8	20.3	

Source: Company, ICICI Direct Research

5G - An opportunity yet to materialise

The company has highlighted a US\$113-133 billion of opportunity in 5G led by growth in open 5G network (expected to grow at CAGR of 65-70% in FY20-25 to US\$40-50 billion), Network on cloud (expected to grow at CAGR of 20-25% over FY20-25 to US\$8-10 billion), Intelligent & Cognitive Managed Ops (expected to grow at CAGR of 15-20% in FY20-25 to US\$10-15 billion), digital OSS (expected to grow at CAGR of 10-12% in FY20-25 to US\$5-8 billion) and Enterprise Network Modernisation (expected to grow at CAGR of 12-14% in FY20-25 to US\$50 billion). While the entire spend in 5G may not be net new and some may be repurposed and some opportunity may be for players outside IT service, it still represents a huge opportunity. TechM expects network transformation in telecom, increased R&D spends on network & devices and use of 5G in enterprise to drive 5G related spends. The company has built IP and platforms like GAiA, netOps.ai, bluemarble, CI.NXt, AINoF.NXt to tap 5G related opportunities. TechM is also reskilling its employees and partnering across segments to tap the upcoming opportunity in 5G.

Margins to witness improved growth

Despite headwinds of increase in travel cost and wage hikes, the company expects margins to improve in coming quarters and reach 15% in FY22E. TechM aims to achieve higher margins led by higher offshoring, lower subcontracting cost, reducing focus on low margin geographies, services & customers, and pyramid rationalisation. However, we conservatively build margin expansion and expect 14.5% EBIT margins in FY22E and 14.8% in FY23E.

Other highlights

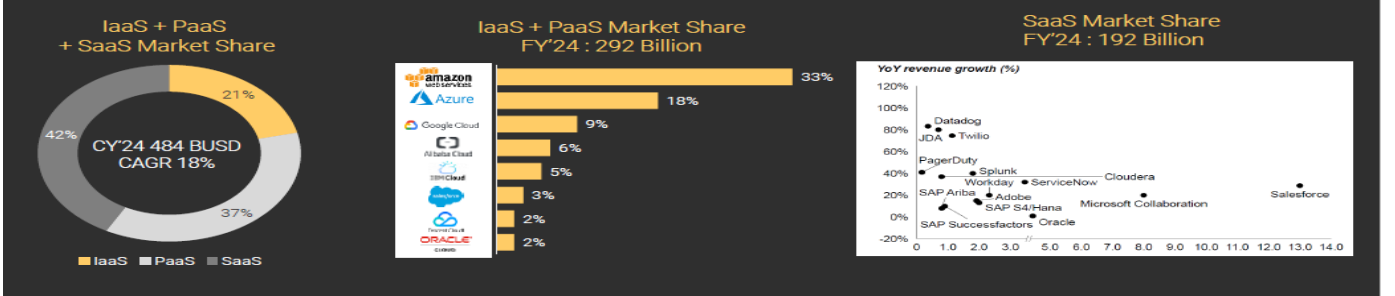
- **Cloud-** In cloud the ticket size starts with US\$100000 and scales up to billion dollar deals. The big bets in cloud are data centre carve outs, large AMS deals and scaling SAAS & hyperscale
- **5G** – US\$62 billion opportunity in Network platform R&D and US\$15 billion opportunity in device platform R&D.
- **Large deals & Strategy** – The company in the repair phase will focus on higher annuity type deals and large deals in enterprise side. TechM sees a large deal size of US\$75-100 million as a sweet spot for itself. The company is also looking to rationalise geos, business lines and customers to better allocate resources. Penetration strategy in Top 60, top 300 and top 650 accounts led by reinforce, retain rotate and removing clients
- **Capital allocation** – With increased focus on annuity revenues (helps reduce revenue volatility) and expected stability in margins we expect improved payout in coming years

