Tech Mahindra

Margin upgrade drives earnings trajectory

Q4FY18 Result Update

May 26, 2018

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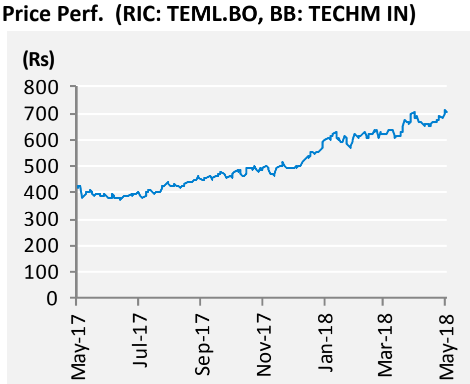
Rating	**BUY**
Price	Rs702
Target Price	Rs760
Implied Upside	8.3%
Sensex	34,925
Nifty	10,605

(Prices as on May 25, 2018)

Trading data			
Market Cap. (Rs bn)			676.5
Shares o/s (m)			963.0
3M Avg. Daily value (Rs m)			1988.5
Major shareholders			
Promoters			36.26%
Foreign			37.93%
Domestic Inst.			13.51%
Public & Other			12.30%
Stock Performance			
(%)	**1M**	**6M**	**12M**
Absolute	2.4	42.3	64.6
Relative	1.1	38.6	51.0
How we differ from Consensus			
EPS (Rs)	**PL**	**Cons.**	***% Diff.***
2019	47.0	41.5	*13.4*
2020	51.4	46.2	*11.2*

Price Perf. (RIC: TEML.BO, BB: TECHM IN)



Source: Bloomberg

Tech Mahindra delivered a strong set of results for 4QFY18 with revenue, EBIDTA margin and PAT above our estimates. Revenues at USD1244 mn were up 2.9% QoQ and above our ests (PLe: USD1240mn). Constant currency growth for the quarter stood at 1.7% QoQ. Telecom vertical (41.6% of total revenues) remained flat QoQ while Enterprise vertical (58.4% of total revenues) grew by 4.9% QoQ. EBIDTA margin at 17.5% was up 128bps QoQ and 550bps YoY and above our ests (PLe: 16.7%). PAT at Rs 12,220mn was 25% above our estimates. Strong PAT beat was also led by higher other income (led by one-off exceptional income from sale of land and higher forex gains) as well as lower tax rate for the quarter. Company continues to trim Employee count. Total Headcount came at 112,807 employees which is net reduction of 2,434 employees QoQ. IT service headcount came at 72,437 employees for 4QFY18 which is down 12% YoY. We believe that Headcount reduction and improvement in margins of subsidiaries (LCC and Comviva) have aided turnaround in margin trajectory in FY18.

Tech M delivered 9.6% USD revenue growth in FY18 (5.7% organic growth and rest owing to acquisitions). Organic constant currency growth for FY18 would be 3.9% YoY owing to softness in telecom vertical led by pruning LCC business. We expect Tech M to deliver 9.5/9.7% USD revenue growth for FY19/FY20E (vs 9.7/9.9% modeled earlier). Led by 4Q margin beat and currency reset (USD vs INR) to lower levels, we upgrade EBIDTA margin assumptions to 16.9/17.3% for FY19E/FY20E (vs 15.5/16% modeled earlier). Our EPS estimates are upped by 11.6/8% for FY19/FY20E to Rs 46.5/51/sh predominately led by margin upgrade. Stock trades at 13.8x FY20E EPS. TP raised by 12% to Rs760/sh (15x FY20E EPS vs 14.5x FY20E EPS earlier). Tech M stock has delivered strong return of 63% over the past one year predominantly led by margin recovery which drove earnings upgrade. With 4QFY18 EBIDTA margin at 17.5%, we believe margin expansion has reached fag end. Recovery in growth in Telecom vertical is key from hereon. Retain BUY.

