

Improved margin trajectory drives performance

- USD rev. grew 2.5% QoQ to USD 1,209mn above our estimates helped by better performance of Manufacturing and Technology vertical. INR revenue improved 2.2% QoQ to ₹ 77.8bn (DCMe: ₹ 77.1 bn).
- EBIT margin improved 169bps QoQ to 12.7% (DCMe: 11.8%) led by improved utilization, better business mix and improved performance of its subsidiaries. PAT improved 12.8% QoQ to ₹ 9.4bn (DCMe: ₹ 8.7bn) helped by better margins and lower tax rate (22%) despite lower forex gain.
- Revenue from US/Europe improved 6.2%/1.9% QoQ, whereas, ROW underperformed with a decline of 3.3% QoQ in USD terms. Manufacturing/Tech/Retail grew 3.1%/13%/1.1% QoQ, respectively while Communication witness muted growth of 0.4% QoQ due to lower growth in VAS business. BFSI vertical declined 3.3% QoQ in USD terms.
- TechM sold Pakistan operation of LCC business for USD 1.4mn; which was included in miscellaneous income. LLC business has turned from loss making to single digit margin and company expects low single digit margin in LCC to be sustainable.
- Utilisation (83%) is almost at lifetime high levels, however mgmt. believes that this will sustain between 80-85%.
- TechM is estimated to report revenue USD revenue CAGR of 9% (FY18-20E) higher than most other large cap IT peers; this will primarily be driven by growth in key verticals (manufacturing, retail and BFSI) as telecom remains muted; however, within telecom, VAS is expected to report strong growth in Q4FY18 led by seasonality
- TechM has reported healthy EBIT margin improvement over the last two quarters (330 bps improvement); we expect margin to sustain in a narrow band of 11.5%-12.5% over the next two years, however, headwinds persist in the form of salary hike in H1FY19, investment in high skill hiring and limited levers for an improved utilization. Further, margin in the LCC segment, which have been a major driver for overall EBIT margin does not offer any scope of improvement from here on.
- TechM has moved up by 25% over the last three months and is now trading at fair valuations of 14.7x/13.2x FY19E/FY20E. We believe healthy revenue growth coupled with minor improvement in margin on a YoY basis for FY19/FY20 may drive share price performance in the near term. We upgrade our estimates factoring better EBIT margin and upgrade TechM to an ACCUMULATE rating; rollover to a Mar'19 TP of ₹ 670 based on 14.5x one-year fwd. PER.

Q3FY18 Result (₹ Mn)

Particulars	Q3FY18	Q2FY18	Q3FY17	QoQ(%)	YoY(%)
USD revenue	1,209	1,179	1,116	2.5	8.3
Revenue	77,760	76,064	75,575	2.2	2.9
EBIT	9,905	8,404	9,385	17.9	5.5
Pre-Tax Profit	11,814	11,240	10,588	5.1	11.6
Net Profit	9,431	8,363	8,550	12.8	10.3
Adj. EPS (₹)	11.2	10.0	10.2	12.8	10.3
Margins (%)					
EBIT Margin	12.7	11.0	12.4	169	32
PBT Margin	15.2	14.8	14.0	42	118
Net Margin	12.1	11.0	11.3	113	82

CMP	₹ 605
Target / Upside	₹ 670/11%
BSE Sensex	36,025
NSE Nifty	11,044

Script Details

Equity / FV	₹ 4,400mn/₹ 5/-
Market Cap	₹ 534bn
	USD 8,347mn
52-week High/Low	₹ 613/357
Avg. Volume (no)	31,20,316
NSE Symbol	TECHM
Bloomberg Code	TECHM IN

Shareholding Pattern Dec'17 (%)

Promoters	36.0
MF/Banks/FIs	13.2
FIIIs	36.5
Public / Others	14.3

Valuation (x)

	FY18E	FY19E	FY20E
P/E	14.6	14.7	13.2
EV/EBITDA	11.1	9.8	8.3
ROE (%)	20.9	19.9	20.3
ROCE (%)	13.2	14.2	14.2

Estimates (₹ Mn)

	FY18E	FY19E	FY20E
Net Sales	306,428	334,409	363,509
EBIT	35,091	40,069	45,223
PAT	34,548	34,498	38,665
EPS (₹)	41.4	41.1	45.9

