

BUY

TP: Rs 780 | ▲ 17%

TECH MAHINDRA

| IT Services

| 28 July 2020

Performance surpasses expectations

Tech Mahindra (TECHM) posted a 6.8% QoQ dollar revenue decline and 10bps EBITDA margin expansion, bettering our estimates for Q1FY21. Though the communication vertical continued its declining streak (-8.6% QoQ), traction in the technology, media and entertainment segment restricted the fall in revenue. We increase FY21 EPS by 10%, baking in the Q1FY21 beat, and hike our target P/E to 13.8x (from 12.5x). Rolling forward, we move to a new Jun'21 TP of Rs 780 (vs. Rs 690). Reiterate BUY.

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Tight cost control: Q1 was expected to bear the brunt of pandemic headwinds, supply-side issues and Comviva seasonality impact. In contrast, TECHM beat estimates with revenue down 6.8% QoQ vs. our/consensus forecast of an 8.5%/8.3% decline. A third of the decline was supply-led and the rest demand-led. BPS recovery commenced in Q1 despite supply-side issues. EBIT margin at 10.1% was flattish QoQ, outperforming our/consensus estimates of 8.3%/8.9%. This was the result of redesigned processes (increased automation) and reduced discretionary costs, which helped margins by 200bps.

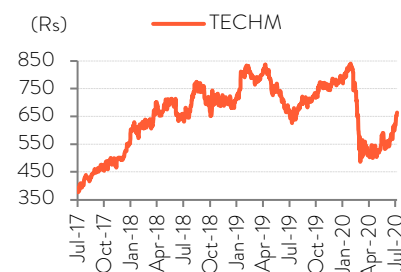
Strong deal pipeline: TCV at US\$ 290mn was down sharply from US\$ 513mn in Q4FY20 as deal activity slackened in the beginning of the quarter due to the pandemic. Management indicated that deal signing gained pace in the second half of Q1. TECHM's deal pipeline is healthy across the communication and enterprise verticals. Moreover, its enterprise pipeline in the US is at a three-year high. Management expects TCV to bounce back in Q2 and Q3.

Cautious outlook: TECHM expects Q1 to be the trough and is hopeful of growth recovery. It is targeting continued operating margin improvement through FY21 on the back of cost rationalisation, delivery efficiency, portfolio entity synergy, and pruning of business in low-yield geographies.

Ticker/Price	TECHM IN/Rs 665
Market cap	US\$ 7.8bn
Shares o/s	873mn
3M ADV	US\$ 39.4mn
52wk high/low	Rs 846/Rs 471
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	347,421	368,677	374,963	422,619	468,176
EBITDA (Rs mn)	63,368	57,261	59,255	76,422	83,954
Adj. net profit (Rs mn)	42,975	42,505	41,294	48,444	54,083
Adj. EPS (Rs)	47.7	48.3	47.0	55.1	61.5
Adj. EPS growth (%)	11.9	1.2	(2.8)	17.3	11.6
Adj. ROAE (%)	21.4	19.8	17.7	18.8	18.9
Adj. P/E (x)	13.9	13.7	14.2	12.1	10.8
EV/EBITDA (x)	9.1	10.1	9.7	7.3	6.3

