

BUY

TP: Rs 1,130 | ▲ 18%

TECH MAHINDRA

| IT Services

| 30 January 2021

Communication leads growth driven by large 5G deal win

Tech Mahindra (TECHM) posted 2.8% QoQ CC revenue growth and 150bps EBITDA margin expansion, bettering our estimates for Q3FY21. The telecom vertical has continued to recover (+4.5% QoQ USD). Traction in the retail and manufacturing segments aided 2.3% QoQ CC growth in the enterprise business. TCV was strong at US\$ 455mn. We raise FY21-FY23 EPS by 3-4% to bake in the Q3 performance and roll over to a revised Dec'21 TP of Rs 1,130 (vs. Rs 1,040), based on an unchanged target P/E of 15.7x. Reiterate BUY.

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Strong growth momentum: Revenue growth of 3.4% USD/2.8% CC QoQ exceeded our estimate of 2% USD/1.7% CC. Communication growth was upbeat at 3.6% QoQ CC, followed by the enterprise segment at 2.3%. Within enterprise, manufacturing and retail transport and logistics revived the most. Europe grew 8.4% USD on account of 5G rollout deals. EBIT margin at 15.9% was up 170bps QoQ on lower employee cost. Margin tailwinds arose from offshoring and better utilisation (+80bps), with the balance coming from automation and delivery optimisation.

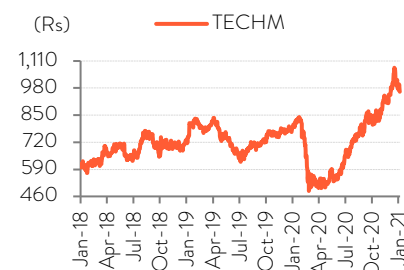
Large 5G deal win: Net new TCV stood at US\$ 455mn (+8% QoQ), nearly back to pre-Covid levels. Q3 TCV included a large 5G network rollout deal from a UK-based service provider, signaling that demand in the 5G ecosystem is finally panning out. Numerous smaller deals have also come through in the communication vertical with an increasing 5G and network services component. Per TECHM, the deal funnel is currently at an all-time high.

Upbeat management outlook: Management expects the large-deal pipeline to accelerate, especially in AI, cloud, 5G ecosystems and cost optimisation. The pipeline remains strong around 5G network services. We are confident of TECHM achieving the higher end of its guided EBIT margin range of 14-15% in FY22.

Ticker/Price	TECHM IN/Rs 961
Market cap	US\$ 11.5bn
Shares o/s	873mn
3M ADV	US\$ 58.7mn
52wk high/low	Rs 1,082/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	383,744	455,172	528,885
EBITDA (Rs mn)	63,368	57,261	68,156	86,904	102,092
Adj. net profit (Rs mn)	42,975	42,505	46,694	56,251	66,692
Adj. EPS (Rs)	47.7	48.3	53.1	64.0	75.8
Adj. EPS growth (%)	11.9	1.2	9.9	20.5	18.6
Adj. ROAE (%)	21.4	19.8	19.9	21.3	22.4
Adj. P/E (x)	20.1	19.9	18.1	15.0	12.7
EV/EBITDA (x)	13.2	14.6	12.2	9.4	7.6