Exhibit 1: Trends and opportunities in customer experience



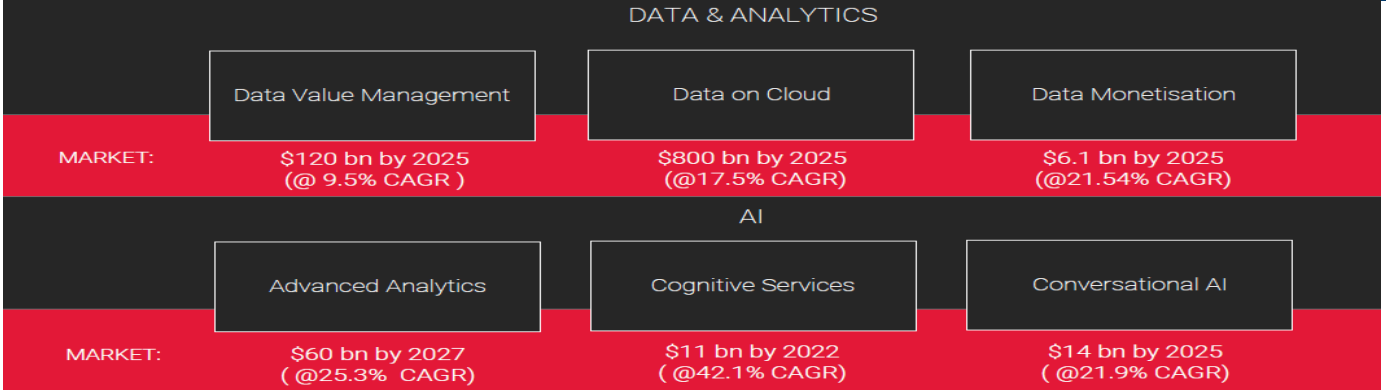
Source: Company, ICICI Direct Research

Exhibit 2: Trends in cloud markets



Source: Company, ICICI Direct Research

Exhibit 3: Data & Analytics and Artificial Intelligence market



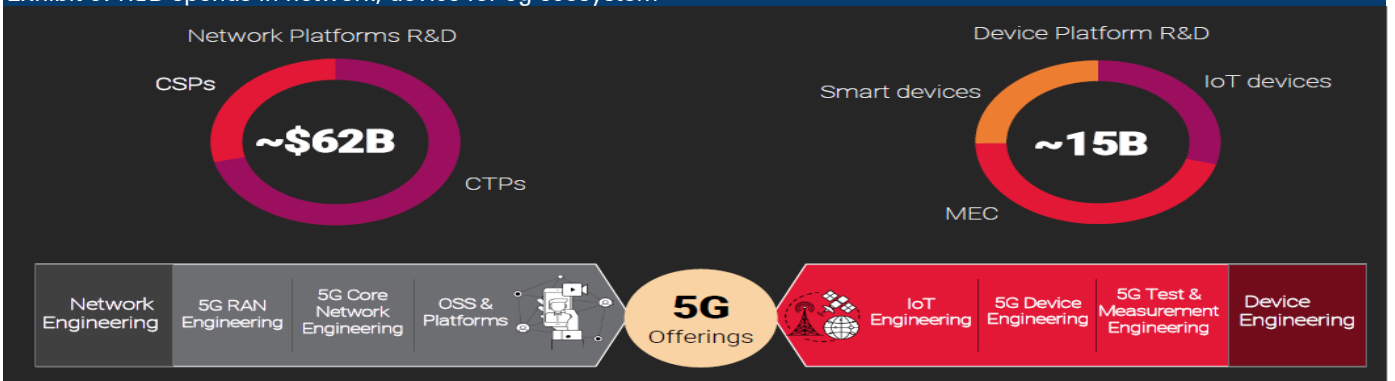
Source: Company, ICICI Direct Research

Exhibit 4: 5G opportunity over FY20-FY25

		Market Opportunity	CAGR % 2020-25	Tech Mahindra Product
1	Open 5G Network	\$40-50B	65-70%	
2	Network on the Cloud	\$8-10B	20-25%	netOps.ai
3	Intelligent & Cognitive Managed Ops	\$10-15B	15-20%	Tech Mahindra GAI A
4	Digital OSS	\$5-8B	10-12%	
5	Enterprise Network Modernization	>\$50B	12-14%	

Source: Company, ICICI Direct Research

Exhibit 5: R&D spends in network, device for 5g ecosystem



Source: Company, ICICI Direct Research

Financial summary

Exhibit 6: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Net sales	36,868	37,536	40,490	44,787
Growth (%)	6	2	8	11
COGS (employee expenses)	25,974	25,900	27,533	30,455
Gross profit	10,893	11,636	12,957	14,332
S,G&A expenses	5,167	5,217	5,507	5,957
Total Operating Expenditure	31,142	31,117	33,040	36,412
EBITDA	5,726	6,419	7,450	8,375
Growth (%)	(10)	12	16	12
Depreciation	1,446	1,472	1,588	1,756
Interest	192	192	192	192
Other Income	1,192	811	880	1,089
PBT	5,281	5,566	6,550	7,516
Total Tax	1,160	1,225	1,441	1,654
Exceptional item	-	-	-	-
PAT	4,033	4,402	5,169	5,923
Growth (%)	(6)	9	17	15
EPS (₹)	45.9	50.0	58.8	67.3

