

REDUCE

TP: Rs 840 | ▲ 5%

TECH MAHINDRA

| IT Services

| 31 January 2020

Good quarter buoyed by communications vertical

Tech Mahindra’s (TECHM) swift ramp-up of the AT&T deal aided a Q3 revenue beat (up 4.3% QoQ CC to US\$ 1.4bn vs. 3% estimated). EBITDA margins at 16.2% (-40bps QoQ) were weighed down by higher subcontracting expenses. A US\$ 900mn deal from Jackson Life Insurance lifted Q3 deal TCV to US\$ 1.2bn. Management is targeting above-industry growth in the enterprise business and steady growth in communications. We increase FY21/FY22 EPS by 7%/6% and roll to a Mar’21 TP of Rs 840 (from Rs 740).

Ruchi Burde
research@bobcaps.in

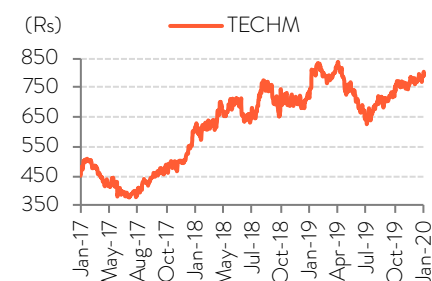
Upbeat revenue...: Revenue at US\$ 1.4bn increased 4.3% QoQ CC, ahead of our/street estimates of 3%/2.2% growth. However, EBITDA margins at 16.2% slipped 40bps QoQ, coming in below our estimate due to higher subcontracting expenses (at 16.3% of revenues vs. 15.1% in Q2) in an otherwise efficient quarter. Utilisation increased 200bps QoQ with a largely stable onsite/offshore revenue mix.

Ticker/Price	TECHM IN/Rs 797
Market cap	US\$ 9.7bn
Shares o/s	873mn
3M ADV	US\$ 23.8mn
52wk high/low	Rs 847/Rs 607
Promoter/FPI/DII	36%/39%/25%

Source: NSE

...led by faster-than-expected AT&T deal transition: The communications vertical led revenue growth at 8.9% QoQ in dollar terms, followed by retail, transport and logistics (+8.1% QoQ) and BFSI (+6.7%QoQ). Enterprise business grew 2.4% QoQ in dollar terms.

STOCK PERFORMANCE



Source: NSE

Skewed performance at top clients: Top 5 client revenue increased 8.5% QoQ in dollar terms, likely aided by ramp-up of the AT&T deal. On the other hand, top 6 to 20 client revenue declined by 5.4% QoQ.

Healthy deal wins: New contract signings worth US\$ 1.2bn marked the second consecutive quarter of US\$ 1bn+ deal TCV. A US\$ 900mn TCV award from Jackson Life Insurance supported healthy deal wins in Q3.

KEY FINANCIALS

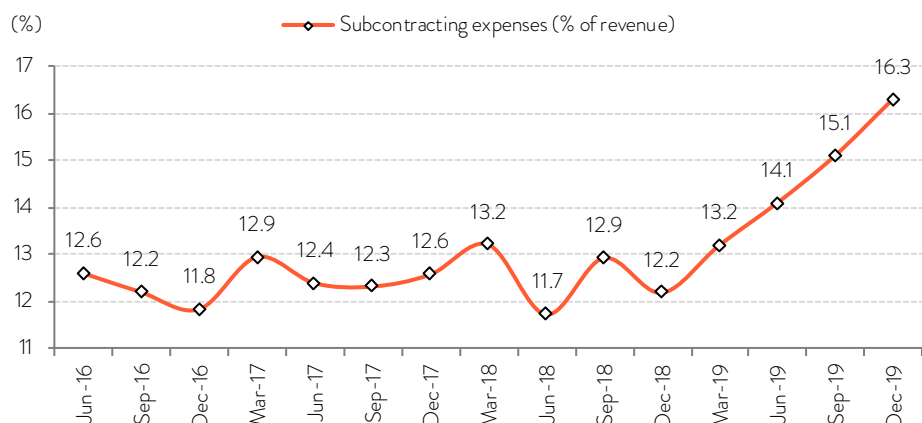
Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	3,07,729	3,47,421	3,70,511	4,10,889	4,54,685
EBITDA (Rs mn)	47,169	63,368	61,195	72,717	84,300
Adj. net profit (Rs mn)	38,001	42,975	44,071	49,601	56,318
Adj. EPS (Rs)	42.7	47.7	50.1	56.4	64.0
Adj. EPS growth (%)	33.6	11.9	5.0	12.5	13.5
Adj. ROAE (%)	21.0	21.4	20.0	20.1	20.3
Adj. P/E (x)	18.7	16.7	15.9	14.1	12.4
EV/EBITDA (x)	14.3	10.9	11.3	9.3	7.6