Source: Company, BOBCAPS Research

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Other highlights

- BPS business grew at a strong 11% QoQ (INR terms) in Q3, bolstered by a spike from the retail vertical, with an all-time high EBITDA margin of 24%.
- Utilisation stood at an industry-high of 87%, up 200bps QoQ. Management expects this to normalise to pre-Covid levels as ~5,000 freshers will be hired over the next two quarters.
- DSO decreased to 95 days, down 2 days QoQ. Post pandemic breakout, TECHM has worked consistently towards reducing its DSO, which has dropped by 17 days from 112 in Q3FY20.
- The company is investing heavily in building capabilities in cloud, analytics, data and AI to capture the accelerated digitisation.
- TECHM has won a deal with a major Netherlands-based telecom player to implement and integrate its cloud ERP for multiple modules in order to simplify the client's overall process lifecycle.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Revenues (US\$ mn)	1,309	1,353	(3.3)	1,265	3.4	3,781	3,887	(2.7)
Revenue	96,471	96,546	(0.1)	93,718	2.9	281,252	273,775	2.7
Operating Expenditure	77,516	80,913	(4.2)	76,688	1.1	232,262	229,992	1.0
Cost of revenues	64,708	67,312	(3.9)	64,245	0.7	194,058	192,847	0.6
as % of sales	67.1	69.7	-	68.6	-	69.0	70.4	-
SG&A expenses	12,808	13,601	(5.8)	12,443	2.9	38,204	37,145	2.9
as % of sales	13.3	14.1	-	13.3	-	13.6	13.6	-
EBITDA	18,955	15,633	21.2	17,030	11.3	48,990	43,783	11.9
Depreciation	3,584	3,848	-	3,717	-	11,133	10,476	6.3
EBIT	15,371	11,785	30.4	13,313	15.5	37,857	33,307	13.7
Other Income	1,793	2,951	-	780	-	6,232	7,611	(18.1)
PBT	17,164	14,736	16.5	14,093	21.8	44,089	40,918	7.7
Total Tax	4,263	3,629	-	3,462	-	11,001	9,212	-
Adjusted PAT	12,901	11,107	16.2	10,631	21.4	33,088	31,706	4.4
(Profit)/loss from JV's/Ass/MI	197	352	-	15	-	379	581	-
APAT after MI	13,098	11,459	14.3	10,646	23.0	33,467	32,287	3.7
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	13,098	11,459	14.3	10,646	23.0	33,467	32,287	3.7
Reported EPS	14.9	13.0	14.3	12.1	23.0	38	37	3.7
Margins (%)			(bps)		(bps)			(bps)
EBITDA	19.6	16.2	350	18.2	150	17.4	16.0	140
EBIT	15.9	12.2	370	14.2	170	13.5	12.2	130
EBT	17.8	15.3	250	15.0	280	15.7	14.9	70
PAT	13.6	11.9	170	11.4	220	11.9	11.8	10
Effective Tax rate	24.8	24.6	20	24.6	30	25.0	22.5	240

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

(in US\$ terms)	Q3FY21 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Revenue by Geography			
North America	46.8	0.0	(6.5)
Europe	26.4	8.4	(5.4)
Rest of the World	26.8	5.0	5.4
Top clients			
Top 5	22.0	3.4	(4.6)
Top 10	31.0	6.9	(3.3)
Top 20	42.0	1.0	(3.5)
Non-Top 10 client revenues	69.0	2.0	(3.3)
Revenue by Vertical			
Telecom	39.7	4.5	(9.8)
Manufacturing	16.3	4.7	(8.8)
Technology, Media and Entertainment	9.4	(0.8)	19.7
BFSI	16.0	0.9	17.3
Retail, Transport and Logistics	7.9	9.0	6.2
Others	10.8	2.5	(14.4)
Revenue by Delivery			
Onsite	63.0	3.4	(6.7)
Offshore	37.0	3.4	3.2
		(bps)	(bps)
Utilisation (including trainees)	87	200	300
Attrition	12	(200)	(800)
Headcount	121,901	(2,357)	(8,938)
	Q3FY21	Q2FY21	Q3FY20
No. of Million \$ Clients			
≥ US\$ 1mn clients	454	460	446
≥ US\$ 5mn clients	162	165	164
≥ US\$ 10mn clients	83	82	83
≥ US\$ 20mn clients	50	50	50
≥ US\$ 50mn clients	21	21	22
DSO	95	97	112

Source: BOBCAPS Research

Valuation methodology

We believe that telecom is a relatively resilient industry in the current environment (see our report [Deep Dive 2: Telecom tech spends resilient – upgrade TECHM](#)). 5G-driven traction and digitisation of telcos will boost the communications vertical, which forms nearly 40% of TECHM’s revenues. With the onset of Covid-19, 5G adoption timelines have shifted to FY22 onwards but demand is coming from adjacent areas such as supply chain transformation, open network on cloud, intelligent and cognitive managed operations, digital OSS, and enterprise network modernisation.