Source: Company, ICICI Direct Research

Exhibit 8: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity Capital	436	436	436	436
Share application money	-	-	-	-
Reserve and Surplus	21,377	23,578	26,938	30,788
Total Shareholders funds	21,813	24,014	27,374	31,224
Minority Interest	393	328	262	197
Total Debt	2,428	2,428	2,428	2,428
Other long term liabilities	4,043	4,043	4,043	4,043
Total Liabilities	28,677	30,813	34,107	37,891
Assets				
Net Block	3,834	3,650	3,425	3,138
Capital WIP	50	50	50	50
Investments	5,848	6,843	7,837	8,832
Deferred tax assets	844	844	844	844
Goodwill on consolidation	3,388	3,388	3,388	3,388
Debtors	7,581	7,882	8,098	8,957
Loans and Advances (short)	-	-	-	-
Other non-current assets	4,175	4,175	4,176	4,176
Cash	3,148	4,402	6,877	9,335
Other current assets	6,799	6,907	7,450	8,241
Total Current Assets	23,176	25,839	30,074	35,181
Trade payables	3,257	3,316	3,577	3,956
Current liabilities	4,983	5,255	5,669	6,270
Provisions	436	444	479	530
Total Current Liabilities	8,676	9,015	9,724	10,756
Application of Funds	28,677	30,813	34,107	37,891

Source: Company, ICICI Direct Research

Exhibit 7: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit before Tax	5,058	5,566	6,550	7,516
Add: Depreciation	1,446	1,472	1,588	1,756
(Inc)/dec in Current Assets	(2,335)	(410)	(760)	(1,651)
Inc/(dec) in CL and Provisions	1,813	339	710	1,032
Taxes paid	(1,513)	(1,225)	(1,441)	(1,654)
CF from operating activities	4,358	5,173	6,109	6,253
(Inc)/dec in Investments	1,298	(1,000)	(1,000)	(1,000)
(Inc)/dec in Fixed Assets	(829)	(938)	(1,012)	(1,120)
Others	253	761	730	939
CF from investing activities	1,029	(1,177)	(1,282)	(1,181)
Issue/(Buy back) of Equity	47	-	-	-
Inc/(dec) in loan funds	193	-	-	-
Dividend paid & dividend tax	(2,492)	(2,201)	(1,809)	(2,073)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(426)	(192)	(192)	(192)
CF from financing activities	(4,466)	(2,743)	(2,351)	(2,615)
Net Cash flow	921	1,254	2,476	2,458
Cash by acquisition	-	-	-	-
Opening Cash	2,043	3,148	4,402	6,877
Cash carried to B/S	3,148	4,402	6,877	9,335

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	45.9	50.0	58.8	67.3
Cash EPS	62.3	66.8	76.8	87.3
BV	248.0	273.0	311.2	355.0
DPS	15.0	25.0	20.6	23.6
Cash Per Share	35.8	50.0	78.2	106.1
Operating Ratios (%)				
EBITDA Margin	15.5	17.1	18.4	18.7
PAT Margin	10.9	11.7	12.8	13.2
Return Ratios (%)				
RoE	18.5	18.3	18.9	19.0
RoCE	19.1	18.7	19.8	20.3
RoIC	21.5	25.0	30.0	33.3
Valuation Ratios (x)				
P/E	19.5	17.8	15.2	13.2
EV / EBITDA	13.9	12.1	10.0	8.4
EV / Net Sales	2.2	2.1	1.8	1.6
Market Cap / Sales	2.3	2.3	2.1	1.9
Price to Book Value	3.6	3.3	2.9	2.5
Solvency Ratios				
Debt/EBITDA	0.4	0.4	0.3	0.3
Current Ratio	1.7	1.6	1.6	1.6
Quick Ratio	1.7	1.6	1.6	1.6

Source: Company, ICICI Direct Research

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