Source: Company, BOBCAPS Research

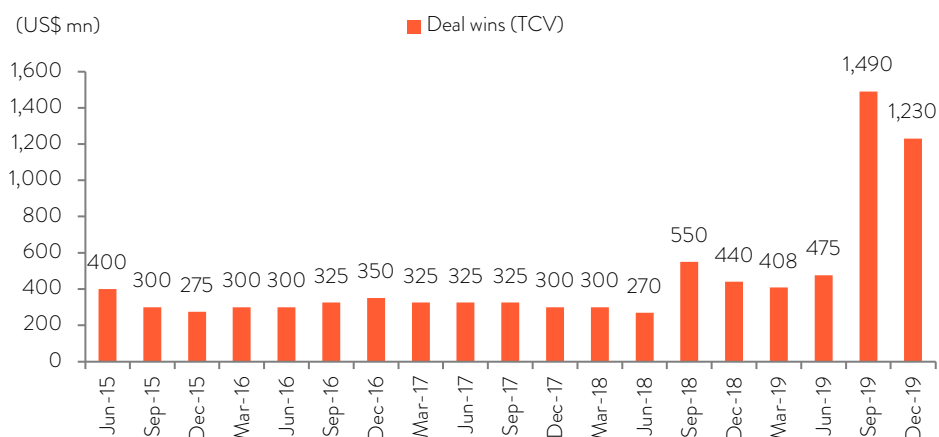
BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – SUBCONTRACTING EXPENSES AT ALL-TIME HIGH

Source: Company, BOBCAPS Research

FIG 2 – US\$ 900MN JACKSON LIFE CONTRACT AIDED Q3 DEAL WINS

Source: Company, BOBCAPS Research

FIG 3 – DEC'19 QUARTER PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Revenues (US\$ mn)	1,353	1,261	7.3	1,287	5.1	3,703	3,887	5.0
Revenue	96,546	89,437	7.9	90,699	6.4	2,58,498	2,73,775	5.9
Operating Expenditure	80,913	72,211	12.1	75,690	6.9	2,11,517	2,29,992	8.7
Cost of revenues	67,312	59,845	12.5	63,893	5.4	1,74,108	1,92,847	10.8
as % of sales	69.7	66.9	-	70.4	-	67.4	70.4	-
SG&A expenses	13,601	12,366	10.0	11,797	15.3	37,409	37,145	(0.7)
as % of sales	14.1	13.8	-	13.0	-	14.5	13.6	-
EBITDA	15,633	17,226	(9.2)	15,009	4.2	46,981	43,783	(6.8)
Depreciation	3,848	2,836	-	3,415	-	8,588	10,476	22.0
EBIT	11,785	14,390	(18.1)	11,594	1.6	38,393	33,307	(13.2)
Other Income	2,951	317	-	1,783	-	2,239	7,611	239.9
PBT	14,736	14,707	0.2	13,377	10.2	40,632	40,918	0.7
Total Tax	3,629	2,638	-	2,265	-	9,009	9,212	-
Adjusted PAT	11,107	12,069	(8.0)	11,112	0.0	31,623	31,706	0.3
(Profit)/loss from JV's/Ass/MI	352	(39)	-	127	-	29	581	-
APAT after MI	11,459	12,030	(4.7)	11,239	2.0	31,652	32,287	2.0
Extraordinary items	0	0	-	0	-	0	0	-

