

REDUCE

TP: Rs 740 | ▼ 4%

TECH MAHINDRA

| IT Services

| 06 November 2019

Enterprise business stage surprising growth

Tech Mahindra reported better than expected Q2FY20 operating performance led by beat on both revenues and operating margins. Surprisingly the revenue growth was led by Enterprise business while communication business growth was modest at 1% QoQ. Robust deal wins at US\$1.49bn were inline with expectations and boosted by AT&T deal. Attrition stayed elevated and cash generation was soft. We revise up FY21/22 EPS by 4/1% on Q2FY20 operational beat while retain REDUCE with revised tp of Rs 740.

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Enterprise business staged a growth surprise: Tech Mahindra reported better than expected Q2FY20 performance with 4.1% QoQ cc growth and 130 bps QoQ EBIT margin expansion V/s our estimate of 2.2% QoQ cc growth and 90 bps margin improvement. The growth composition was surprisingly contrasting compared to company's commentary in recent quarters and deal wins skewed by communication vertical. Revenue growth in Q2FY20 was led by Enterprise business (up 4.8% QoQ in dollar terms) and Communication business was relatively laggard with 1% QoQ dollar revenue growth.

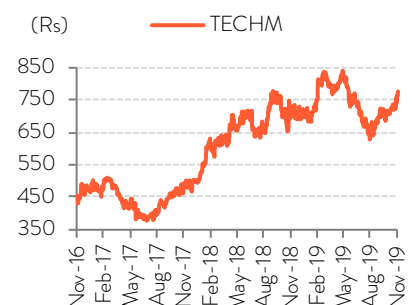
Mixed bag internals: Deal wins at US\$1.49bn (~3x the recent quarterly run rate) was largely on expected lined boosted by AT&T deal. Headcount addition was skewed by 7,193 BPO employee addition while IT services headcount contracted by 1496 people on QoQ basis. Attrition at 21% continued to be elevated. Cash generation (CFO to EBITDA at 51.3%) was soft.

Reiterate REDUCE: We revise up FY21/22 EPS by ~4%/1% respectively as we accommodate Sep'19 quarter performance. Retain REDUCE with revised Sep'20 TP of Rs 740, (V/s Rs 660 earlier) based on target P/E of 12.5x.

Ticker/Price	TECHM IN/Rs 773
Market cap	US\$ 9.6bn
Shares o/s	873mn
3M ADV	US\$ 29.9mn
52wk high/low	Rs 847/Rs 607
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	3,07,729	3,47,421	3,64,153	3,97,481	4,35,530
EBITDA (Rs mn)	47,169	63,368	60,868	70,345	80,749
Adj. net profit (Rs mn)	38,001	42,975	42,975	48,115	53,455
Adj. EPS (Rs)	42.7	47.7	48.8	54.6	60.7
Adj. EPS growth (%)	33.6	11.9	2.2	12.0	11.1
Adj. ROAE (%)	21.0	21.4	19.5	19.5	19.4
Adj. P/E (x)	18.1	16.2	15.8	14.2	12.7
EV/EBITDA (x)	14.2	10.6	11.0	9.1	7.5

Source: Company, BOBCAPS Research

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Outlook:

Management reiterated its FY20 growth outlook of similar to industrywide growth in communication vertical and relatively softer growth in Enterprise business. Management indicated that the Enterprise business growth will moderate in quarters ahead V/s Q2FY20 growth rate of 4.8% QoQ. Management is optimistic to return to ~15% EBIT margin range by FY21 and expect ~150 to 250bps margin decline in FY20 (V/s FY19 EBIT margin of 15%).

