

BUY

TP: Rs 1,190 | ▲ 24%

TECH MAHINDRA

| IT Services

| 26 April 2021

Subdued Q4; deal win acceleration lends visibility

Tech Mahindra (TECHM) posted below-estimated Q4FY21 dollar revenue growth of 1.6% QoQ. EBIT margin expanded 60bps QoQ, bettering our estimate. The telecom vertical has continued to recover (+1.4% QoQ USD), and traction in the manufacturing and BFSI segments aided 1.8% QoQ USD growth in the enterprise business. TCV was strong at US\$ 1.04bn. We keep EPS estimates broadly intact and roll forward to a new Mar'22 TP of Rs 1,190 (vs. Rs 1,130), based on an unchanged target P/E of 15.7x. Maintain BUY.

Ruchi Burde

research@bobcaps.in

Q4 underperformance: TECHM posted 1.6% QoQ dollar revenue growth, underperforming our estimate of 3.3%. However, the telecom vertical continued to recover (+1.4% QoQ USD). Traction in the BFSI, technology and manufacturing segments aided 1.8% QoQ USD growth in the enterprise business. EBIT margin at 16.5% was the highest in six years and beat our forecast of 15.8%, expanding 60bps QoQ led by automation, offshoring and lower depreciation. Management has guided for a >15% EBIT margin in FY22.

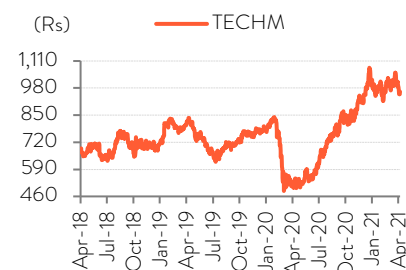
Strong TCV momentum: TCV rebounded to pre-Covid levels after three quarters of recovery, breaching the billion-dollar mark with a print of US\$ 1.04bn (+106% YoY), divided equally between enterprise (US\$ 525mn) and communications (US\$ 518mn). The Telefonica Germany deal win contributed significantly. Q1FY22 deal wins are expected to be on similar lines.

Acquisition in BPS space: TECHM has acquired a 100% stake in US-based business process services company Eventus Solutions for a cash consideration of US\$ 44mn. The transaction is expected to close by 15 June this year. The company has more than 100 employees and posted revenue of US\$ 33.2mn (+38% YoY) in CY20. The acquisition will enable TECHM to move up the value chain in the BPS business.

Ticker/Price	TECHM IN/Rs 962
Market cap	US\$ 11.2bn
Shares o/s	873mn
3M ADV	US\$ 55.8mn
52wk high/low	Rs 1,082/Rs 490
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	347,421	368,677	378,551	448,118	528,753
EBITDA (Rs mn)	63,368	57,261	68,471	85,580	102,096
Adj. net profit (Rs mn)	42,975	42,505	44,281	56,345	66,900
Adj. EPS (Rs)	47.7	48.3	50.4	64.1	76.1
Adj. EPS growth (%)	11.9	1.2	4.2	27.2	18.7
Adj. ROAE (%)	21.4	19.8	18.7	21.1	22.3
Adj. P/E (x)	20.2	19.9	19.1	15.0	12.6
EV/EBITDA (x)	13.2	14.6	12.2	9.7	8.0