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Reported PAT	11,459	12,030	(4.7)	11,239	2.0	31,652	32,287	2.0
Reported EPS	13.0	13.5	(3.1)	12.8	2.1	35	37	3.5
Margins (%)			(bps)		(bps)			(bps)
EBITDA	16.2	19.3	(310)	16.5	(40)	18.2	16.0	(220)
EBIT	12.2	16.1	(390)	12.8	(60)	14.9	12.2	(270)
EBT	15.3	16.4	(120)	14.7	50	15.7	14.9	(80)
PAT	11.9	13.5	(160)	12.4	(50)	12.2	11.8	(50)
Effective Tax rate	24.6	17.9	670	16.9	770	22.2	22.5	30

Source: Company, BOBCAPS Research

FIG 4 – DEC'19 QUARTER OPERATING METRICS

Particulars	Q3FY20 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Revenue by Geography			
North America	48.4	4.9	9.6
Europe	27.0	6.3	0.3
Rest of the World	24.6	3.8	11.4
Revenue by Client Bracket			
Top 5	22.3	8.5	5.9
Top 10	31.0	3.4	5.3
Top 20	42.1	1.5	2.7
Non-Top 10 client revenues	69.0	5.9	8.3
Revenue by Vertical			
Telecom	42.6	8.9	11.2
Manufacturing	17.3	1.0	(9.4)
Technology, Media and Entertainment	7.6	(1.4)	16.5
BFSI	13.2	6.7	5.7
Retail, Transport and Logistics	7.2	8.1	15.3
Others	12.2	0.2	15.9
Revenue by Delivery			
Onsite	65.3	5.0	7.0
Offshore	34.7	5.4	7.9
		(bps)	(bps)
Utilisation (including trainees)	84%	200	200
Attrition	20%	(100)	(100)
Headcount	1,30,839	(683)	8,997
		Q3FY20	Q2FY20
No. of Million Dollar Clients		Q3FY19	
≥ \$1mn clients	446	437	416
≥ \$5mn clients	164	155	157
≥ \$10mn clients	83	80	88
≥ \$20mn clients	50	49	46
≥ \$50mn clients	22	22	18
DSO	112	114	107

Source: Company, BOBCAPS Research

Valuation methodology

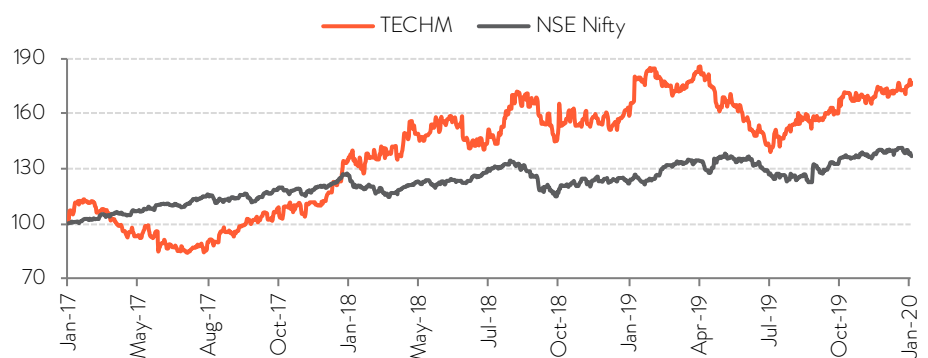
We raise FY21/FY22 EPS estimates by 7%/6% largely factoring in the upbeat Q3 revenue performance. However, we believe valuations at 14.1x/12.4x FY21E/ FY22E P/E leave limited upside considering TECHM's communications-heavy portfolio and operational volatility. Retain REDUCE as we roll forward to a revised Mar'21 target price of Rs 840 (from Rs 740) based on a target one-year forward P/E of 13x.

