

Tech Mahindra Ltd. (TechM)

Analyst Recommendation: BUY

BSE Code: 532755 NSE: TECHM Reuters Code: TEMPLNS Bloomberg Code: TECHM:IN

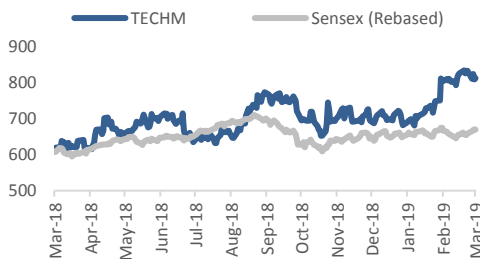
CMP: Rs 781
1 Year Target - Rs 899

Face Value	5.0
Market Cap (Rscr)	69,158
52 week high/low	840/605
Avg. Daily Volume (6m)	0.3 cr units
Shares O/S (Cr)	98.1
Book Value per Share (Rs)	213.3
Sensex	38,862
Nifty	11,666

Investor's Rationale

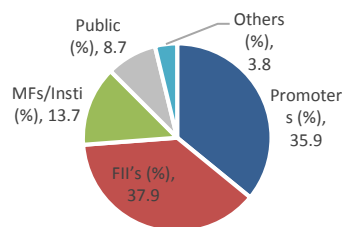
- **Growth across pockets led to strong revenue growth:** TechM posted healthy revenue growth of 3.5% QoQ in USD terms (+4.3% QoQ in CC terms) in Q3FY19 powered by sustained traction in enterprise business (~4% QoQ) and key communication vertical (41% of rev, +2.6% QoQ). While growth in enterprise business was powered by continued momentum in manufacturing (5.7% QoQ) & BFSI (2.9% QoQ) verticals and traction in digital (33% of rev, +10% QoQ), deal wins anchored growth in communication business. Deal wins stood healthy with TCV of USD440mn in Q3FY19 of which USD 200mn in enterprise vertical and USD 240mn in telecom vertical.
- **Multiple levers to trigger margin expansion:** EBITDA margin expanded by 50 bps QoQ in Q3FY19 to 19.3% (higher than expected) largely aided by decline in SG&A cost coupled with lower sub-contracting cost and higher utilisation which helped to offset the impact of transition costs in large deals and change in business mix. Going forward, while there are various margin levers in place like a) change in business mix b) yield management c) improvement in performance of portfolio companies d) higher offshoring e) automation benefits and f) higher realisation, multiple headwinds such as visa constraints, supply side pressure, transition costs in large deals and measures to restrict attrition would restrict the pace of margin expansion in FY20E/21E. Notably, sustained traction in digital business (currently 33% of total revenues) could provide further impetus to margin expansion. Resultantly, we factor EBITDA margin of 18.7%/19% for FY20E/21E.
- **Robust 5G opportunity to capitalise on:** We factor revenue CAGR of 10% over FY19-21E largely powered by robust opportunity in the communication vertical powered by uptick in deal wins and robust deal pipeline. Although management highlighted that uptick in 5G spends are yet to gain pace, however we believe the company is well-placed to capitalise on 5G opportunity given its strong capabilities in communications (IT & network) vertical and creating a whole ecosystem through investments in platforms and partnerships.

1 yr. Price Chart of Stock and BSE



Valuation: Robust commentary on communication vertical coupled with improving trajectory in digital, uptick in deal wins and robust deal pipeline provides visibility on overall growth. Hence, we recommend 'BUY' rating on the stock with a target price of Rs. 899 based on 14.5x FY21E EPS.

Shareholding pattern as on 31st December 2018



	FY18	FY19E	FY20E	FY21E
Revenue (Rs.Cr)	30,773	35,001	38,667	42,590
EBITDA (Rs. cr)	4,710	6,461	7,215	8,075
Adj. profit (Rs.Cr)	3,800	4,342	4,837	5,488
Adj. EPS (Rs.)	43.0	49.1	54.7	62.0
P/E (x)	18.2	15.9	14.3	12.6
P/BV (x)	3.7	3.2	2.8	2.5
EV/EBITDA (x)	14.5	10.4	9.1	8.0
ROE (%)	21.5	21.5	21.0	21.0
ROCE (%)	25.7	26.1	26.3	26.5