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Exhibit 1:Q3FY18 performance

₹ mn	Q3FY18	DCMe	Diff. (%)	Q2FY18	QoQ (%)	Q3FY17	YoY (%)
USD revenue	1,209	1,191	1.5	1,179	2.5	1,116	8.3
Revenue	77,760	77,080	0.9	76,064	2.2	75,575	2.9
EBIT	9,905	9,095	8.9	8,404	17.9	9,385	5.5
EBITDA	12,647	11,895	6.3	11,057	14.4	11,865	6.6
Pre-Tax Profit	11,814	11,595	1.9	11,240	5.1	10,588	11.6
Net Profit	9,431	8,697	8.4	8,363	12.8	8,550	10.3
Adj. EPS (₹)	11.2	10.4	8.5	10.0	12.8	10.2	10.3
Margins (%)							
Operating Margin	12.7	11.8		11.0		12.4	
EBITDA Margin	16.3	15.4		14.5		15.7	
Net Margin	12.1	11.3		11.0		11.3	

Source: Company, DART

Exhibit 2:Geographic split

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
Revenues (USD mn)					
America	521	534	567	6.2	9
Europe	328	354	360	1.9	10
ROW	267	291	282	(3.3)	6
(%) of Total Revenue					
America	46.7	45.3	46.9	160	20
Europe	29.4	30.0	29.8	(20)	40
ROW	23.9	24.7	23.3	(140)	(60)

Source: Company, DART

Exhibit 3:Split by Industry

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
Revenues (USD mn)					
Communication	528	515	517	0.4	(2.0)
Manufacturing	205	224	231	3.1	12.5
Technology, Media & Entertainment	71	70	79	13.0	10.0
Banking, Fin.Services & Insurance	146	166	161	(3.3)	10.0
Retail, Transport & Logistics	85	85	86	1.1	1.2
Others	79	117	137	17.0	72.4
(%) of Total Revenue					
Communication	47.3	43.7	42.8	(90)	(450)
Manufacturing	18.4	19.0	19.1	10	70
Technology, Media & Entertainment	6.4	5.9	6.5	60	10
Banking, Fin.Services & Insurance	13.1	14.1	13.3	(80)	20
Retail, Transport & Logistics	7.6	7.2	7.1	(10)	(50)
Others	7.1	9.9	11.3	140	420

Source: Company, DART

Exhibit 4: Delivery split

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
Revenues (USD mn)					
Onsite	713	756	796	5.3	11.6
Offshore	403	423	414	(2.3)	2.6
(%) of Total Revenue					
Onsite	63.9	64.1	65.8	170	190
Offshore	36.1	35.9	34.2	(170)	(190)

Source: Company, DART

Exhibit 5: Client Details

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
Top 5	310	292	281	(4)	(10)
Top 10	429	414	401	(3)	(6)
Top 20	564	545	544	0	(3)
(%) of Total Revenue					
Top 5	27.8	24.8	23.2	(160)	(460)
Top 10	38.4	35.1	33.2	(190)	(520)
Top 20	50.5	46.2	45.0	(120)	(550)

Source: Company, DART

Exhibit 6: Client Mix

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
No. of Active Clients	837	885	903	2	8
% of Repeat Business	93	95	93	(210)	(50)

Source: Company, DART

Exhibit 7: Headcount metrics

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
Software Professionals	80,858	75,587	73,460	(3)	(9)
BPO Professionals	29,372	35,287	35,496	1	21
Sales & Support	6,865	6,351	6,285	(1)	(8)
Total Employees	117,095	117,225	115,241	(2)	(2)
				bps	bps
IT Attrition % (LTM)	18.0	16.0	17.0	100	(100)
IT Utilization %	77.0	81.0	83.0	200	600
IT Utilization % (Excl. Trainees)	83.0	81.0	83.0	200	0

Source: Company, DART

Exhibit 8: Number of \$ Mn Clients

	Q3FY17	Q2FY18	Q3FY18	QoQ (%)	YoY (%)
≥ \$1 million clients	356	390	389	0	9
≥ \$5 million clients	128	147	154	5	20
≥ \$10 million clients	65	81	83	2	28
≥ \$20 million clients	38	40	40	0	5
≥ \$50 million clients	14	14	16	14	14