Key financials (Y/e March)	**2017**	**2018**	**2019E**	**2020E**
Revenues (Rs m)	291,408	307,730	343,260	372,255
Growth (%)	*10.0*	*5.6*	*11.5*	*8.4*
EBITDA (Rs m)	41,844	47,161	57,937	64,245
PAT (Rs m)	28,152	38,001	41,270	45,116
EPS (Rs)	32.1	42.7	46.5	50.7
Growth (%)	*(8.5)*	*35.0*	*8.6*	*9.3*
Net DPS (Rs)	9.0	13.0	14.1	15.4

Profitability & Valuation	**2017**	**2018**	**2019E**	**2020E**
EBITDA margin (%)	*14.4*	*15.3*	*16.9*	*17.3*
RoE (%)	*18.2*	*21.5*	*20.4*	*19.6*
RoCE (%)	*17.2*	*20.3*	*19.3*	*18.7*
EV / sales (x)	1.9	1.8	1.5	1.3
EV / EBITDA (x)	13.5	11.7	9.1	7.8
PE (x)	21.9	16.2	14.9	13.7
P / BV (x)	3.5	3.1	2.7	2.4
Net dividend yield (%)	*1.3*	*1.8*	*2.0*	*2.2*

Source: Company Data; PL Research

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Exhibit 1: Q4FY18 Result Table

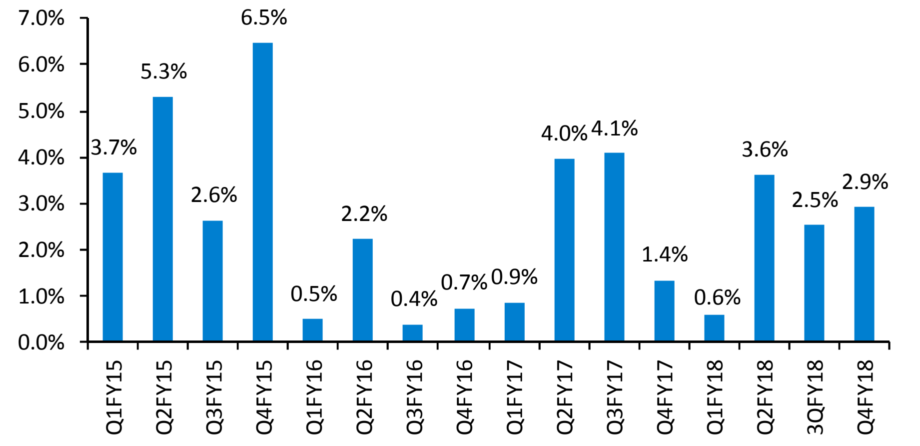
(Rs mn)	Q4FY18	Q3FY18	QoQ gr.	Q4FY17	YoY gr.	Ple	Variance (Actual vs PLe)
Sales (US $ mn)	1,244	1,209	*2.9%*	1,131	*10.0%*	1,240	*0.3%*
Sales	80,545	77,760	*3.6%*	74,950	*7.5%*	80,119	*0.5%*
EBITDA	14,119	12,638	*11.7%*	8,987	*57.1%*	13,380	*5.5%*
EBITDA Margins	*17.5%*	*16.3%*	*128 bps*	*12.0%*	*554 bps*	*16.7%*	*83 bps*
Net Income	12,220	9,432	*29.6%*	5,879	*107.9%*	9,710	*25.8%*
EPS (Rs)	13.7	10.6	*29.3%*	6.6	*107.6%*	10.9	*25.6%*

Source: Company Data, PL Research

- **Revenues beat estimates:** Revenues came at USD1244mn, up 2.9% QoQ and slightly above our ests (PLe: USD1240mn). Onsite revenues accounted for 67% of total revenues in 4QFY18 (vs. 65.8% in 3QFY18). Revenues from Top 10 clients grew by 1.4% QoQ but were down 4.3% YoY.

