

Weak performance...

Tech Mahindra (TechM) reported a below expected performance on the operational front. The subdued performance in Q4FY19 revenues was mainly due to a decline in enterprise segment (led by seasonality in retail, cut down of less profitable projects, revenue pressure in healthcare and lower growth in financial segment). Further, EBITDA margins declined 80 bps QoQ mainly led by rupee impact and one off provisions of 30-40 bps. Adjusted for one offs, EBITDA margins were at 18.7% (still below our estimate of 19.0%).

Conversion of deal pipeline key trigger

Communication grew well better than expectations in the quarter. We expect momentum in communication to continue in FY20E. Hence, we expect growth to be more balanced between communications and enterprise segment vs. prior expectations of mid-single digit growth in communication and 8-10% growth in the latter. Lower growth in enterprise is due to weak outlook in healthcare, BFSI and cut down of less profitable projects. On the deal front, pipeline continues to be healthy with TCV of US\$408 million in Q4FY19 and 33% YoY growth in FY19. Although the company has a large deal pipeline, its conversion is a key thing to watch in FY20. Conversion of large deals in enterprise and the company's focus on 50 major customers within the company and outside will be key triggers for revenue growth. Considering the delay in deal closure and seasonality in communication segment, we expect FY20 growth to be more back ended. Further, we expect improving 5G spend to only have a trickle-down effect in FY21E. Hence, we conservatively build in revenue growth in FY19-21E (CAGR 7.8% to \$5775 million in FY19-21E).

Miss on margins, gradual improvement expected

Taking into account the miss in margin estimates in this quarter, considerable margin drop in Q1FY20E (due to wage hike, visa cost, Comviva seasonality) and only gradual improvement thereon, we revise our margin estimates downwards. We now expect EBITDA margins at 18.5% in FY20E and 18.8% in FY21E. Key levers for margins are utilisation, offshoring and improving profits of acquired companies.

Valuation & Outlook

Improving growth trajectory in communication and healthy deal pipeline are key positives. However, slower growth in enterprise revenues, absence of currency benefit and higher wage hike compared to prior year are expected to keep revenues and margins under check in the near term. Further, trade war uncertainty could play spoilsport for communication growth (not factored in our estimates). Hence, we revise our rating to **HOLD** with a revised target price of ₹ 845/share (~15x FY21E EPS).

Key Financial Summary

Key Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net sales	29,140	30,773	34,742	37,350	40,426	7.9%
EBITDA	4,184	4,710	6,337	6,910	7,600	9.5%
EBITDA Margin (%)	14.4	15.3	18.2	18.5	18.8	
Net Profit	2,812	3,800	4,298	4,624	5,229	10.3%
EPS (₹)	31.7	42.8	47.7	51.4	58.1	
P/E	23.7	17.6	15.8	14.6	13.0	
RoNW (%)	17.1	20.2	21.2	19.8	19.4	
RoCE (%)	19.4	21.5	23.6	23.2	23.2	

Source: Company, ICICI Direct Research

Tech Mahindra

Particulars

Particular	Amount
Market Capitalization (₹ Crore)	67,722.5
Total Debt (₹ Crore)	1,404.7
Cash and Investments (₹ Crore)	8,948.6
EV (₹ Crore)	60,178.6
52 week H/L	846 / 612
Equity capital	443.7
Face value	₹ 5

Key Highlights

- Revenue growth expected to be more back ended with growth broadly balance between its two segments of communication and enterprise
- EBITDA margins miss estimates, Q1FY20E to witness quarterly drop and only gradual improvement thereon
- Revise our recommendation from BUY to **HOLD** with revised target price of ₹ 845

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Exhibit 1: Variance Analysis