Source: Company, BOBCAPS Research | P – Provisional

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Other highlights

- TECHM's effective tax rate has shot up to 32% in Q4FY21 due to a one-off tax increase for one of its subsidiaries.
- DSO stood at 92 days in Q4, down 20 days YoY and 3 days QoQ.
- Salary hikes will be carried out in Q1FY22.
- The board has recommended a high dividend of Rs 45/sh for FY21, which includes a special dividend of Rs15/sh.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenues (in US\$ mn)	1,330	1,295	2.7	1,309	1.6	5,111	5,182	(1.4)
Revenue	97,299	94,902	2.5	96,471	0.9	378,551	368,677	2.7
Operating Expenditure	77,818	81,424	(4.4)	77,516	0.4	310,080	311,416	(0.4)
Cost of revenues	64,497	66,896	(3.6)	64,708	(0.3)	258,555	259,743	(0.5)
as % of sales	66.3	70.5	-	67.1	-	68.3	70.5	-
SG&A expenses	13,321	14,528	(8.3)	12,808	4.0	51,525	51,673	(0.3)
as % of sales	13.7	15.3	-	13.3	-	13.6	14.0	-
EBITDA	19,481	13,478	44.5	18,955	2.8	68,471	57,261	19.6
Depreciation	3,444	3,982	-	3,584	-	14,577	14,458	0.8
EBIT	16,037	9,496	68.9	15,371	4.3	53,894	42,803	25.9
Other Income	(89)	2,335	-	1,793	-	5,636	9,946	(43.3)
Impairment of goodwill and non-current assets	507	-	-	-	-	-	-	-
PBT	15,441	9,656	59.9	17,164	(10.0)	59,530	50,574	17.7
Total Tax	4,998	2,392	-	4,263	-	15,999	11,604	-
Adjusted PAT	10,443	7,264	43.8	12,901	(19.1)	43,531	38,970	11.7
(Profit)/loss from JV's/Ass/MI	371	775	-	197	-	750	1,356	-
APAT after MI	10,814	8,039	34.5	13,098	(17.4)	44,281	40,326	9.8
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	10,814	8,039	34.5	13,098	(17.4)	44,281	40,326	9.8
Reported EPS	12.3	9.1	34.5	14.9	(17.4)	50	46	9.9
Margins (%)			(bps)		(bps)			(bps)
EBITDA	20.0	14.2	580	19.6	40	18.1	15.5	260
EBIT	16.5	10.0	650	15.9	60	14.2	11.6	260
EBT	15.9	10.2	570	17.8	(190)	15.7	13.7	200
PAT	11.1	8.5	260	13.6	(250)	11.7	10.9	80
Effective Tax rate	32.4	24.8	760	24.8	750	26.9	22.9	390

Source: BOBCAPS Research, Company

FIG 2 – OPERATING METRICS

(in US\$ terms)	Q4FY21 (% Contr. to revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Geography			
North America	45.5	(1.2)	(2.0)
Europe	26.5	2.0	2.7
Rest of the World	28.0	6.2	11.5
Top Clients			
Top 5	22.0	1.6	5.6
Top 10	31.0	1.6	2.7
Top 20	43.0	4.0	1.3
Non-Top 10 client revenues	69.0	1.6	2.7
Revenue by Vertical			
Telecom	39.6	1.4	(0.3)
Manufacturing	16.3	1.6	(5.4)
Technology, Media and Entertainment	9.3	0.5	29.1
BFSI	16.5	4.8	10.8
Retail, Transport and Logistics	7.5	(3.5)	5.5
Others	10.8	1.6	(3.5)
Revenue by Delivery			
Onsite	63.0	1.6	(0.7)
Offshore	37.0	1.6	9.2
		(bps)	(bps)
Utilisation (including trainees)	87	-	400
Attrition	13	100	(600)
Headcount (nos.)	121,054	(847)	(4,182)
		Q4FY21	Q3FY21
No. of Million Dollar Clients			
≥ US\$ 1mn clients	451	454	446
≥ US\$ 5mn clients	169	162	160
≥ US\$ 10mn clients	85	83	85
≥ US\$ 20mn clients	50	50	49
≥ US\$ 50mn clients	21	21	22
DSO	92	95	112

Source: BOBCAPS Research, Company

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, app modernisation, open network on cloud, intelligent and cognitive managed operations, digital OSS, and enterprise network modernisation.

Incorporating management’s guidance of accelerated deal wins, Eventus acquisition and factoring in the Q4 performance, we keep earnings estimates for TECHM broadly intact and roll forward to a new Mar’22 target price of Rs 1,190 (vs. Rs 1,130), based on an unchanged target P/E of 15.7x. Reiterate BUY.

FIG 3 – REVISED ESTIMATES

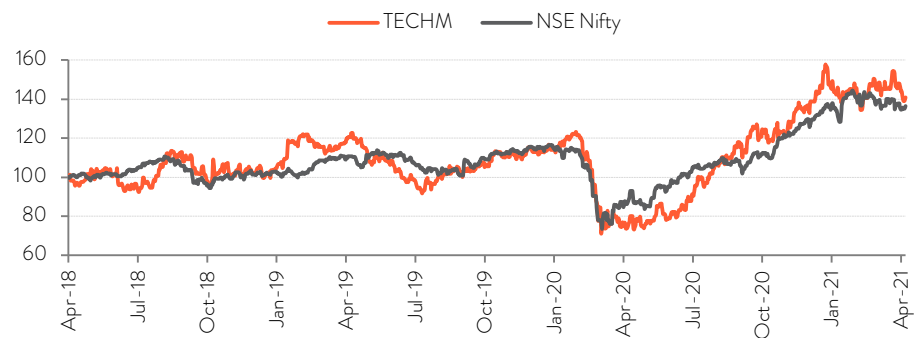
(Rs mn)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
US\$ Revenues (US\$ mn)	5,892	5,856	(0.6)	6,802	6,756	(0.7)
YoY growth (%)	14.8	14.6	-	15.5	15.4	-
Revenues	450,816	448,118	(0.6)	530,591	528,753	(0.3)
EBITDA (Rs mn)	86,075	85,580	(0.6)	102,443	102,096	(0.3)
EBITDA margins (%)	19.1	19.1	-	19.3	19.3	-
EBIT margins (%)	15.0	15.0	-	15.1	15.1	-
Net Profits	55,957	56,345	0.7	67,129	66,900	(0.3)
EPS (Rs)	63.6	64.1	0.7	76.3	76.1	(0.3)