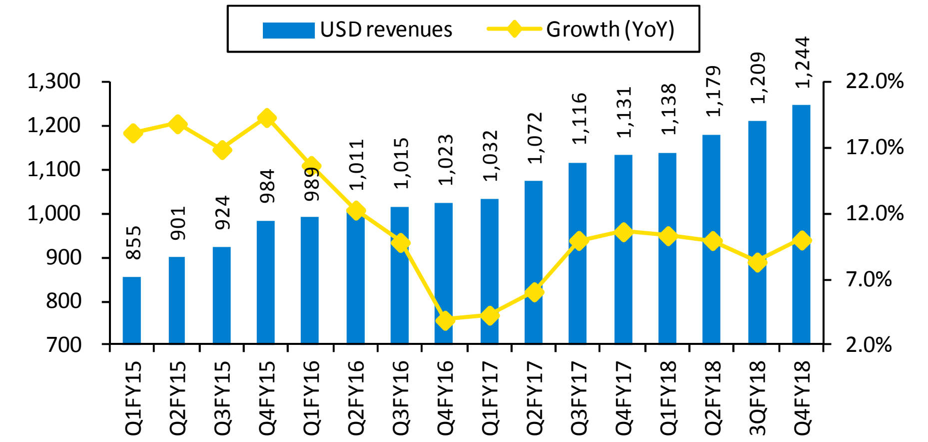
- For FY18, USD revenues came at USD4771mn up 9.6% YoY. Constant currency revenues grew by 7.8% YoY in FY18. Telecom vertical revenues were down 0.6% YoY in FY18 owing to pruning of LCC business. Enterprise vertical revenues grew by 19.1% YoY led by organic growth as well acquisitions. Enterprise vertical revenues have grown 11.5% YoY organically in our view.

Exhibit 2: USD Revenue growth (QoQ)



Source: Company Data, PL Research Growth includes acquisitions*

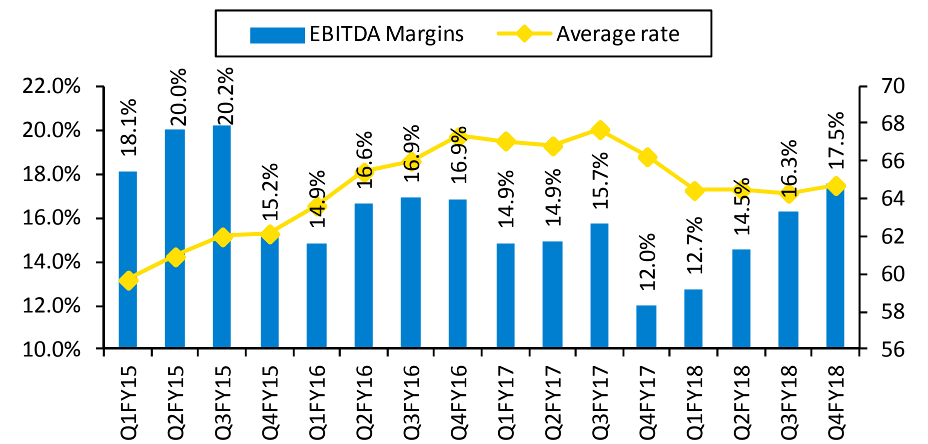
Exhibit 3: US$ Revenues (USD mn) and growth YoY in (%)



Source: Company Data, PL Research, acquisition have also aided in higher YoY USD revenue growth over FY15/FY16.

Steady margin improvement: EBITDA margin at 17.5% was up 128bps QoQ and beat our ests (PLe: 16.7%). EBIT margin at 13.8% up 110bps QoQ. We believe that headcount reduction, turnaround in profitability of LCC and improvement in margins of Comviva have been the key drivers for steady margin turnaround.

Exhibit 4: EBIDTA Margins vs. Average rate (USD vs. INR)



Source: Company Data, PL Research

Key Metrics

Exhibit 5: Revenue mix by geography (%)

Revenues by Geography	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Americas	48.9	47.8	46.8	49.0	48.3	46.7	45.1	46.8	45.3	46.9	47.4
Europe	29.3	28.9	28.5	28.3	29.7	29.4	29.6	29.8	30.0	29.8	29.6
ROW	21.9	23.2	24.7	22.8	22.0	23.9	25.3	23.4	24.7	23.3	23

Source: Company Data, PL Research

Exhibit 6: Geography wise revenues (USD mn) and growth in revenues (%)