	Q4FY19	Q4FY19E	Q4FY18	YoY (%)	Q3FY19	1oQ (%)	Comments
Revenue	8,892.3	9,024.6	8,054.5	10.4	8,943.7	-0.6	Revenues came in below our expectations on the back of a decline in enterprise segment while it was offset by an improved performance in the communication segment
Employee expenses	5,948.2	6,046.5	5,488.5	8.4	5,984.5	-0.6	
Gross Margin	2,944.1	2,978.1	2,566.0	14.7	2,959.2	-0.5	
Gross margin (%)	33.1	33.0	31.9	125 bps	33.1	2 bps	
SG&A expenses	1,305.4	1,263.4	1,154.1	13.1	1,236.6	5.6	
EBITDA	1,638.7	1,714.7	1,411.9	16.1	1,722.6	-4.9	
EBITDA Margin (%)	18.4	19.0	17.5	91 bps	19.3	-75 bps	EBITDA margins came in below our expectations mainly led by an increase in SG&A cost and currency headwind (40-45 bps impact)
Depreciation & amortisation	270.4	288.8	298.6	-9.4	283.6	-4.7	
EBIT	1,368.3	1,425.9	1,113.3	22.9	1,439.0	-4.9	
EBIT Margin (%)	15.4	15.8	13.8	157 bps	16.1	-70 bps	
Other income (less interest)	139.0	79.2	398.6	-65.1	44.8	210.3	
PBT	1,507.3	1,505.1	1,511.9	-0.3	1,483.8	1.6	
Tax paid	353.5	376.3	281.0	25.8	263.8	34.0	
PAT	1,132.5	1,124.9	1,221.9	-7.3	1,202.9	-5.9	PAT was better than our expectations on account of higher other income

Key Metrics

Closing employees	121,082	122,000	112,807	7.3	121,842	-0.6	
IT attrition (%)	21.0	20.5	18.0	300 bps	21.0	0 bps	Reporting attrition seems to be higher while on an annualised basis it is lower
Utilisation ex trainees (%)	82.0	84.0	84.0	-200 bps	83.0	-100 bps	
Average \$/₹	70.2	70.4	64.7	8.4	70.9	-1.1	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY19		FY20E		FY21E			
(₹ Crore)	New	Old	New	% Change	Old	New	% Change	Comments
Revenue	34,742	38,396	37,350	-2.7	41,661	40,426	-3.0	Change in revenue estimate mainly due to a change in exchange rate assumption and revision in enterprise revenue estimates
EBITDA	6,337	7,180	6,910	-3.8	7,916	7,600	-4.0	
EBITDA Margin (%)	18.2	18.7	18.5	-20 bps	19.0	18.8	-20 bps	We revise our margin estimate downwards to factor in quarter performance, drop in Q1FY20E and higher wage hike
PAT	4,298	4,906	4,624	-5.7	5,510	5,229	-5.1	
EPS (₹)	47.7	54.5	51.4	-5.7	61.2	58.1	-5.1	

Source: Company, ICICI Direct Research

Conference Call Highlights

- Revenue outlook:** In the current quarter, the company registered poor revenue growth mainly led by the poor performance of the enterprise segment. The pain in the enterprise segment was mainly due to seasonality in retail, cut down in less profitable projects, revenue pressure in healthcare and lower growth in financial segment. Going forward, we expect poor outlook in healthcare, BFSI and cut down of less profitable projects to weigh on growth in enterprise segment. This has prompted the company to revise revenue guidance for enterprise segment downwards from earlier expectation of 8-10%. We expect 7.0% YoY growth in enterprise segment. However, the lower growth in enterprise segment is expected to be offset by higher growth in communication. The company expects communication segment to grow higher than 5.0% as expected earlier. The revenue growth in communication and enterprise is expected to be more back ended in FY20E. As a strategy, the company plans to focus on 50 major customers within and outside the company to boost its revenue growth
- Q1FY20E outlook:** The company expects Q1FY20E to be impacted by seasonality in Comviva while a delay in deal ramp up in enterprise might impact revenue growth, to some extent. Further, a wage hike (higher than FY19 wage hikes), Comviva seasonality, and visa cost may impact margins in Q1FY20E
- Digital revenues:** Digital revenues in Q4FY19 were at 34% of overall revenues and grew 4.0% QoQ. Digital revenues increased ~41% YoY to form 31% of revenues in FY19. The company sees traction in cyber security, IoT, blockchain and traction in 5G. The company expects IT services revenues to be driven by growth in digital revenues partly offset by a decline in legacy business
- Deal wins:** The company has won \$408 million deal wins with \$171 million in communication segment and \$237 million in enterprise segment
- Huawei impact:** The company does not expect impact of trade ban on Huawei. Huawei is not in top 20 customers of the company. Huawei is absent in the network side in the US. TechM has partnered with Huawei in Europe and Middle East. The company believes the partnership with Huawei is not in sensitive zones
- Margin snapshot:** Going forward, the company believes it has significant margin levers in terms of improving profits of acquired companies, higher utilisation and higher offshoring
- Employee Update:** Employee headcount was at 121,082 at the end of FY19 vs. 112,807 in FY18. The number of employees in software professionals declined to 71,477 (vs. 72,437 in FY18). However, BPO headcount increased from 34,190 to 43,081 in FY19
- DSO and cash position:** DSO days were at 102 days vs. 107 in Q3FY19. Cash & cash equivalent at end of FY19 was at ₹ 8,949 crore
- Capital allocation:** The company plans to pay out 35-40% as dividend. Some portion may be used for M&A while the company may also consider a buyback