FIG 1 – SEP'19 QUARTER RESULT SUMMARY

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	YoY (%)	QoQ (%)	H1FY19	H1FY20	YoY (%)
Revenues (US\$ mn)	1,224	1,218	1,261	1,268	1,247	1,287	5.7	3.2	2,534	2,442	3.8
Revenue	82,763	86,298	89,437	88,923	86,530	90,699	5.1	4.8	1,77,229	1,69,061	4.8
Operating Expenditure	69,194	70,112	72,211	72,536	73,389	75,690	8.0	3.1	1,49,079	1,39,306	7.0
Cost of revenues	57,340	56,923	59,845	59,482	61,642	63,893	12.2	3.7	1,25,535	1,14,263	9.9
as % of sales	69.3	66.0	66.9	66.9	71.2	70.4	-	-	70.8	67.6	-
SG&A expenses	11,854	13,189	12,366	13,054	11,747	11,797	(10.6)	0.4	23,544	25,043	(6.0)
as % of sales	14.3	15.3	13.8	14.7	13.6	13.0	-	-	13.3	14.8	-
EBITDA	13,569	16,186	17,226	16,387	13,141	15,009	(7.3)	14.2	28,150	29,755	(5.4)
Depreciation	2,808	2,944	2,836	2,704	3,213	3,415	-	-	6,628	5,752	15.2
EBIT	10,761	13,242	14,390	13,683	9,928	11,594	(12.4)	16.8	21,522	24,003	(10.3)
Other Income	690	1,232	317	1,117	2,877	1,783	-	-	4,660	1,923	142.4
PBT	11,451	14,474	14,707	14,800	12,805	13,377	(7.6)	4.5	26,182	25,926	1.0
Total Tax	2,457	3,914	2,638	3,535	3,318	2,265	-	-	5,583	6,371	-
Adjusted PAT	8,994	10,560	12,069	11,265	9,487	11,112	5.2	17.1	20,599	19,555	5.3
(Profit)/loss from JV's/Ass/MI	(16)	84	(39)	59	102	127	-	-	229	68	-
APAT after MI	8,978	10,644	12,030	11,324	9,589	11,239	5.6	17.2	20,828	19,623	6.1
Extra ordinary items	0	0	0	0	0	0	-	-	0	0	-
Reported PAT	8,978	10,644	12,030	11,324	9,589	11,239	5.6	17.2	20,828	19,623	6.1
Reported EPS	10.1	11.9	13.5	12.6	10.9	12.8	7.0	17.2	24	22	7.5
Margins (%)							(bps)	(bps)			(bps)
EBITDA	16.4	18.8	19.3	18.4	15.2	16.5	(220)	140	15.9	17.6	(170)
EBIT	13.0	15.3	16.1	15.4	11.5	12.8	(260)	130	12.1	14.2	(210)
EBT	13.8	16.8	16.4	16.6	14.8	14.7	(200)	-	14.8	15.3	(60)
PAT	10.8	12.3	13.5	12.7	11.1	12.4	10	130	11.8	11.6	10
Effective Tax rate	21.5	27.0	17.9	23.9	25.9	16.9	(1,010)	(900)	21.3	24.6	(330)

Source: Company, BOBCAPS Research

FIG 2 – SEP'19 QUARTER OPERATING METRICS

	Q2FY20	Growth (%)	
		QoQ	YoY
Revenue by Geography (%)			
North America	48.5	5.2	9.0
Europe	26.7	(0.2)	(4.7)
Rest of the World	24.9	3.6	12.4
Top client			
Top 5	21.6	4.2	(2.0)
Top 10	31.5	5.9	1.8
Top 20	43.6	3.2	1.0
Non Top 10 client revenues	68.5	2.0	7.5
Segment Wise revenue			
Telecom	41.1	1.0	4.6
Manufacturing	18.0	(4.2)	(5.4)
Technology, Media and Entertainment	8.1	10.0	17.2
BFSI	13.0	4.8	1.8
Retail, Transport and Logistics	7.0	16.5	13.8
Others	12.8	11.0	20.8
Revenue by delivery			
Onsite	65.4	3.4	7.1
Offshore	34.6	2.9	3.0
		(bps)	(bps)
Utilization (including trainees)	82	200	100
Attrition	21	-	100
Headcount	1,31,522	5,749	13,131
	Q2FY20	Q1FY20	Q2FY19
No. of Million \$ Clients			
≥ \$1mn clients	437	429	407
≥ \$5mn clients	155	160	157
≥ \$10mn clients	80	81	86
≥ \$20mn clients	49	49	45
≥ \$50mn clients	22	21	17
DSO	114	110	112