Revenues and growth by geography	Q4FY18	Q3FY18	*QoQ gr.*	Q4FY17	*YoY gr.*
Americas	589.8	567.0	*4.0%*	510.2	*15.6%*
Europe	368.3	360.3	*2.2%*	334.8	*10.0%*
ROW	286.2	281.7	*1.6%*	286.2	*0.0%*

Source: Company Data, PL Research

Exhibit 7: Revenue mix by verticals (%)

Revenues by verticals	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Telecom	51.3	50.9	49.2	48.4	47.3	46.3	45.2	43.7	42.8	41.6
Manufacturing	17.1	17.1	18.1	19.2	18.4	19.2	19.3	19.0	19.1	19.3
Technology ,media and Entertainment	7.4	7.5	7.5	7.2	6.4	6.2	6.0	5.9	6.5	7.3
BFSI	9.8	10.6	11.3	11.5	13.1	14.1	14.4	14.1	13.3	13
Retail, Transport and logistics	6.8	6.2	6.5	6.8	7.6	6.5	6.8	7.2	7.1	6.2
Others	7.6	7.7	7.3	6.8	7.1	7.7	8.3	9.9	11.3	12.6

Source: Company Data, PL Research

Exhibit 8: Vertical wise revenues (USD mn) and growth in revenues

Revenues and growth by verticals	Q4FY18	Q3FY18	*QoQ gr.*	Q4FY17	*YoY gr.*
Telecom	517.6	517.5	*0.0%*	523.7	*-1.2%*
Manufacturing	240.1	230.9	*4.0%*	217.2	*10.6%*
Technology ,media and Entertainment	90.8	78.6	*15.6%*	70.1	*29.5%*
BFSI	161.8	160.8	*0.6%*	159.5	*1.4%*
Retail, Transport and logistics	77.1	85.8	*-10.1%*	73.5	*4.9%*
Others	156.8	136.6	*14.8%*	87.1	*80.0%*

Source: Company Data, PL Research

Exhibit 9: Revenues by delivery (%)

Revenues by delivery	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Onsite	62.7	63.2	63.4	63.5	63.9	64.3	63.7	64.1	65.8	67.0
Offshore	37.3	36.8	36.6	36.5	36.1	35.7	36.3	35.9	34.2	33.0

Source: Company Data, PL Research

Exhibit 10: Client Metrics

Revenues by client	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Top 5 client	28.0	27.9	28.8	28.5	27.8	26.6	25.9	24.8	23.2	23.2
Top 10 clients	40.0	39.0	40.0	39.9	38.4	37.6	36.3	35.1	33.2	32.7
Top 20	52.0	51.9	52.6	51.7	50.5	49.0	48.5	46.2	45.0	45.7
Client Bucket										
>1 m	326	319	317	341	356	354	377	390	389	392
> 5 m	105	112	120	120	128	134	139	147	154	156
> 10 m	63	63	64	66	65	71	74	81	83	85
>20 m	37	40	42	40	38	36	41	40	40	44
> 50 m	14	14	14	14	14	14	14	14	16	16

Source: Company Data, PL Research

Exhibit 11: Headcount Details

	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Software Professionals (IT services)	72,125	73590	78,404	80,858	82,403	78,996	75,587	73,460	72,437
BPO	27,254	27,326	27,669	29,372	28,414	30,322	35,287	35,496	34,190
Sales and Support	6,053	6,300	6,813	6,865	6,876	6,662	6351	6285	6180
Total Employees	105,432	107,216	112,886	117,095	117,693	115,980	117,225	115,241	1,12,807
Net addition	(1,705)	1,784	5,670	4,209	598	(1,713)	1245	(1984)	(2434)
IT Attrition	21%	21%	19%	18%	17%	17%	16%	17%	18%
IT Utilization	77%	78%	78%	77%	77%	77%	81%	83%	84%
IT utilization (Excluding trainees)	80%	80%	82%	83%	81%	81%	81%	83%	84%

Source: Company Data, PL Research

- Company has shown steep reduction in IT services headcount over the past four quarters. IT Services headcount came at 72437 employees down 12% over 4QFY17.