Source: Company, BOBCAPS Research

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Other highlights

- Due to Covid-19, communication deals have been delayed by 5-7 months. The 5G roadmap remains intact, albeit delayed at the moment. Aggregation of networks and expanding software-based networks will be the key focus areas in network services going forward. TECHM is undertaking functional and electronic design for 5G appliance makers.
- Most verticals declined sequentially in Q1 with telecom/manufacturing/others falling the most, by 8.6%/11.5%/9.2% QoQ, USD. BFSI/online retail business did reasonably well, declining at a slower 4.3%/6.8% QoQ. Technology, media and entertainment was the only vertical to post sequential growth, at 13.4%.
- Currently, TECHM has achieved 92% work-from-home levels in BPS vs. 85% in Q4FY20. Most of the supply-side issues have been sorted.
- Closer integration of subsidiaries is the company's main focus. Demand weakness in the automobile sector continues to pose challenges for Pininfarina.
- TECHM is continuing its strategy of cannibalization of BPS business through extreme automation, thus taking advantage of the shift from voice to chat.
- DSOs declined to 107 days vs. 112 in Q4FY20.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue (US\$ mn)	1,207	1,247	(3.2)	1,295	(6.8)
Revenue	91,063	86,530	5.2	94,902	(4.0)
Operating Expenditure	78,058	73,389	6.4	81,424	(4.1)
Cost of revenues	65,105	61,642	5.6	66,896	(2.7)
as % of sales	71.5	71.2	-	70.5	-
SG&A expenses	12,953	11,747	10.3	14,528	(10.8)
as % of sales	14.2	13.6	-	15.3	-
EBITDA	13,005	13,141	(1.0)	13,478	(3.5)
Depreciation	3,832	3,213	-	3,982	-
EBIT	9,173	9,928	(7.6)	9,496	(3.4)
Other Income	3,659	2,877	-	2,335	-
PBT	12,832	12,805	0.2	11,831	8.5
Total Tax	3,276	3,318	-	2,392	-
Adjusted PAT	9,556	9,487	0.7	9,439	1.2
(Profit)/loss from JV's/Ass/MI	167	102	-	775	-
APAT after MI	9,723	9,589	1.4	10,214	(4.8)
Extra ordinary items	-	0	-	(2,175)	-
Reported PAT	9,723	9,589	1.4	8,039	20.9
Reported EPS	11	11	1.5	9	20.9

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Margins (%)			(bps)		(bps)
EBITDA	14.3	15.2	(90)	14.2	10
EBIT	10.1	11.5	(140)	10.0	10
EBT	14.1	14.8	(70)	12.5	160
PAT	10.7	11.1	(40)	8.5	220
Effective Tax rate	25.5	25.9	(40)	20.2	530

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

	Q1FY21 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Revenue by Geography (%)			
North America	49.3	(3.6)	0.2
Europe	25.8	(9.2)	(9.5)
Rest of the World	24.9	(10.0)	(2.8)
Top clients			
Top 5	22.0	(4.2)	(0.5)
Top 10	31.0	(6.8)	(2.3)
Top 20	43.0	(8.0)	(4.5)
Non-Top 10 client revenues	69.0	(6.8)	(3.6)
Revenue by Segment (%)			
Telecom	40.0	(8.6)	(7.8)
Manufacturing	16.8	(11.5)	(16.2)
Technology, Media and Entertainment	9.0	13.4	14.6
BFSI	15.7	(4.3)	18.7
Retail, Transport and Logistics	7.3	(6.8)	14.0
Others	11.2	(9.2)	(8.9)
Revenue by Delivery			
Onsite	64.0	(8.5)	(5.1)
Offshore	36.0	(3.6)	0.4
		(bps)	(bps)
Utilisation (including trainees)	82	(100)	200
Attrition	17	(200)	(400)
Headcount	123,416	(1,820)	(2,357)

	Q1FY21	Q4FY20	Q1FY20
No. of Million \$ Clients			
≥ \$1mn clients	451	446	429
≥ \$5mn clients	161	160	160
≥ \$10mn clients	81	85	81
≥ \$20mn clients	48	49	49
≥ \$50mn clients	21	22	21
DSO	107	112	110

Source: BOBCAPS Research

Valuation methodology

We believe that telecom is a relatively resilient industry in the current environment (see [Deep Dive 2: Telecom tech spends resilient – upgrade TECHM](#)). While we do expect TECHM to experience near-term weakness related to the pandemic (supply-side issues in BPO, slowdown in manufacturing/retail and delays in new deal execution), we believe 5G-driven traction will boost the communications vertical which forms 40% of revenues.