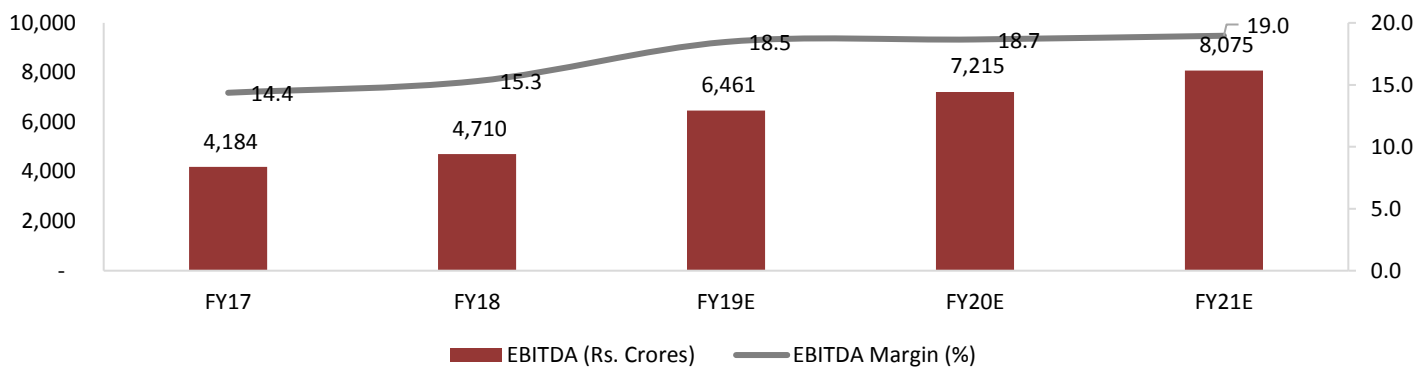
Growth across pockets led to strong revenue growth

TechM posted healthy revenue growth of 3.5% QoQ in USD terms (+4.3% QoQ in CC terms) in Q3FY19 powered by sustained traction in enterprise business (~4% QoQ) and key communication vertical (41% of rev, +2.6% QoQ). While growth in enterprise business was powered by continued momentum in manufacturing (5.7% QoQ) & BFSI (2.9% QoQ) verticals and traction in digital (33% of rev, +10% QoQ), deal wins anchored growth in communication business. Deal wins stood healthy with TCV of USD440mn in Q3FY19 of which USD 200mn in enterprise vertical and USD 240mn in telecom vertical.

Multiple levers to trigger margin expansion

EBITDA margin expanded by 50 bps QoQ in Q3FY19 to 19.3% (higher than expected) largely aided by decline in SG&A cost coupled with lower sub-contracting cost and higher utilisation which helped to offset the impact of transition costs in large deals and change in business mix. In line with robust operational performance coupled with lower tax rate led by tax reversal, net profit grew by 13% QoQ in Q3FY19. Going forward, while there are various margin levers in place like a) change in business mix b) yield management c) improvement in performance of portfolio companies d) higher offshoring e) automation benefits and f) higher realisation, multiple headwinds such as visa constraints, supply side pressure, transition costs in large deals and measures to restrict attrition would restrict the pace of margin expansion in FY20E/21E. Notably, sustained traction in digital business (currently 33% of total revenues) could provide further impetus to margin expansion. Resultantly, we factor EBITDA margin of 18.7%/19% for FY20E/21E.