Exhibit 12: Financial summary of Tech M

	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
USD Revenues (USD mn)	2632	3098	3664	4038	4351	4771	5221	5727
Growth (%)	6.8%	17.7%	18.3%	10.2%	7.8%	9.6%	9.5%	9.7%
Organic Growth (%)	6.8%	12.7%	14.4%	1.0%	3.9%	5.7%	8.7%	9.7%
Average Rate (USD vs. INR)	54.46	60.72	61.20	65.60	66.97	64.50	65.75	65.00
Revenues (Rs mn)	143,320	188,313	226,213	264,942	291,408	307,730	343,260	372,255
Growth (%)	22.5%	31.4%	20.1%	17.1%	10.0%	5.6%	11.5%	8.4%
EBIDTA	30,632	41,837	41,529	43,184	41,843	47,161	57,937	64,245
EBIT	26,736	36,615	35,415	35,564	32,062	36,312	46,618	52,981
APAT	21,157	26,821	26,277	31,180	28,409	38,001	41,270	45,116
EBIDTA Margin (%)	21.4%	22.2%	18.4%	16.3%	14.4%	15.3%	16.9%	17.3%
EBIT Margin (%)	18.7%	19.4%	15.7%	13.4%	11.0%	11.8%	13.6%	14.2%
NPM (%)	14.8%	14.2%	11.6%	11.8%	9.7%	12.3%	12.0%	12.1%
Adjusted Diluted EPS (ex-Treasury)	24.62	31.21	30.58	35.12	31.94	42.7	46.4	50.7
Growth (%)	17.1%	26.8%	-2.0%	14.9%	-9.1%	35.1%	8.6%	9.3%
P/E(Ex - Treasury Share EPS)	24.6	22.4	22.9	20.1	22.3	16.5	15.2	13.9
EV/EBIDTA	17.0	15.0	16.0	15.0	15.0	13	10	9
ROE (%)	36.3%	33.5%	24.5%	23.4%	18.4%	21.5%	20.4%	19.6%
Consolidated Balance sheet (Rs mn)								
Net Cash on Balance Sheet	25606	31444	24904	41575	36273	54233	76965	116379
Net Cash per Share on balance sheet	27.6	33.8	26.0	42.3	40.8	61.0	86.5	130.8
Net cash per share as a % of stock price	4.6%	5.6%	4.3%	7.0%	6.7%	8.6%	12.3%	18.6%
Consolidated Cash Flows (Rs mn)								
Cash flow from Operating Activities	18994	15928	23974	32132	40714	32063	41688	44996
Capex+ Acquisitions	(10,250)	(10,508)	(24,873)	(9,046)	(21,272)	(9,000)	(9,000)	(9,000)
Free Cash Flow	8,744	5,420	(899)	23,086	19,442	23,063	32,688	35,996
FCF/EBIDTA	28.5%	13.0%	-2.2%	53.5%	46.5%	48.9%	56.4%	56.0%

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2017	2018	2019E	2020E
Net Revenue	**291,408**	**307,730**	**343,260**	**372,255**
Employee Expenses	154,539	215,299	236,849	256,856
Gross Profit	136,869	92,431	106,411	115,399
Other Cost	—	—	—	—
Other Expenses	95,025	45,270	48,473	51,154
EBITDA	**41,844**	**47,161**	**57,937**	**64,245**
Depr. & Amortization	9,781	10,849	11,319	11,264
Net Interest	1,286	1,624	1,000	800
Other Income	7,776	14,102	9,000	7,200
Profit before Tax	**38,553**	**48,789**	**54,618**	**59,381**
Total Tax	10,021	10,925	13,378	14,252
Profit after Tax	**28,532**	**37,864**	**41,240**	**45,130**
Ex-Od items / Min. Int.	380	(137)	(30)	14
Adj. PAT	**28,152**	**38,001**	**41,270**	**45,116**
Avg. Shares O/S (m)	**877.6**	**877.6**	**882**	**883**
EPS (Rs.)	**32.1**	**43.0**	**46.5**	**50.7**