Key Metrics

Exhibit 3: Geography wise split up

	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
<u>Revenue by geography (%)</u>						
Americas	46.9	47.4	48.2	47.0	47.4	46.4
Europe	29.8	29.6	30.0	29.6	28.9	28.6
Rest of World	23.3	23.0	21.9	23.4	23.7	24.9
<u>Growth QoQ (%)</u>						
Americas	6.2	4.0	0.0	-3.0	4.4	-1.6
Europe	1.9	2.2	-0.3	-1.8	1.0	-0.5
Rest of World	-3.3	1.6	-6.3	6.3	4.8	5.6

Source: Company, ICICI Direct Research

Growth in dollar terms was weak in Europe and Americas

Exhibit 4: Industry wise break-up

	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
<u>Revenue by verticals (%)</u>						
Telecom	42.8	41.6	39.6	41.5	41.1	42.7
Manufacturing	19.1	19.3	20.1	20.1	20.5	20.2
Technology, media & entertainment	6.5	7.3	7.2	7.3	7.0	7.5
Banking, financial services & insurance	13.3	13.0	13.6	13.5	13.4	13.1
Retail, transport & logistics	7.1	6.2	6.1	6.5	6.7	6.4
Others	11.3	12.6	13.4	11.2	11.3	10.2
<u>Growth QoQ (%)</u>						
Telecom	0.4	0.0	-6.4	4.3	2.5	4.4
Manufacturing	3.1	4.0	2.5	-0.5	5.6	-0.9
Technology, media & entertainment	13.0	15.6	-3.0	0.9	-0.8	7.7
Banking, financial services & insurance	-3.3	0.6	2.9	-1.2	2.7	-1.7
Retail, transport & logistics	1.1	-10.1	-3.2	6.0	6.7	-4.0
Others	17.0	14.8	4.6	-16.8	4.4	-9.3

Source: Company, ICICI Direct Research

Retail declined in the quarter due to high base and seasonality. Deferral of some contracts led to decline in healthcare segment, which is visible in others de-growth

Exhibit 5: Client & human resource matrix

	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
<u>Client Metrics</u>						
≥ \$1 million clients	389	392	396	407	416	425
≥ \$5 million clients	154	156	154	157	157	156
≥ \$10 million clients	83	85	86	86	88	83
≥ \$20 million clients	40	44	47	45	46	50
≥ \$50 million clients	16	16	16	17	18	20
<u>Headcount, Attrition, Utilization</u>						
Total Employees	115241	112807	113552	118391	121842	121082
IT Attrition (LTM)	17.0	18.0	19.0	20.0	21.0	21.0
IT Utilization % (Excluding Trainees)	83.0	84.0	84.0	83.0	83.0	82.0