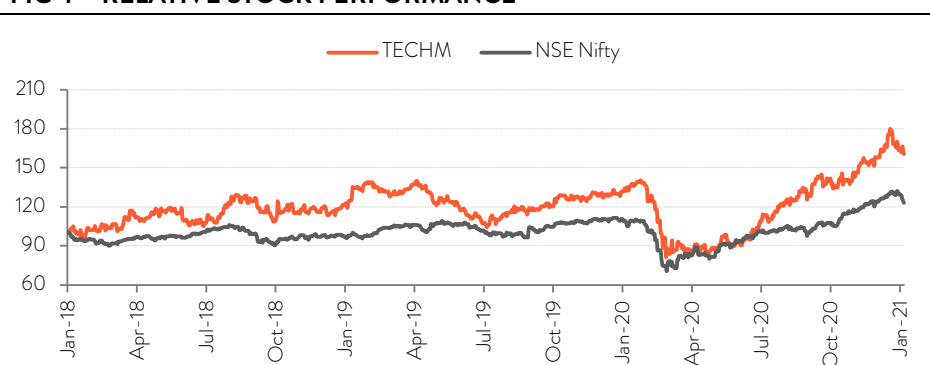
Incorporating management’s guidance of accelerated deal wins and the robust Q3 performance, we marginally raise FY21/FY22/FY23 EPS estimates by 3%/2%/4%. On rollover, our Dec’21 target price changes to Rs 1,130 (Rs 1,040 earlier), set at an unchanged target P/E of 15.7x. Reiterate BUY.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
US\$ Revenue (US\$ mn)	5,126	5,148	0.4	5,749	5,949	3.5	6,495	6,781	4.4
YoY growth (%)	(1)	(1)	-	12.1	15.6	-	13.0	14.0	-
Revenues	385,822	383,744	(0.5)	448,388	455,172	1.5	506,640	528,885	4.4
EBITDA (Rs mn)	66,649	68,156	2.3	85,553	86,904	1.6	97,783	102,092	4.4
EBITDA margins (%)	17.3	17.8	-	19.1	19.1	-	19.3	19.3	-
EBIT margins (%)	13.2	13.8	-	15.0	15.0	-	15.1	15.1	-
Net Profits	45,483	46,694	2.7	55,259	56,251	1.8	63,907	66,692	4.4
EPS (Rs)	51.7	53.1	2.7	62.8	64.0	1.8	72.7	75.8	4.4

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Slow growth in communication business
- Lack of synergy among portfolio companies
- Prolonged delay in 5G timeline

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	347,421	368,677	383,744	455,172	528,885
EBITDA	63,368	57,261	68,156	86,904	102,092
Depreciation	11,292	14,458	15,233	18,678	22,213
EBIT	52,076	42,803	52,923	68,226	79,879
Net interest income/(expenses)	(1,332)	(1,919)	(1,636)	(1,550)	(1,650)
Other income/(expenses)	5,342	11,924	9,770	5,933	8,263
Exceptional items	0	0	0	0	0
EBT	55,431	52,753	61,078	72,648	86,532
Income taxes	12,544	11,604	15,163	17,997	21,440
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(567)	1,301	799	1,640	1,640
Reported net profit	42,975	42,505	46,694	56,251	66,692
Adjustments	0	0	0	0	0
Adjusted net profit	42,975	42,505	46,694	56,251	66,692

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	99,879	118,469	137,655
Provisions	9,753	11,055	10,514	12,470	14,490
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	243,943	274,890	311,878
Shareholders' fund	207,621	222,064	248,302	279,249	316,237
Total liabilities and equities	334,469	373,535	395,280	446,775	504,968
Cash and cash eq.	20,427	30,167	63,556	102,389	148,973
Accounts receivables	69,586	75,772	75,697	89,787	104,328
Inventories	752	358	358	358	358
Other current assets	88,020	121,702	115,773	121,643	127,702
Investments	77,926	61,046	61,046	61,046	61,046
Net fixed assets	71,667	76,047	70,408	63,109	54,118
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	395,280	446,775	504,968

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	50,112	55,607	61,148	73,329	87,305
Interest expenses	(745)	(13,843)	(11,406)	(7,483)	(9,913)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(10,574)	(13,356)	1,511	587	606
Other operating cash flows	5,527	17,667	0	0	0
Cash flow from operations	44,320	46,075	51,253	66,434	77,998
Capital expenditures	(7,793)	(15,386)	(9,594)	(11,379)	(13,222)
Change in investments	(23,216)	(16,880)	0	0	0
Other investing cash flows	9,967	13,843	11,406	7,483	9,913
Cash flow from investing	(21,042)	(18,423)	1,812	(3,897)	(3,310)
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)	(19,677)	(23,704)	(28,104)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(22,512)	(17,912)	(19,677)	(23,704)	(28,104)
Changes in cash and cash eq.	766	9,740	33,388	38,833	46,585
Closing cash and cash eq.	20,427	30,167	63,556	102,389	148,973