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018	2019E	2020E
Shareholder's Funds	176,685	201,400	228,213	257,106
Total Debt	3,853	3,153	2,453	1,753
Other Liabilities	16,207	16,070	16,040	16,054
Total Liabilities	**196,745**	**220,623**	**246,706**	**274,912**
Net Fixed Assets	41,040	39,191	36,871	34,608
Goodwill	26,279	26,279	26,279	26,279
Investments	3,319	3,319	3,319	3,319
Net Current Assets	99,345	125,078	153,481	183,933
Cash & Equivalents	*53,833*	*69,393*	*90,925*	*116,379*
Other Current Assets	*109,441*	*119,747*	*128,241*	*136,342*
Current Liabilities	*63,929*	*64,062*	*65,685*	*68,788*
Other Assets	26,753	26,753	26,753	26,753
Total Assets	**196,736**	**220,620**	**246,703**	**274,912**

Cash Flow Abstract (Rs m)

Y/e March	2017	2018	2019E	2020E
C/F from Operations	40,714	32,063	41,688	44,996
C/F from Investing	(30,489)	(898)	(4,000)	(1,800)
C/F from Financing	(7,799)	(16,004)	(16,557)	(17,742)
Inc. / Dec. in Cash	2,426	15,160	21,131	25,455

Quarterly Financials (Rs m)

Y/e March	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Net Revenue	**73,361**	**76,064**	**77,760**	**80,545**
EBITDA	**9,347**	**11,057**	**12,638**	**14,119**
% of revenue	*12.7*	*14.5*	*16.3*	*17.5*
Depr. & Amortization	2,468	2,653	2,742	2,986
Net Interest	(3,737)	(2,836)	(1,919)	(3,986)
Other Income	4,107	3,222	2,260	4,513
Profit before Tax	**10,616**	**11,240**	**11,815**	**15,118**
Total Tax	2,698	2,847	2,570	2,810
Profit after Tax	**7,987**	**8,362**	**9,432**	**12,220**
Adj. PAT	**7,987**	**8,362**	**9,432**	**12,220**

Source: Company Data, PL Research.

Key Financial Metrics

Y/e March	2017	2018	2019E	2020E
Growth				
Revenue (%)	10.0	5.6	11.5	8.4
EBITDA (%)	(3.1)	12.7	22.9	10.9
PAT (%)	(9.6)	35.0	8.6	9.3
EPS (%)	(8.5)	35.0	8.6	9.3
Profitability				
EBITDA Margin (%)	14.4	15.3	16.9	17.3
PAT Margin (%)	9.7	12.3	12.0	12.1
RoCE (%)	17.3	20.3	19.3	18.7
RoE (%)	18.3	21.5	20.4	19.6
Balance Sheet				
Net Debt : Equity	(0.3)	(0.3)	(0.4)	(0.4)
Valuation				
PER (x)	21.9	16.2	14.9	13.7
P / B (x)	3.5	3.1	2.7	2.4
EV / EBITDA (x)	13.5	11.7	9.1	7.8
EV / Sales (x)	1.9	1.8	1.5	1.3
Earnings Quality				
Eff. Tax Rate	26.0	22.4	24.5	24.0
Other Inc / PBT	20.2	28.9	16.5	12.1

Source: Company Data, PL Research.

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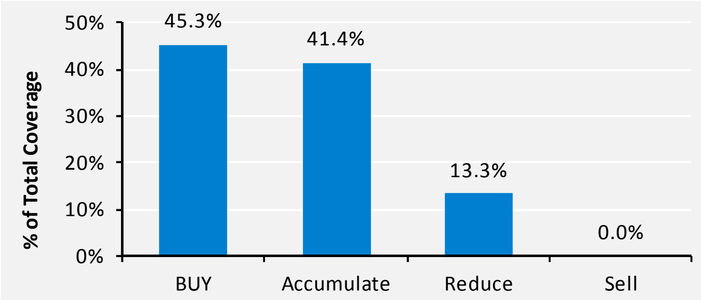

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BUY	:	Over 15% Outperformance to Sensex over 12-months
Accumulate	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months
Sell	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month
Trading Sell	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock
Under Review (UR)	:	Rating likely to change shortly

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