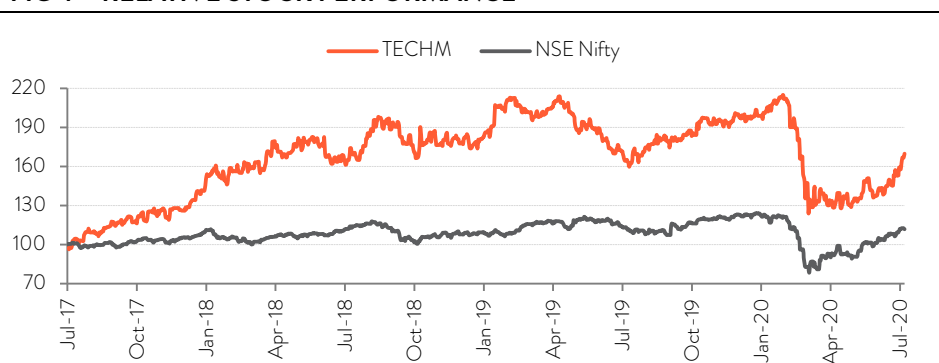
TECHM's Q1FY21 results are better than our as well as consensus estimates on both revenue and margins. We increase FY21 EPS by 10% and keep FY22 EPS unchanged. Rolling valuations forward, we move to a new Jun'21 target price of Rs 780 (vs. Rs 690), set at an increased Jun'21E P/E of 13.8x vs. 12.5x earlier. Our target multiple is in line with the last five-year average and rises as we unwind the 10% discount built in earlier, considering the better-than-expected operating show in these challenging times. Reiterate BUY.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Change (%)	Old	New	Change (%)	New
US\$ Revenues (US\$ mn)	4,935	4,918	(0.3)	5,437	5,418	(0.3)	6,002
YoY growth (%)	(4.8)	(5)	-	10.2	10.2	-	10.8
Revenues	377,550	374,963	(0.7)	424,104	422,619	(0.4)	468,176
EBITDA (Rs mn)	60,626	59,255	(2.3)	76,691	76,422	(0.4)	83,954
EBITDA margins (%)	16.1	15.8	-	18.1	18.1	-	17.9
EBIT margins (%)	12.0	11.6	-	14.0	14.0	-	13.7
Net Profits	37,414	41,294	10.4	48,648	48,444	(0.4)	54,083
EPS (Rs)	42.5	47.0	10.4	55.3	55.1	(0.4)	61.5

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Continued decline in communication business
- Lack of synergy among portfolio companies
- Slow recovery of enterprise business

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	347,421	368,677	374,963	422,619	468,176
EBITDA	63,368	57,261	59,255	76,422	83,954
Depreciation	11,292	14,458	15,756	17,337	19,663
EBIT	52,076	42,803	43,499	59,085	64,291
Net interest income/(expenses)	(1,332)	(1,919)	(1,441)	(1,550)	(1,650)
Other income/(expenses)	5,342	11,924	11,509	5,302	7,766
Exceptional items	0	0	0	0	0
EBT	55,431	52,753	53,599	62,878	70,446
Income taxes	12,544	11,604	13,671	16,034	17,964
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(567)	1,301	1,398	1,640	1,640
Reported net profit	42,975	42,505	41,294	48,444	54,083
Adjustments	0	0	0	0	0
Adjusted net profit	42,975	42,505	41,294	48,444	54,083

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	90,744	103,830	97,593	109,997	121,854
Provisions	9,753	11,055	10,273	11,579	12,827
Debt funds	14,047	24,282	24,282	24,282	24,282
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,437	4,359	4,359	4,359	4,359
Reserves & surplus	203,184	217,705	240,231	266,660	296,353
Shareholders' fund	207,621	222,064	244,590	271,019	300,712
Total liabilities and equities	334,469	373,535	389,042	429,181	471,978
Cash and cash eq.	20,427	30,167	60,514	94,107	132,132
Accounts receivables	69,586	75,772	73,965	83,366	92,352
Inventories	752	358	358	358	358
Other current assets	88,020	121,702	115,051	118,968	122,712
Investments	77,926	61,046	61,046	61,046	61,046
Net fixed assets	71,667	76,047	69,665	62,894	54,935
CWIP	2,763	501	501	501	501
Intangible assets	28,163	33,877	33,877	33,877	33,877
Deferred tax assets, net	6,091	8,443	8,443	8,443	8,443
Other assets	0	0	0	0	0
Total assets	334,469	373,535	389,042	429,181	471,979

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	50,112	55,607	55,683	64,181	72,146
Interest expenses	(745)	(13,843)	(12,949)	(6,852)	(9,416)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(10,574)	(13,356)	1,439	392	374
Other operating cash flows	5,527	17,667	0	0	0
Cash flow from operations	44,320	46,075	44,173	57,720	63,105
Capital expenditures	(7,793)	(15,386)	(9,374)	(10,565)	(11,704)
Change in investments	(23,216)	(16,880)	0	0	0
Other investing cash flows	9,967	13,843	12,949	6,852	9,416
Cash flow from investing	(21,042)	(18,423)	3,575	(3,713)	(2,289)
Equities issued/Others	(1,747)	0	0	0	0
Debt raised/repaid	(4,504)	0	0	0	0
Interest expenses	(1,354)	0	0	0	0
Dividends paid	(14,907)	(17,912)	(17,401)	(20,414)	(22,790)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(22,512)	(17,912)	(17,401)	(20,414)	(22,790)
Changes in cash and cash eq.	766	9,740	30,346	33,593	38,026
Closing cash and cash eq.	20,427	30,167	60,514	94,107	132,132