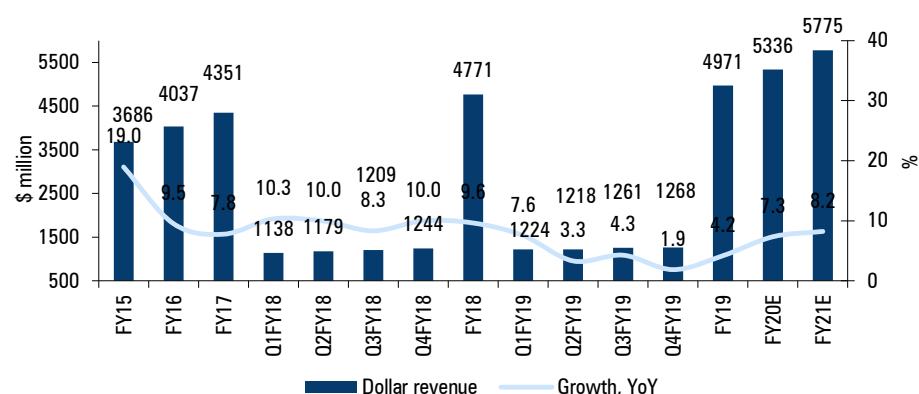
Source: Company, ICICI Direct Research

The company added four clients in US\$20 million and two clients in US\$50 million+, which is a healthy sign

Management expects healthy employee addition in the coming year while utilisation also has a scope to inch up

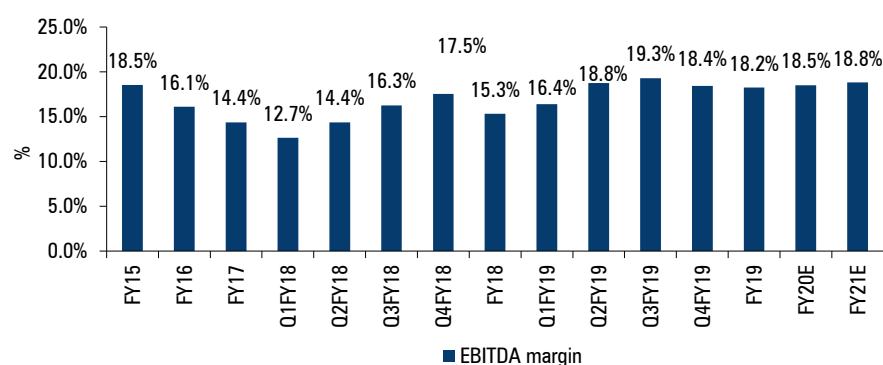
Financial story in charts

Exhibit 6: Dollar revenues may grow at 7.8% CAGR in FY19-21E



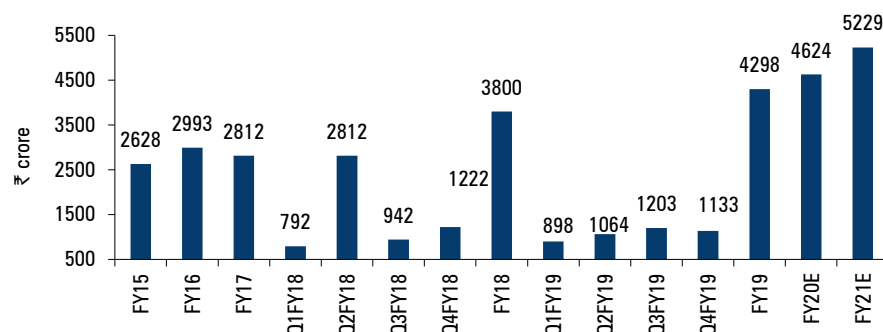
Source: Company, ICICI Direct Research

Exhibit 7: Revise our margin estimates downwards



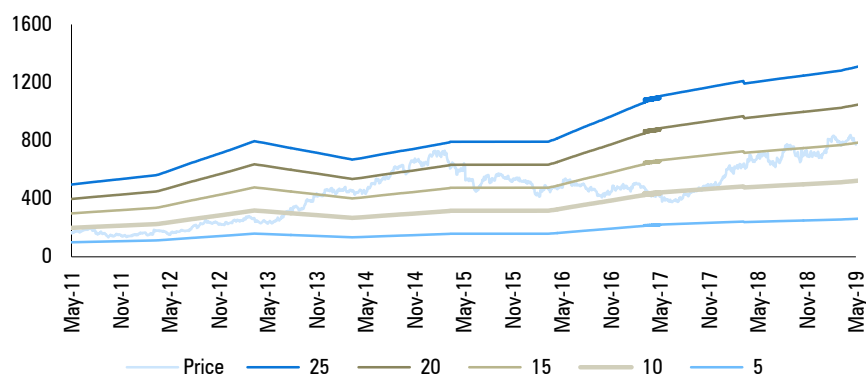
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