EBITDA margin to stay robust

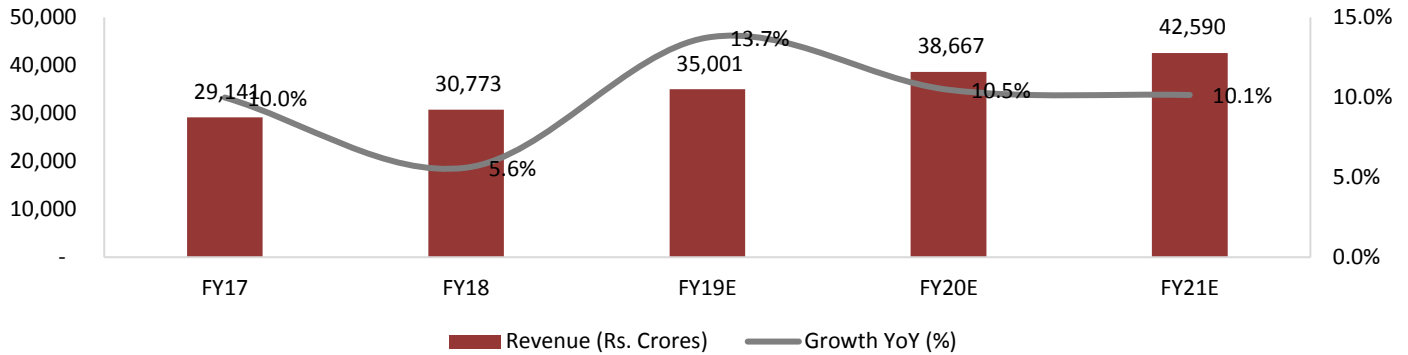


Source: Company, In-house research

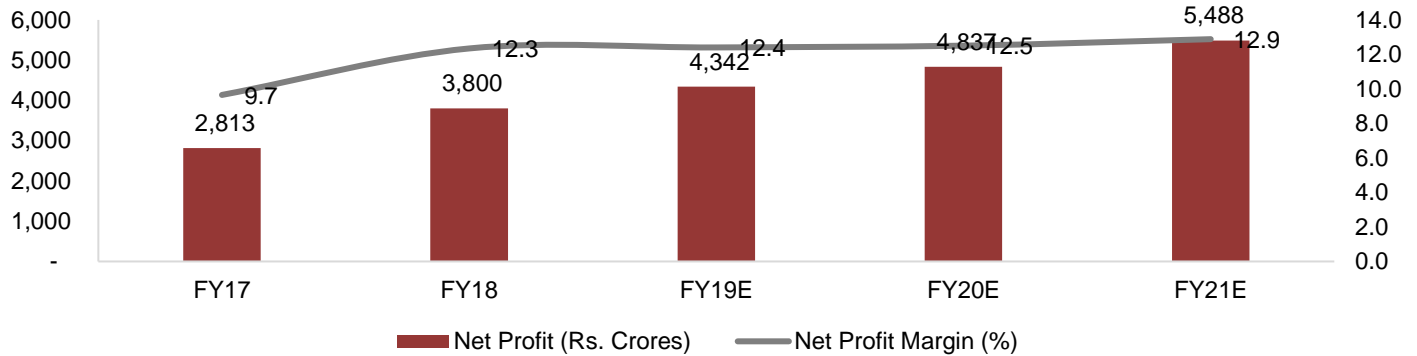
Robust 5G opportunity to capitalise on

We factor revenue CAGR of 10% over FY19-21E largely powered by robust opportunity in the communication vertical powered by uptick in deal wins and robust deal pipeline. Although management highlighted that uptick in 5G spends are yet to gain pace, however we believe the company is well-placed to capitalise on 5G opportunity given its strong capabilities in communications (IT & network) vertical and creating a whole ecosystem through investments in platforms and partnerships. Further continued strong deal wins with TCV of USD440 mn in Q3FY19 (USD 550 mn in Q2FY19), of which signings of USD 240 mn are in the communication vertical led by investments aimed at transforming digital platforms for customer management, supply-chain management and device & inventory management ahead of the commencement of 5G related spend, provides strong growth visibility in the communication space.