Source: Company, BOBCAPS Research

Valuation methodology

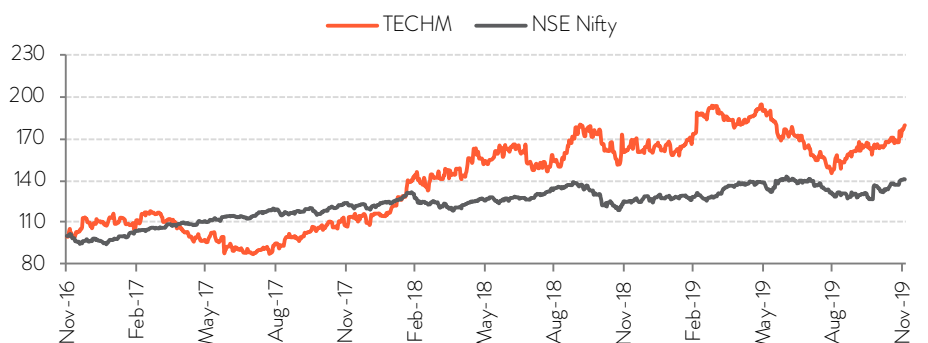
We revise up FY21/22 EPS by 4/1% respectively as we accommodate Q2FY20 operational beat. In our view, valuations at 14.1x/12.7x FY21/22 leaves limited upside considering TechM's communication skewed portfolio and operational volatility. Retain REDUCE with revised Sep20 TP of Rs 740 based on target P/E 12.5x.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
US\$ Revenues (US\$ mn)	5,190	5,210	0.4	5,659	5,701	0.8	6,201	6,247	0.7
YoY growth (%)	4.4	4.8	-	9.0	9.4	-	9.6	9.6	-
Revenues	3,58,619	3,64,534	1.6	3,96,126	3,99,099	0.8	4,34,069	4,37,307	0.7
EBITDA (Rs mn)	59,878	60,937	1.8	70,105	70,631	0.8	80,478	81,078	0.7
EBITDA margins (%)	16.7	16.7	-	17.7	17.7	-	18.5	18.5	-
EBIT margins (%)	13.0	13.0	-	14.0	14.0	-	14.8	14.8	-
Net Profits	40,951	43,015	5.0	46,568	48,285	3.7	53,199	53,659	0.9
EPS (Rs)	46.5	48.9	5.0	52.9	54.8	3.7	60.4	60.9	0.9

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Sharp favorable currency movements
- Disproportionately higher revenue uptick led by 5G deals
- More than expected margin expansion

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	3,07,729	3,47,421	3,64,153	3,97,481	4,35,530
EBITDA	47,169	63,368	60,868	70,345	80,749
Depreciation	10,849	11,292	13,544	14,707	16,115
EBIT	36,320	52,076	47,324	55,638	64,634
Net interest income/(expenses)	(1,624)	(1,332)	(1,462)	(1,250)	(1,550)
Other income/(expenses)	14,093	5,342	10,214	10,135	8,607
Exceptional items	0	0	0	0	0
EBT	48,789	55,431	55,841	64,422	71,591
Income taxes	10,925	12,544	13,145	16,428	18,256
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	137	(567)	44	20	20
Reported net profit	38,001	42,975	42,975	48,115	53,455
Adjustments	0	0	0	0	0
Adjusted net profit	38,001	42,975	42,975	48,115	53,455

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	71,708	90,744	94,779	1,03,454	1,13,357
Provisions	9,581	9,753	9,977	10,890	11,932
Debt funds	17,260	14,047	14,047	14,047	14,047
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,417	4,437	4,437	4,437	4,437
Reserves & surplus	1,89,102	2,03,184	2,27,872	2,55,591	2,86,401
Shareholders' fund	1,93,519	2,07,621	2,32,309	2,60,028	2,90,838
Total liabilities and equities	3,04,372	3,34,469	3,63,416	4,00,723	4,42,478
Cash and cash eq.	19,661	20,427	48,513	81,275	1,17,624
Accounts receivables	65,117	69,586	71,833	78,407	85,913
Inventories	659	752	752	752	752
Other current assets	76,857	88,020	90,973	93,713	96,840
Investments	59,595	77,926	77,926	77,926	77,926
Net fixed assets	76,717	71,667	67,227	62,457	57,230
CWIP	2,399	2,763	2,763	2,763	2,763
Intangible assets	27,727	28,163	28,163	28,163	28,163
Deferred tax assets, net	5,766	6,091	6,091	6,091	6,091
Other assets	0	0	0	0	0
Total assets	3,04,372	3,34,469	3,63,314	4,00,621	4,42,376

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	44,374	50,112	56,240	62,701	69,450
Interest expenses	169	(745)	(11,676)	(11,385)	(10,157)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(7,832)	(10,574)	(941)	274	313
Other operating cash flows	(1,176)	5,527	0	0	0
Cash flow from operations	35,535	44,320	43,623	51,591	59,606
Capital expenditures	(7,902)	(7,793)	(9,104)	(9,937)	(10,888)
Change in investments	(20,701)	(23,216)	0	0	0
Other investing cash flows	(4,590)	9,967	11,676	11,385	10,157
Cash flow from investing	(33,193)	(21,042)	2,572	1,448	(731)
Equities issued/Others	251	359	0	0	0
Debt raised/repaid	7,486	(4,504)	0	0	0
Interest expenses	(993)	(3,460)	0	0	0
Dividends paid	(9,438)	(14,907)	(18,110)	(20,276)	(22,526)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,694)	(22,512)	(18,110)	(20,276)	(22,526)
Changes in cash and cash eq.	(352)	766	28,086	32,763	36,348
Closing cash and cash eq.	19,661	20,427	48,513	81,275	1,17,624