Source: BOBCAPS Research

FIG 4 – PEER COMPARISON

Company	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS	BUY	3,780	17.2	118	135	44	41	28.0
INFO	ADD	1,540	13.1	56	59	30	30	26.0
HCLT	BUY	1,190	11.9	55	63	23	23	18.8
TECHM	BUY	1,190	15.0	64	76	21	22	15.7
LTI	BUY	4,740	20.1	136	161	33	33	30.4
MPHL	REDUCE	1,550	14.4	81	96	22	24	16.9
MTCL	ADD	2,180	14.4	89	93	31	28	23.4
PSYS	SELL	1,260	12.8	57	68	16	17	19.2
COFORGE	BUY	3,350	24.2	121	154	24	25	22.0

Source: BOBCAPS Research

FIG 5 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

Key downside risks to our estimates are:

- low growth in the communication business,
- lack of synergy among portfolio companies, and
- prolonged delay in 5G timelines.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue	347,421	368,677	378,551	448,118	528,753
EBITDA	63,368	57,261	68,471	85,580	102,096
Depreciation	11,292	14,458	14,577	18,390	22,208
EBIT	52,076	42,803	53,894	67,190	79,889
Net interest income/(expenses)	(1,332)	(1,919)	(1,740)	(1,550)	(1,650)
Other income/(expenses)	5,342	11,924	7,871	6,830	8,212
Exceptional items	0	0	0	0	0
EBT	55,431	52,753	59,530	72,509	86,490
Income taxes	12,544	11,604	15,999	17,765	21,190
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(567)	1,301	762	1,640	1,640
Reported net profit	42,975	42,505	44,281	56,345	66,900
Adjustments	0	0	0	0	0
Adjusted net profit	42,975	42,505	44,281	56,345	66,900

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	90,744	103,830	102,292	116,633	137,621
Provisions	9,753	11,055	13,121	12,277	14,486
Debt funds	14,047	24,282	16,618	16,618	16,618
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,437	4,359	4,370	4,370	4,370
Reserves & surplus	203,184	217,705	248,075	277,719	313,217
Shareholders' fund	207,621	222,064	252,445	282,089	317,587
Total liabilities and equities	334,469	373,535	396,780	439,922	498,616
Cash and cash eq.	20,427	30,167	26,904	49,934	95,083
Accounts receivables	69,586	75,772	64,728	88,396	104,302
Inventories	752	358	242	242	242
Other current assets	88,020	121,702	110,932	114,564	121,191
Investments	77,926	61,046	104,436	104,436	104,436
Net fixed assets	71,667	76,047	80,405	73,218	64,229
CWIP	2,763	501	1,183	1,183	1,183
Intangible assets	28,163	33,877	40,082	40,082	40,082
Deferred tax assets, net	6,091	8,443	9,133	9,133	9,133
Other assets	0	0	0	0	0
Total assets	334,469	373,535	396,780	439,922	498,616

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	50,112	55,607	58,108	73,135	87,508
Interest expenses	(745)	(13,843)	(9,104)	(8,380)	(9,862)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(10,574)	(13,356)	20,800	(13,802)	663
Other operating cash flows	5,527	17,667	(4,980)	0	0
Cash flow from operations	44,320	46,075	64,824	50,953	78,309
Capital expenditures	(7,793)	(15,386)	(12,048)	(11,203)	(13,219)
Change in investments	(23,216)	(16,880)	43,390	0	0
Other investing cash flows	9,967	13,843	(64,787)	8,380	9,862
Cash flow from investing	(21,042)	(18,423)	(33,445)	(2,823)	(3,357)
Equities issued/Others	(1,747)	0	(569)	0	0
Debt raised/repaid	(4,504)	0	(13,624)	0	0
Interest expenses	(1,354)	0	(1,789)	0	0
Dividends paid	(14,907)	(17,912)	(18,660)	(25,100)	(29,803)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(22,512)	(17,912)	(34,642)	(25,100)	(29,803)
Changes in cash and cash eq.	766	9,740	(3,263)	23,030	45,149
Closing cash and cash eq.	20,427	30,167	26,904	49,934	95,083