Exhibit 9: One year forward rolling price to earnings

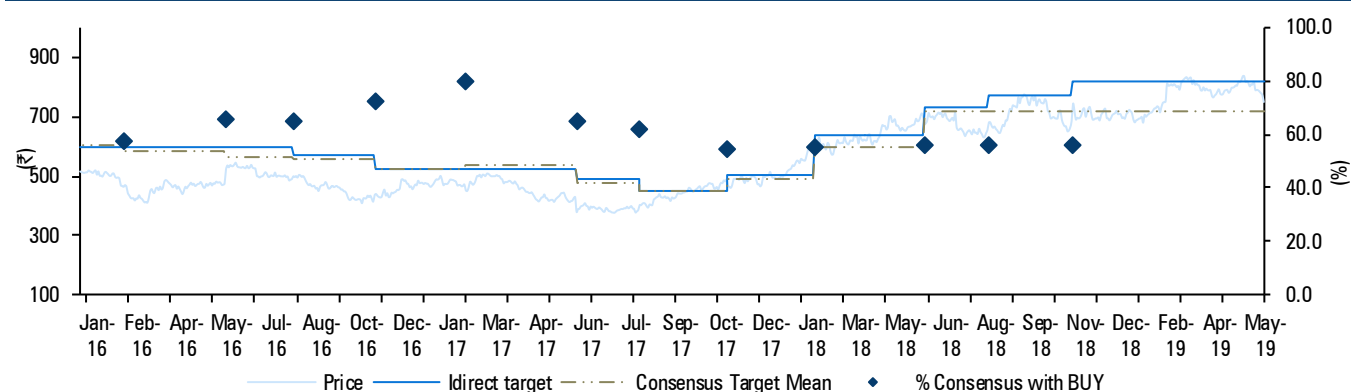


Source: Company, ICICI Direct Research

Exhibit 10: Valuation

	Sales	Growth	EPS	Growth	PE	EV/EBITD	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY17	29,140	10.0	31.7	0.1	23.7	15.2	17.1	19.4
FY18	30,773	5.6	42.8	35.1	17.6	13.4	20.2	21.5
FY19E	34,742	12.9	47.7	11.4	15.8	9.5	21.2	23.6
FY20E	37,350	7.5	51.4	7.6	14.6	8.2	19.8	23.2
FY21E	40,426	8.2	58.1	13.1	13.0	6.9	19.4	23.2

Source: Company, ICICI Direct Research

Exhibit 11: Recommendation History vs. Consensus


Source: Bloomberg, Company, ICICI Direct Research

Exhibit 12: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Mahindra Group	12-Apr-19	26.1%	251.5	-4.7
2	TML Benefit Trust	12-Apr-19	9.8%	94.2	-1.8
3	Stewart Investors	31-Mar-19	5.6%	54.2	6.4
4	ICICI Prudential Asset Management Co. Ltd.	31-Dec-17	1.9%	18.6	-0.7
5	Aditya Birla Sun Life AMC Limited	31-Mar-19	1.8%	17.2	-2.7
6	BlackRock Institutional Trust Company, N.A.	30-Apr-19	1.8%	17.0	0.0
7	The Vanguard Group, Inc.	30-Apr-19	1.7%	16.7	-0.5
8	Norges Bank Investment Management (NBIM)	31-Mar-18	1.4%	13.7	0.0
9	LIC Mutual Fund Asset Management Company	31-Mar-19	1.3%	12.9	0.0
10	Hermes Investment Management Ltd.	31-Mar-19	1.2%	12.0	0.0