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	42.7	47.7	48.8	54.6	60.7
Adjusted EPS	42.7	47.7	48.8	54.6	60.7
Dividend per share	14.0	14.0	17.1	19.1	21.2
Book value per share	217.3	230.6	263.8	295.3	330.3

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.2	1.9	1.8	1.6	1.4
EV/EBITDA	14.2	10.6	11.0	9.1	7.5
Adjusted P/E	18.1	16.2	15.8	14.2	12.7
P/BV	3.6	3.4	2.9	2.6	2.3

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	77.9	77.5	77.0	74.7	74.7
Interest burden (PBT/EBIT)	134.3	106.4	118.0	115.8	110.8
EBIT margin (EBIT/Revenue)	11.8	15.0	13.0	14.0	14.8
Asset turnover (Revenue/Avg TA)	108.9	108.8	104.4	104.1	103.3
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.5
Adjusted ROAE	21.0	21.4	19.5	19.5	19.4

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	5.6	12.9	4.8	9.2	9.6
EBITDA	12.7	34.3	(3.9)	15.6	14.8
Adjusted EPS	33.6	11.9	2.2	12.0	11.1
Profitability & Return ratios (%)					
EBITDA margin	15.3	18.2	16.7	17.7	18.5
EBIT margin	11.8	15.0	13.0	14.0	14.8
Adjusted profit margin	12.3	12.4	11.8	12.1	12.3
Adjusted ROAE	21.0	21.4	19.5	19.5	19.4
ROCE	15.0	19.3	17.1	20.0	23.8
Working capital days (days)					
Receivables	70	71	71	69	69
Inventory	1	1	1	1	1
Payables	90	104	112	111	112
Ratios (x)					
Gross asset turnover	4.3	4.7	5.2	6.1	7.3
Current ratio	2.0	1.8	2.0	2.2	2.4
Net interest coverage ratio	(22.4)	(39.1)	(32.4)	(44.5)	(41.7)
Adjusted debt/equity	0.0	0.0	(0.1)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

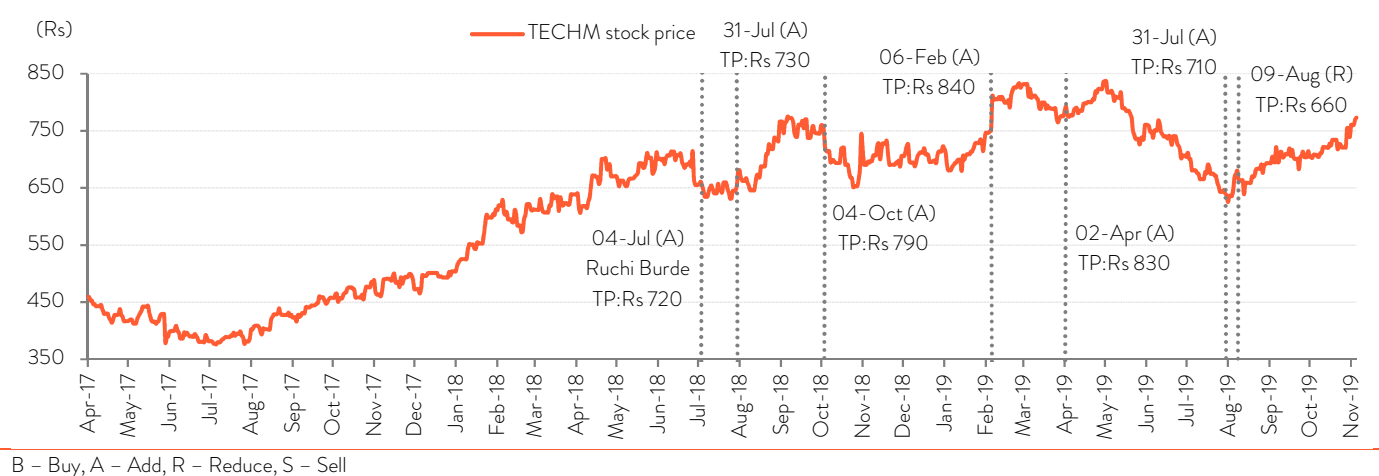
ADD – Expected return from >+5% to +15%

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)

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