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	47.7	48.3	47.0	55.1	61.5
Adjusted EPS	47.7	48.3	47.0	55.1	61.5
Dividend per share	14.0	16.9	16.4	19.3	21.5
Book value per share	230.6	252.5	278.1	308.2	341.9

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	1.7	1.6	1.5	1.3	1.1
EV/EBITDA	9.1	10.1	9.7	7.3	6.3
Adjusted P/E	13.9	13.7	14.2	12.1	10.8
P/BV	2.9	2.6	2.4	2.2	1.9

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	77.5	80.6	77.0	77.0	76.8
Interest burden (PBT/EBIT)	106.4	123.2	123.2	106.4	109.6
EBIT margin (EBIT/Revenue)	15.0	11.6	11.6	14.0	13.7
Asset turnover (Revenue/Avg TA)	108.8	104.1	98.3	103.3	103.9
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
Adjusted ROAE	21.4	19.8	17.7	18.8	18.9

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	12.9	6.1	1.7	12.7	10.8
EBITDA	34.3	(9.6)	3.5	29.0	9.9
Adjusted EPS	11.9	1.2	(2.8)	17.3	11.6
Profitability & Return ratios (%)					
EBITDA margin	18.2	15.5	15.8	18.1	17.9
EBIT margin	15.0	11.6	11.6	14.0	13.7
Adjusted profit margin	12.4	11.5	11.0	11.5	11.6
Adjusted ROAE	21.4	19.8	17.7	18.8	18.9
ROCE	19.3	15.1	14.4	20.3	22.9
Working capital days (days)					
Receivables	71	72	73	68	68
Inventory	1	1	0	0	0
Payables	104	114	116	109	110
Ratios (x)					
Gross asset turnover	4.7	5.0	5.1	6.4	7.9
Current ratio	1.8	2.0	2.3	2.4	2.6
Net interest coverage ratio	(39.1)	(22.3)	(30.2)	(38.1)	(39.0)
Adjusted debt/equity	0.0	0.0	(0.1)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

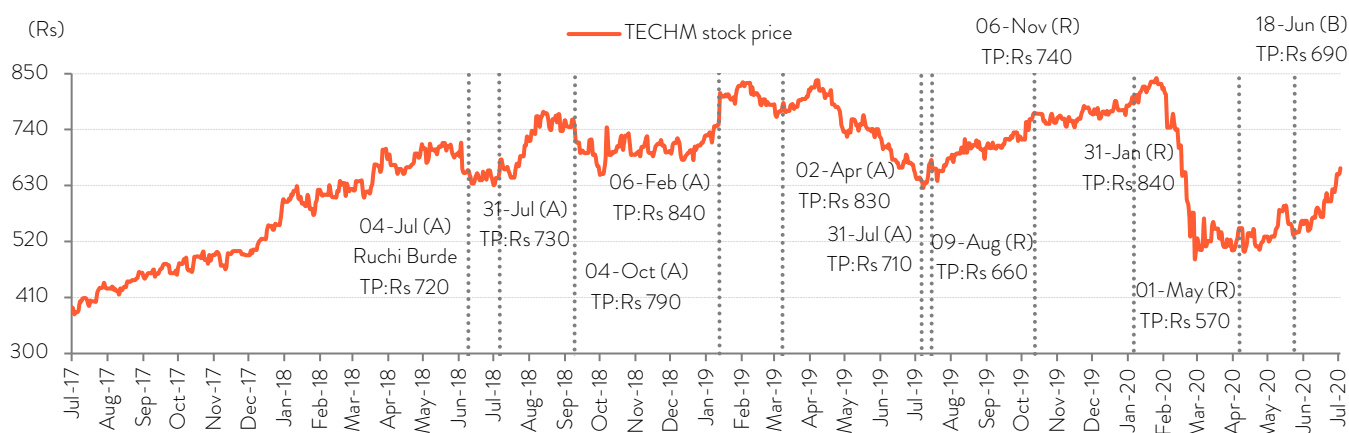
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): TECH MAHINDRA (TECHM IN)



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

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