Source: Company, DART

Exhibit 9: Estimate Revision

(₹ mn)	New			Old			Change (%)		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Revenue	306,428	334,409	363,509	308,247	338,812	362,952	(0.6)	(1.3)	0.2
EBIT	35091	40069	45223	31321	35603	38514	12.0	12.5	17.4
Pre-Tax Profit	45,504	45,393	50,874	39,240	40,850	43927	16.0	11.1	15.8
Net Profit	34,548	34,498	38,665	29,262	30,433	32725	18.1	13.4	18.1
Adj EPS	41.4	41.1	45.9	34.9	36.2	38.8	18.7	13.4	18.1
Reported EPS	36.0	35.9	40.3	30.5	31.7	34.1	18.1	13.4	18.1
Margins (%)									
EBIT Margin	11.5	12.0	12.4	10.2	10.5	10.6			
Net margin	11.3	10.3	10.6	9.5	9.0	9.0			

Source: Company, DART

Income Statement (₹ Mn)

Particulars	Mar17	Mar18E	Mar19E	Mar20E
Net Sales	291,408	306,428	334,409	363,509
Total Income	291,408	306,428	334,409	363,509
Total Expenditure	249,565	260,680	282,014	303,298
Cost of Goods Sold	205,661	214,836	236,869	256,042
Other Expenses	43,904	45,844	45,145	47,256
Gross Profit	85,747	91,593	97,540	107,467
EBIDTA	41,843	45,748	52,395	60,211
Depreciation	9,781	10,657	12,326	14,988
EBIT	32,062	35,091	40,069	45,223
Interest	(6,489)	(10,412)	(5,324)	(5,652)
Profit Before Tax	38,551	45,504	45,393	50,874
Tax	9,785	10,955	10,894	12,210
Net Profit	28,766	34,548	34,498	38,665
Minority Interest	23	0	0	0
Net Profit (After MI)	28,743	34,548	34,498	38,665

Balance Sheet (₹ Mn)

Particulars	Mar17	Mar18E	Mar19E	Mar20E
Equity Capital	4,383	4,415	4,415	4,415
Other Reserves	159,984	161,611	176,352	195,166
Net Worth	164,367	166,026	180,767	199,581
Secured Loans	17,160	22,565	22,565	22,565
Loan Funds	17,160	22,565	22,565	22,565
Total Capital Employed	181,527	188,591	203,332	222,146

Applications of Funds

Gross Block	72,958	81,550	99,550	117,550
Less: Accumulated Dep.	39,042	49,699	62,025	77,013
Net Block	33,916	31,851	37,525	40,537
Capital Work in Progress	1,541	1,541	1,541	1,541
Investments	2,308	7,096	7,096	7,096
Current Assets, Loans & Advances				
Sundry Debtors	53,377	65,674	71,307	76,726
Cash and Bank Balance	53,833	50,013	43,792	55,458
Other Current Assets	115,685	122,206	131,972	136,306
<i>sub total</i>	222,895	237,893	247,070	268,490

Less: Current Liabilities & Provisions

Current Liabilities	69,062	78,664	77,719	82,411
Provisions	10,071	11,126	12,181	13,107
<i>sub total</i>	79,133	89,791	89,900	95,518
Net Current Assets	143,762	148,103	157,170	172,972
Total Assets	181,527	188,591	203,332	222,146

E – Estimates

Cash Flow (₹ Mn)

Particulars	Mar17	Mar18E	Mar19E	Mar20E
Reported Net Profit	28,743	34,548	34,498	38,665
Depreciation & w.o.	9,781	10,657	12,326	14,988
(Inc.) / Dec. in WC Req. (-/+)	510	6,870	(15,289)	(4,135)
(A) CF from Opt. Activities	39,034	52,076	31,536	49,518
Capex	(31,775)	(23,623)	(18,000)	(18,000)
Free Cash Flow to Firm	7,259	28,453	13,536	31,518
Inc. / (Dec.) in Investments	(1,130)	(4,788)	0	0
(B) CF from Invst. Activities	(32,905)	(28,411)	(18,000)	(18,000)
Issue of Equity / Preference	(1,430)	(13,133)	0	0
Inc. / (Dec.) in Debt	6,597	5,405	0	0
Dividend Paid (Incl. Tax)	(8,891)	(19,757)	(19,757)	(19,851)
(C) CF from Financing	(3,724)	(27,485)	(19,757)	(19,851)
Net Change in Cash	2,405	(3,820)	(6,221)	11,667
Opening Cash balances	51,428	53,833	50,013	43,792
Closing Cash balances	53,833	50,013	43,792	55,458