Source: Reuters, ICICI Direct Research

Exhibit 13: Recent Activity

Buys			Sells		
Investor name	Value (\$m)	Shares	Investor name	Value (\$m)	Shares
Stewart Investors	71.51m	6.38m	Mahindra Group	-56.43m	-4.70m
First State Investments (HK) Ltd.	55.51m	4.95m	Aditya Birla Sun Life AMC Limited	-29.95m	-2.67m
Caisse de Depot et Placement du Quebec	14.33m	1.38m	TML Benefit Trust	-21.18m	-1.76m
Colonial First State Global Asset Management	10.95m	0.98m	First State Investments (Singapore)	-19.17m	-1.71m
GIC Private Limited	10.91m	0.97m	DSP Investment Managers Pvt. Ltd.	-13.51m	-1.13m

Source: Reuters, ICICI Direct Research

Exhibit 14: Shareholding Pattern

(in %)	Sep-18	Dec-18	Mar-19
Promoter	35.96	35.94	35.87
Public	64.00	64.02	64.12
Others	0.04	0.04	0.01
Total	100.00	100.00	100.00

Source: Company, ICICI Direct Research

Financial summary

Exhibit 15: Profit and loss statement ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
Net sales	30,773	34,742	37,350	40,426
Growth (%)	6	13	8	8
COGS (employee expenses)	21,530	23,359	25,137	27,085
Gross profit	9,243	11,383	12,214	13,340
S,G&A expenses	4,533	5,046	5,304	5,740
Total Operating Expenditure	26,063	28,405	30,441	32,826
EBITDA	4,710	6,337	6,910	7,600
Growth (%)	13	35	9	10
Depreciation	1,085	1,129	1,214	1,314
Interest	162	133	120	108
Other Income	1,417	534	666	870
PBT	4,879	5,609	6,242	7,048
Total Tax	1,093	1,254	1,560	1,762
Exceptional item	-	-	-	-
PAT	3,800	4,298	4,624	5,229
Growth (%)	35	13	8	13
EPS (₹)	42.8	47.7	51.4	58.1

Source: Company, ICICI Direct Research

Exhibit 17: Balance sheet ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
Liabilities				
Equity Capital	442	444	444	444
Share application money	-	-	-	-
Reserve and Surplus	18,401	19,841	22,939	26,443
Total Shareholders funds	18,843	20,284	23,383	26,886
Minority Interest	509	478	469	460
Total Debt	1,726	1,405	1,405	1,405
Other long term liabilities	2,398	2,145	2,145	2,145
Total Liabilities	23,475	24,312	27,401	30,896
Assets				
Net Block	2,981	2,623	2,394	2,145
Capital WIP	240	276	276	276
Investments	4,691	7,342	8,276	9,211
Deferred tax assets	577	609	609	609
Goodwill on consolidation	2,773	2,816	2,816	2,816
Debtors	6,512	6,965	7,488	8,104
Loans and Advances (short)	150	-	-	-
Other non-current assets	2,632	3,176	3,177	3,177
Cash	3,044	2,359	4,906	7,906
Other current assets	4,904	5,583	5,583	5,583
Total Current Assets	18,121	21,572	25,642	30,259
Trade payables	2,037	2,489	2,676	2,897
Current liabilities	4,522	6,251	6,720	7,273
Provisions	403	395	425	460
Total Current Liabilities	6,962	9,135	9,821	10,630
Application of Funds	23,475	24,312	27,401	30,896

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit before Tax	4,879	5,543	6,242	7,048
Add: Depreciation	1,085	1,129	1,214	1,314
(Inc)/dec in Current Assets	(1,044)	(1,619)	(523)	(617)
Inc/(dec) in CL and Provisions	261	562	686	809
Taxes paid	(1,526)	(1,661)	(1,560)	(1,762)
CF from operating activities	3,554	4,432	6,843	7,769
(Inc)/dec in Investments	(2,070)	(2,457)	(1,000)	(1,000)
(Inc)/dec in Fixed Assets	(790)	(779)	(985)	(1,066)
Others	125	148	(666)	(870)
CF from investing activities	(3,360)	(2,116)	(2,650)	(2,935)
Issue/(Buy back) of Equity	86	36	-	-
Inc/(dec) in loan funds	749	(450)	-	-
Dividend paid & dividend tax	(944)	(1,491)	(1,526)	(1,726)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(160)	(135)	(120)	(108)
CF from financing activities	(269)	(2,251)	(1,646)	(1,834)
Net Cash flow	(76)	64	2,547	3,000
Cash by acquisition	-	-	-	-
Opening Cash	3,219	3,044	2,359	4,906
Cash carried to B/S	3,044	2,359	4,906	7,906