FIG 5 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
US\$ Revenues (US\$ mn)	5,190	5,269	1.5	5,659	5,870	3.7	6,201	6,496	4.7
YoY growth (%)	4.4	6.0	-	9.0	11.4	-	9.6	10.7	-
Revenues	3,58,619	3,70,511	3.3	3,96,126	4,10,889	3.7	4,34,069	4,54,685	4.7
EBITDA (Rs mn)	59,878	61,195	2.2	70,105	72,717	3.7	80,478	84,300	4.7
EBITDA margins (%)	16.7	16.5	-	17.7	17.7	-	18.5	18.5	-
EBIT margins (%)	13.0	12.7	-	14.0	14.0	-	14.8	14.8	-
Net Profits	40,951	44,071	7.6	46,568	49,601	6.5	53,199	56,318	5.9
EPS (Rs)	46.5	50.1	7.8	52.9	56.4	6.6	60.4	64.0	6.0

Source: BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates are:

- sharp favourable currency movements,
- a disproportionately higher revenue uptick led by 5G deals, and
- above-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	3,70,511	4,10,889	4,54,685
EBITDA	47,169	63,368	61,195	72,717	84,300
Depreciation	10,849	11,292	14,055	15,203	16,823
EBIT	36,320	52,076	47,140	57,514	67,477
Net interest income/(expenses)	(1,624)	(1,332)	(1,700)	(1,250)	(1,550)
Other income/(expenses)	14,093	5,342	11,410	10,254	9,607
Exceptional items	0	0	0	0	0
EBT	48,789	55,431	56,701	66,418	75,434
Income taxes	10,925	12,544	13,236	16,937	19,236
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	137	(567)	456	20	20
Reported net profit	38,001	42,975	44,071	49,601	56,318
Adjustments	0	0	0	0	0
Adjusted net profit	38,001	42,975	44,071	49,601	56,318

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	96,434	1,06,944	1,18,343
Provisions	9,581	9,753	10,151	11,257	12,457
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	2,28,507	2,57,086	2,89,552
Shareholders' fund	1,93,519	2,07,621	2,32,944	2,61,523	2,93,989
Total liabilities and equities	3,04,372	3,34,469	3,65,880	4,06,075	4,51,139
Cash and cash eq.	19,661	20,427	49,224	83,066	1,21,348
Accounts receivables	65,117	69,586	73,087	81,052	89,691
Inventories	659	752	752	752	752
Other current assets	76,857	88,020	91,496	94,815	98,414
Investments	59,595	77,926	77,926	77,926	77,926
Net fixed assets	76,717	71,667	66,875	61,944	56,488
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	3,65,451	4,05,646	4,50,710

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	44,374	50,112	57,520	64,684	73,021
Interest expenses	169	(745)	(13,109)	(11,504)	(11,157)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(7,832)	(10,574)	(889)	332	360
Other operating cash flows	(1,176)	5,527	0	0	0
Cash flow from operations	35,535	44,320	43,522	53,513	62,225
Capital expenditures	(7,902)	(7,793)	(9,263)	(10,272)	(11,367)
Change in investments	(20,701)	(23,216)	0	0	0
Other investing cash flows	(4,590)	9,967	13,109	11,504	11,157
Cash flow from investing	(33,193)	(21,042)	3,847	1,231	(210)
Equities issued/Others	251	(1,747)	0	0	0
Debt raised/repaid	7,486	(4,504)	0	0	0
Interest expenses	(993)	(1,354)	0	0	0
Dividends paid	(9,438)	(14,907)	(18,572)	(20,902)	(23,732)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,694)	(22,512)	(18,572)	(20,902)	(23,732)
Changes in cash and cash eq.	(352)	766	28,797	33,842	38,282
Closing cash and cash eq.	19,661	20,427	49,224	83,066	1,21,348

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	42.7	47.7	50.1	56.4	64.0
Adjusted EPS	42.7	47.7	50.1	56.4	64.0
Dividend per share	14.0	14.0	17.5	19.7	22.4
Book value per share	217.3	230.6	264.9	297.4	334.3