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	47.7	48.3	53.1	64.0	75.8
Adjusted EPS	47.7	48.3	53.1	64.0	75.8
Dividend per share	14.0	16.9	18.6	22.4	26.5
Book value per share	230.6	252.5	282.3	317.5	359.6

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.4	2.3	2.2	1.8	1.5
EV/EBITDA	13.2	14.6	12.2	9.4	7.6
Adjusted P/E	20.1	19.9	18.1	15.0	12.7
P/BV	4.2	3.8	3.4	3.0	2.7

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	77.5	80.6	76.4	77.4	77.1
Interest burden (PBT/EBIT)	106.4	123.2	115.4	106.5	108.3
EBIT margin (EBIT/Revenue)	15.0	11.6	13.8	15.0	15.1
Asset turnover (Revenue/Avg TA)	108.8	104.1	99.8	108.1	111.1
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
Adjusted ROAE	21.4	19.8	19.9	21.3	22.4

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	4.1	18.6	16.2
EBITDA	34.3	(9.6)	19.0	27.5	17.5
Adjusted EPS	11.9	1.2	9.9	20.5	18.6
Profitability & Return ratios (%)					
EBITDA margin	18.2	15.5	17.8	19.1	19.3
EBIT margin	15.0	11.6	13.8	15.0	15.1
Adjusted profit margin	12.4	11.5	12.2	12.4	12.6
Adjusted ROAE	21.4	19.8	19.9	21.3	22.4
ROCE	19.3	15.1	17.7	23.6	28.8
Working capital days (days)					
Receivables	71	72	72	66	67
Inventory	1	1	0	0	0
Payables	104	114	118	108	110
Ratios (x)					
Gross asset turnover	4.7	5.0	5.2	6.8	9.0
Current ratio	1.8	2.0	2.3	2.4	2.5
Net interest coverage ratio	(39.1)	(22.3)	(32.4)	(44.0)	(48.4)
Adjusted debt/equity	0.0	0.0	(0.2)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

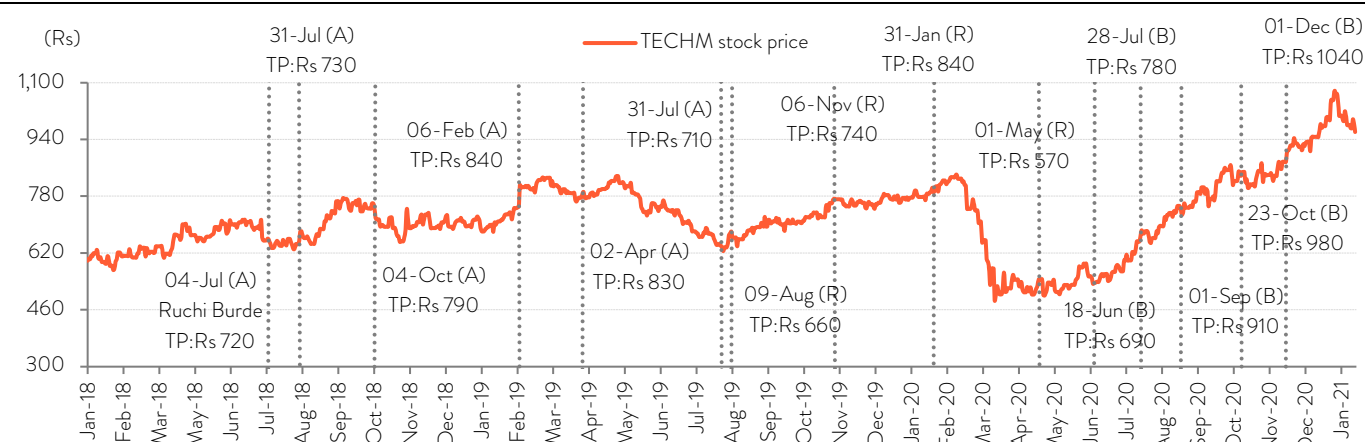
ADD – Expected return from >+5% to +15%

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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