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	47.7	48.3	50.4	64.1	76.1
Adjusted EPS	47.7	48.3	50.4	64.1	76.1
Dividend per share	14.0	16.9	17.6	23.7	28.1
Book value per share	230.6	252.5	287.1	320.8	361.1

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	2.4	2.3	2.2	1.9	1.5
EV/EBITDA	13.2	14.6	12.2	9.7	8.0
Adjusted P/E	20.2	19.9	19.1	15.0	12.6
P/BV	4.2	3.8	3.4	3.0	2.7

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	77.5	80.6	74.4	77.7	77.3
Interest burden (PBT/EBIT)	106.4	123.2	110.5	107.9	108.3
EBIT margin (EBIT/Revenue)	15.0	11.6	14.2	15.0	15.1
Asset turnover (Revenue/Avg TA)	108.8	104.1	98.3	107.1	112.7
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
Adjusted ROAE	21.4	19.8	18.7	21.1	22.3

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
YoY growth (%)					
Revenue	12.9	6.1	2.7	18.4	18.0
EBITDA	34.3	(9.6)	19.6	25.0	19.3
Adjusted EPS	11.9	1.2	4.2	27.2	18.7
Profitability & Return ratios (%)					
EBITDA margin	18.2	15.5	18.1	19.1	19.3
EBIT margin	15.0	11.6	14.2	15.0	15.1
Adjusted profit margin	12.4	11.5	11.7	12.6	12.7
Adjusted ROAE	21.4	19.8	18.7	21.1	22.3
ROCE	19.3	15.1	16.3	19.7	23.5
Working capital days (days)					
Receivables	71	72	68	62	67
Inventory	1	1	0	0	0
Payables	104	114	121	110	109
Ratios (x)					
Gross asset turnover	4.7	5.0	4.8	5.8	7.7
Current ratio	1.8	2.0	1.8	2.0	2.1
Net interest coverage ratio	(39.1)	(22.3)	(31.0)	(43.3)	(48.4)
Adjusted debt/equity	0.0	0.0	0.0	(0.1)	(0.2)

Source: Company, BOBCAPS Research

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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

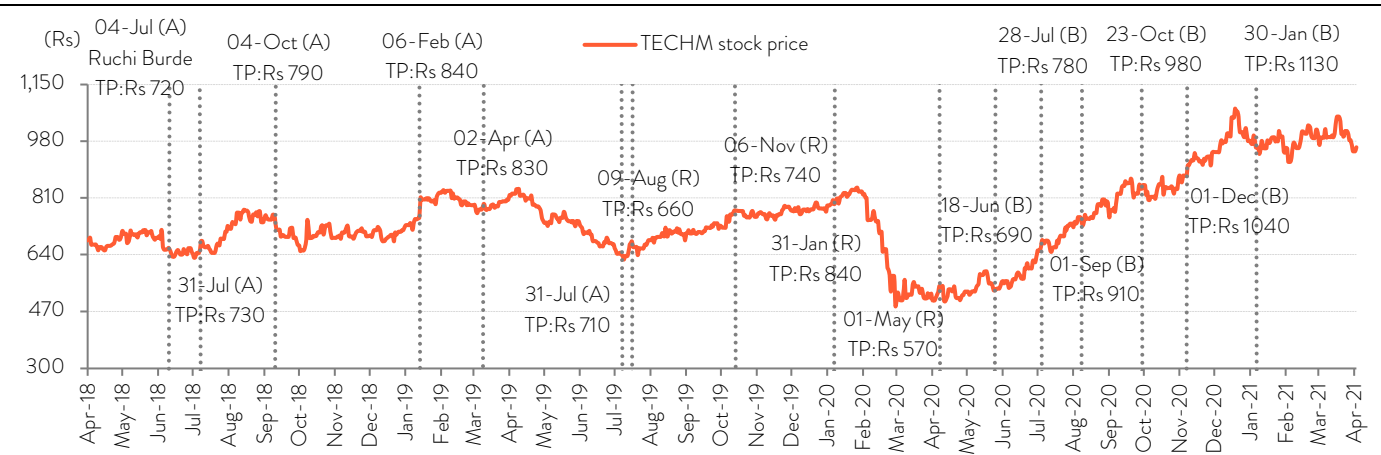
REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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



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

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