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.2	2.0	1.9	1.6	1.4
EV/EBITDA	14.3	10.9	11.3	9.3	7.6
Adjusted P/E	18.7	16.7	15.9	14.1	12.4
P/BV	3.7	3.5	3.0	2.7	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	77.9	77.5	77.7	74.7	74.7
Interest burden (PBT/EBIT)	134.3	106.4	120.3	115.5	111.8
EBIT margin (EBIT/Revenue)	11.8	15.0	12.7	14.0	14.8
Asset turnover (Revenue/Avg TA)	108.9	108.8	105.9	106.6	106.2
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.5
Adjusted ROAE	21.0	21.4	20.0	20.1	20.3

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	6.6	10.9	10.7
EBITDA	12.7	34.3	(3.4)	18.8	15.9
Adjusted EPS	33.6	11.9	5.0	12.5	13.5
Profitability & Return ratios (%)					
EBITDA margin	15.3	18.2	16.5	17.7	18.5
EBIT margin	11.8	15.0	12.7	14.0	14.8
Adjusted profit margin	12.3	12.4	11.9	12.1	12.4
Adjusted ROAE	21.0	21.4	20.0	20.1	20.3
ROCE	15.0	19.3	17.1	20.7	24.9
Working capital days (days)					
Receivables	70	71	70	68	69
Inventory	1	1	1	1	1
Payables	90	104	110	110	111
Ratios (x)					
Gross asset turnover	4.3	4.7	5.3	6.4	7.7
Current ratio	2.0	1.8	2.0	2.2	2.4
Net interest coverage ratio	(22.4)	(39.1)	(27.7)	(46.0)	(43.5)
Adjusted debt/equity	0.0	0.0	(0.2)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

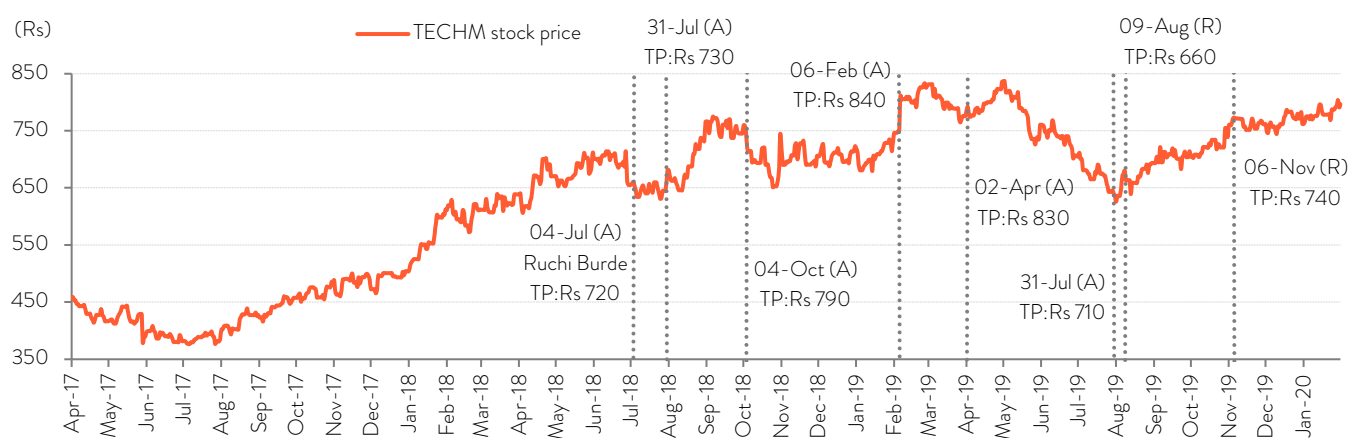
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: TECH MAHINDRA (TECHM IN)



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

Rating distribution

As of 31 December 2019, out of 83 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 50 have BUY ratings, 18 are rated ADD, 9 are rated REDUCE and 6 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.