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	42.8	47.7	51.4	58.1
Cash EPS	55.0	60.3	64.8	72.7
BV	212.4	225.2	259.6	298.6
DPS	14.0	14.0	19.8	22.4
Cash Per Share	34.3	26.2	54.5	87.8
Operating Ratios (%)				
EBITDA Margin	15.3	18.2	18.5	18.8
PAT Margin	12.3	12.4	12.4	12.9
Return Ratios (%)				
RoE	20.2	21.2	19.8	19.4
RoCE	21.5	23.6	23.2	23.2
RoIC	21.6	34.5	38.9	44.5
Valuation Ratios (x)				
P/E	17.6	15.8	14.6	13.0
EV / EBITDA	13.4	9.5	8.2	6.9
EV / Net Sales	2.0	1.7	1.5	1.3
Market Cap / Sales	2.2	1.9	1.8	1.7
Price to Book Value	3.5	3.3	2.9	2.5
Solvency Ratios				
Debt/EBITDA	0.4	0.2	0.2	0.2
Current Ratio	1.7	1.4	1.3	1.3
Quick Ratio	1.7	1.4	1.3	1.3

Source: Company, ICICI Direct Research

Exhibit 19: ICICI Direct coverage universe (IT)

Sector / Company	CMP			M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Cyient (INFENT)	538	620	Hold	6,530	36.0	42.4	46.6	16.1	13.7	12.4	10.3	9.1	7.5	21.4	21.4	20.7	17.3	18.7	18.1
Eclerx (ECLSER)	934	910	Sell	3,931	72.9	58.9	64.2	14.2	17.5	16.1	9.1	11.1	9.9	28.2	22.8	23.1	24.1	17.3	17.5
Firstsource (FIRSOU)	50	60	Buy	3,502	4.8	5.4	5.9	10.7	9.4	8.6	8.8	7.2	6.2	13.0	14.0	15.7	13.9	13.9	13.8
HCL Tech (HCLTEC)	1,059	1,190	Hold	146,833	62.6	74.7	76.7	17.3	14.5	14.1	12.5	10.1	9.1	27.4	26.5	26.0	23.8	24.5	22.5
Infosys (INFTEC)	712	805	Buy	314,663	32.3	35.4	39.5	22.4	20.4	18.3	15.2	13.8	12.3	30.9	32.9	32.9	22.5	23.7	24.4
L&T Intotech (LTINFO)	1,784	1,940	Buy	29,148	64.7	87.3	94.6	26.0	19.2	17.7	23.2	14.3	12.3	36.0	40.4	36.4	28.8	31.0	27.8
NIIT Tech (NIITEC)	1,279	1,395	Hold	7,677	45.6	65.7	76.1	27.8	19.0	16.7	13.8	10.4	8.9	19.4	24.2	24.3	15.8	19.9	20.2
Persistent (PSYS)	602	650	Hold	5,119	40.5	44.0	48.7	15.8	14.6	13.2	9.1	7.1	6.4	19.8	20.5	20.5	15.2	15.0	14.9
TCS (TCS)	2,081	2,065	Hold	775,500	67.4	83.8	88.6	30.6	24.6	23.3	22.5	18.6	16.8	37.6	43.8	43.1	29.6	34.4	34.0
Tech M (TECMAH)	752	845	Hold	67,723	42.8	47.7	51.4	17.6	15.8	14.6	13.4	9.5	8.2	21.5	23.6	23.2	20.2	21.2	19.8
Wipro (WIPRO)	282	315	Buy	171,636	12.7	14.9	17.3	22.5	19.1	16.4	14.8	12.0	10.2	16.9	17.8	18.1	16.6	15.8	16.7

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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