Revenue to grow at 11% CAGR over FY18-21E



Net profit to grow at a CAGR of 13% over FY18-21E

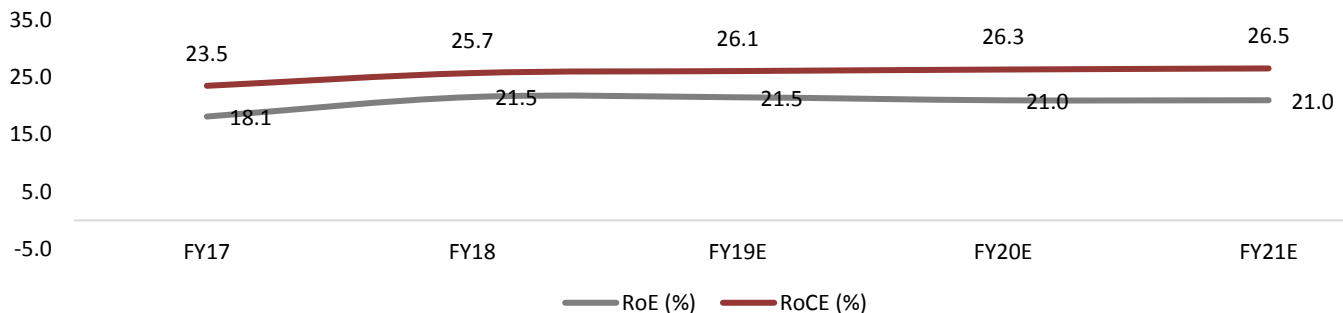


Source: Company, In-house research

Outlook and Valuation

Robust commentary on communication vertical coupled with improving trajectory in digital, uptick in deal wins and robust deal pipeline provides visibility on overall growth. Hence, we recommend 'BUY' rating on the stock with a target price of Rs. 899 based on 14.5x FY21E EPS.

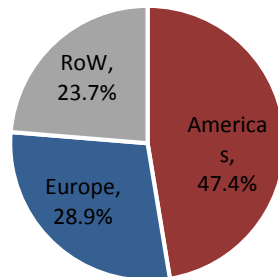
Return ratios trend



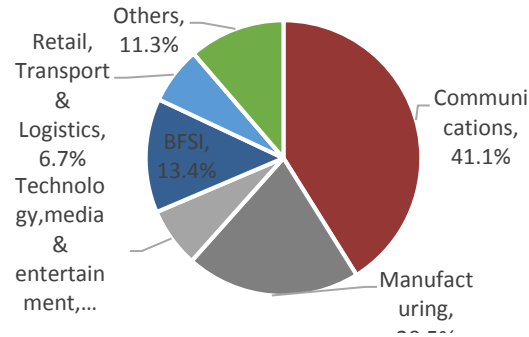
Tech Mahindra - Company Overview

Tech Mahindra (TechM), a part of Mahindra Group, offers technology services and solutions across Telecom IT & Network Services, Consulting, Application & Infrastructure Outsourcing, Engineering Services, BPO & Platform Solutions, among others. The company provides software services across communication, manufacturing, technology, media & entertainment, BFSI, retail, transport & logistics, among others. Of which, communication vertical accounts for majority of the revenue (~41% of overall revenue) given its strong capabilities in communications (IT & network) and works with almost all the key global communications companies. It has talent pool of more than 121,000 serving clients across 90 countries.

Geographic mix



Segment mix



Quarterly Financials (Consolidated)

(Rs cr)	Q3FY19	Q3FY18	YoY Growth %	Q2FY19	QoQ Growth %	9MFY19	9MFY18	Growth %
Sales	8,944	7,776	15.0	8,630	3.6	25,850	22,718	13.8
EBITDA	1,723	1,265	36.2	1,619	6.4	4,698	3,305	42.2
EBITDA margin (%)	19.3%	16.3%	300bps	18.8%	50bps	18.2%	14.5%	363bps
Depreciation	284	274	3.4	294	(3.7)	859	786	9.2
EBIT	1,439	990	45.3	1,324	8.7	3,839	2,519	52.4
Interest	36	34	5.0	39	(7.7)	105	110	(4.2)
Other Income	81	225	(64.2)	175	(54.0)	367	958	(61.7)
Exceptional Items	-	-	-	-	-	-	-	-
PBT	1,484	1,181	25.6	1,461	1.6	4,101	3,367	21.8
Tax	264	257	2.6	391	(32.6)	901	812	11.0
PAT	1,220	924	32.0	1,069	14.1	3,201	2,555	25.2
Minority Interest/P&L from associates	17	(19)	-	5	249.0	35	(22)	-
Reported PAT	1,203	943	27.6	1,064	13.0	3,165	2,578	22.8
Adjustment	-	-	-	-	-	-	-	-
Adj PAT	1,203	943	27.6	1,064	13.0	3,165	2,578	22.8

Source: Company, In-house research

Key Risks

- Appreciation of INR against USD.
- Slower than expected pick-up in global IT spend.