Important Ratios

Particulars	Mar17	Mar18E	Mar19E	Mar20E
(A) Measures of Performance (%)				
EBIDTA Margin	14.4	14.9	15.7	16.6
EBIT Margin	11.0	11.5	12.0	12.4
Gross Profit Margin	29.4	29.9	29.2	29.6
Tax/PBT	25.4	24.1	24.0	24.0
Net Profit Margin	9.9	11.3	10.3	10.6

(B) As Percentage of Net Sales

COGS	70.6	70.1	70.8	70.4
Other Expenses	15.1	15.0	13.5	13.0

(C) Measures of Financial Status

Debt / Equity (x)	0.1	0.1	0.1	0.1
Interest Coverage (x)	32.5	31.8	38.4	44.1
Debtors Period (days)	66.9	78.2	77.8	77.0
Fixed Assets Turnover (x)	4.0	3.8	3.4	3.1
Working Cap. Turnover (x)	2.0	2.1	2.1	2.1
Non-Cash WC (₹ Mn)	89,929	98,090	113,379	117,514

(D) Measures of Investment

Adj EPS (₹)	33.8	41.4	41.1	45.9
DPS (₹)	9.0	20.0	20.0	20.1
Dividend Payout (%)	26.6	48.3	48.7	43.7
Profit Ploughback (%)	73.4	51.7	51.3	56.3
Book Value (₹)	195.7	197.6	215.2	237.3
RoANW (%)	18.5	20.9	19.9	20.3
RoACE (%)	13.2	13.2	14.2	14.2
RoAIC (%)	19.1	18.4	18.6	18.5

(E) Valuation Ratios

CMP (₹)	605	605	605	605
P/E (x)	17.9	14.6	14.7	13.2
Market Cap. (₹ Mn.)	530,343	534,215	534,215	534,215
MCap / Sales (x)	1.8	1.7	1.6	1.5
EV (₹ Mn)	493,670	506,767	512,988	501,322
EV/Sales (x)	1.7	1.7	1.5	1.4
EV/EBDITA (x)	11.8	11.1	9.8	8.3
P/BV (x)	3.1	3.1	2.8	2.5
Dividend Yield (%)	1.5	3.3	3.3	3.3
FCFE Yield (%)	2.6	6.4	2.6	6.0

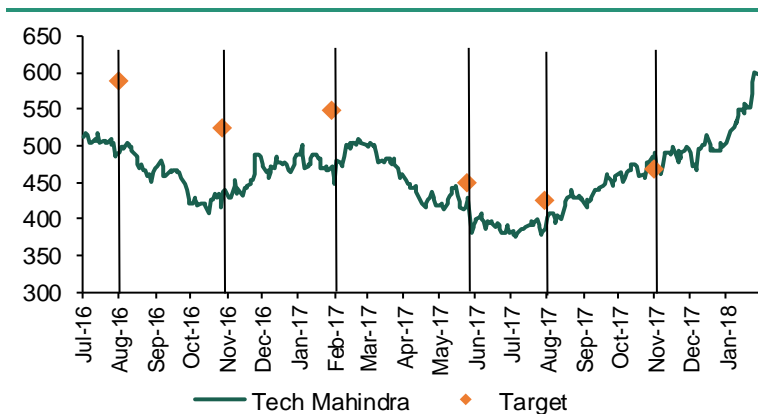
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)*
Aug-16	Buy	590	490
Oct-16	Buy	525	415
Jan-17	Buy	550	472
May-17	Reduce	450	429
Jul-17	Accumulate	425	386
Nov-17	Reduce	470	489

* As on Recommended Dated

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