Balance sheet (Consolidated)

(Rs crore)	FY18	FY19E	FY20E	FY21E
Liabilities				
Paid up capital	442	443	443	443
Reserves and Surplus	18,401	21,123	24,128	27,309
Net worth	18,843	21,565	24,571	27,751
Minority interest	509	510	511	513
Total Debt	1,726	1,726	1,726	1,726
Other non-current liabilities	1,161	1,161	1,161	1,161
Total Liabilities	22,239	24,963	27,969	31,151
Assets				
Total fixed assets	4,850	4,690	4,712	4,625
Capital WIP	240	240	240	240
Goodwill	2,773	2,844	2,844	2,844
Investments	4,691	5,691	6,691	7,691
Net Current assets	6,470	8,282	10,266	12,536
Deferred tax assets (Net)	571	571	571	571
Other non-current assets	2,646	2,646	2,646	2,646
Total Assets	22,239	24,963	27,969	31,151

Profit & Loss Account (Consolidated)

(Rs crore)	FY18	FY19E	FY20E	FY21E
Total operating Income	30,773	35,001	38,667	42,590
Raw Material cost	-	-	-	-
Employee cost	16,624	17,921	19,759	21,636
Other operating expenses	9,439	10,619	11,693	12,879
EBITDA	4,710	6,461	7,215	8,075
Depreciation	1,085	1,160	1,177	1,288
EBIT	3,625	5,302	6,038	6,787
Interest cost	162	143	147	148
Other Income	1,416	548	628	748
Profit before tax	4,879	5,707	6,519	7,387
Tax	1,093	1,313	1,630	1,847
Profit after tax	3,786	4,394	4,889	5,540
Minority Interests	(14)	1	1	1
P/L from Associates	0	(51)	(51)	(51)
Adjusted PAT	3,800	4,342	4,837	5,488
E/o inc./(Exp.)	-	-	-	-
Reported PAT	3,800	4,342	4,837	5,488

Cash Flow (Consolidated)

Y.E March (Rs crore)	FY18	FY19E	FY20E	FY21E
Pretax profit	4,879	5,656	6,468	7,336
Depreciation	1,085	1,160	1,177	1,288
Chg in Working Capital	(783)	(804)	(619)	(673)
Others	(101)	(405)	(481)	(600)
Tax paid	(1,526)	(1,313)	(1,630)	(1,847)
Cash flow from operating activities	3,554	4,294	4,916	5,505
Capital expenditure	(1,017)	(1,071)	(1,200)	(1,200)
Chg in investments	(3,202)	(1,000)	(1,000)	(1,000)
Other investing cashflow	859	548	628	748
Cash flow from investing activities	(3,360)	(1,523)	(1,572)	(1,452)
Equity raised/(repaid)	86	1	-	-
Debt raised/(repaid)	749	-	-	-
Dividend paid	(944)	(1,621)	(1,831)	(2,307)
Other financing activities	(160)	(143)	(147)	(148)
Cash flow from financing activities	(269)	(1,763)	(1,978)	(2,456)
Net chg in cash	(76)	1,008	1,365	1,597

Key Ratios & Valuations (Consolidated)

Y.E. March	FY18	FY19E	FY20E	FY21E
Growth (%)				
Net Sales	5.6	13.7	10.5	10.1
EBITDA	12.6	37.2	11.7	11.9
Net profit	35.1	14.3	11.4	13.5
Margin (%)				
EBITDA	15.3	18.5	18.7	19.0
NPM	12.3	12.4	12.5	12.9
Return Ratios (%)				
RoE	21.5	21.5	21.0	21.0
RoCE	25.7	26.1	26.3	26.5
Per share data (Rs.)				
EPS	43.0	49.1	54.7	62.0
DPS	14.0	15.3	17.2	21.7
Valuation(x)				
P/E	18.2	15.9	14.3	12.6
EV/EBITDA	14.5	10.4	9.1	8.0
EV/Net Sales	2.2	1.9	1.7	1.5
P/B	3.7	3.2	2.8	2.5
Turnover Ratios (x)				
Net Sales/GFA	3.0	3.0	3.0	3.0
Sales/Total Assets	1.1	1.1	1.1	1.1

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Between 10% & -5%	Accumulate*	Upside between 10% & 15%
Reduce	Less than -5%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%.

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* TechM is a large-cap company.



Member: BSE, NSE, MCX, MCX-SX, CDSL

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