

Tech Mahindra

Estimate change



TP change



Rating change



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Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USD\$)	641.7 / 8.4
52-Week Range (INR)	846 / 470
1, 6, 12 Rel. Per (%)	11/-8/3
12M Avg Val (INR M)	2298

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	369	381	426
EBIT Margin (%)	11.6	11.0	12.8
PAT	40	37	46
EPS (INR)	46.3	42.9	52.7
EPS Gr. (%)	(5.9)	-7.1	22.9
BV/Sh. (INR)	235.6	273.1	308.0

Ratios

RoE (%)	18.5	15.6	17.0
RoCE (%)	13.1	11.5	13.5
Payout (%)	32.7	35.2	28.6

Valuations

P/E (x)	14.3	15.5	12.6
P/BV (x)	2.8	2.4	2.2
EV/EBITDA (x)	9.6	8.3	6.1
Div Yield (%)	2.3	2.3	2.3

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	35.8	35.9	35.9
DII	13.2	13.4	12.0
FII	39.6	39.7	39.0
Others	11.3	11.1	13.1

FII Includes depository receipts

CMP: INR664

TP: INR750 (+13%)

Neutral

Good execution; Optimistic outlook

Recovery likely to be quicker than earlier expected

- TechM's resilience in revenue (-5% QoQ, CC), especially in Enterprise, is encouraging given the current context. Decline in Communications (8.2% QoQ) was on expected lines given the overhang in Network Services. The margin surprise was led by better-than-expected control on SG&A costs. Understandably, net new deal wins (USD290m) were weaker than the usual run-rate.
- Despite the elongated decision-making cycles, the company hinted at improving deal pipeline. Revenue and margins are expected to improve from hereon. Relatively higher client concentration and the resultant impact on pricing and working capital were key concerns initially. However, management commentary suggests these are not insurmountable. Ramp-up in recently won mega deals was largely on track, a key positive.
- We upgrade our EPS estimates over FY21–22E by 17% as we revisit our growth and margin trajectory in light of the surprise in 1QFY21 and optimistic commentary. Remain NEUTRAL.

Revenue and margin performance surprise

- TechM reported revenue (USD) / EBIT / PAT growth of -3%/-8%/1% YoY v/s our estimate of -5%/-18%/-23% YoY.
- Revenue declined 6.3% QoQ (CC), lower than the consensus expectation of 7.5–9% decline. While the Communications segment declined 8.2% QoQ (CC), a relatively resilient performance from the Enterprise segment (-5.1% QoQ, CC) aided in containing the decline.
- Within Enterprise, Technology, Media & Enterprise (+13.1% QoQ) reported a strong performance, while other verticals reported sharp declines.
- Across geographies, Americas (-3.5% QoQ, CC) fared relatively well, while the other two geographies reported sharp declines.
- Adjusted for the PM-CARES fund contribution in 4QFY20, the company was able to more or less defend its EBIT margins. Given its historical track record of poor margin management, the consensus expectation was for sequential margin contraction of 80–170bp for the quarter. However, the reported EBIT margin was 110bp above our estimates.
- Revenue decline, associated drop in utilization, and seasonality at Comviva were the key margin headwinds. Headcount reduction, tight control on SG&A costs, and INR depreciation were the key tailwinds.
- Cash collections were another cause for concern on the street. However, DSO (including unbilled) showed significant improvement (to 107 days from 112 days). Healthy cash conversion was further aided by a one-time tax refund.
- The company announced net new deal wins of USD290m during the quarter.

Key highlights from management commentary

- Around 7% decline in revenue was attributed to the COVID-19 impact. 25% of this impact was driven by supply-side challenges. In addition to COVID-19, seasonality at Comviva further hurt revenue and margins.
- Management indicated that the worst related to COVID-19 is behind, and it expects revenue and margins to improve from hereon. Supply-side issues are largely out of the way.
- Deal wins were weak due to slow movement in the pipeline in the first half of the quarter. However, the deal pipeline accelerated as the quarter progressed.
- Despite decision-making cycles remaining elongated, the company has hinted at improving deal pipeline.
- Ramp-up in recently won mega deals was more or less on track. However, management indicated that timelines related to Phase II of the AT&T deal ramp-up are uncertain as of now.
- The company does not expect any material headwinds related to pricing or collection going forward.

Valuation and view – Expect some catch-up in multiples

- Concerns around: a) intense pricing pressure given high client concentration in the Communications segment and b) underperformance in the Enterprise segment were the key reasons for our downgrade of the stock three months ago ([Link](#)).
- Execution and commentary in 1QFY21 indicate this impact (pricing and enterprise performance) may not be to the extent that was earlier feared. On the back of an optimistic outlook on both revenue and margins, we upgrade our EPS estimates by 17%.
- Across cycles, P/E multiples of the stock averaged to 13x. Even as the entire sector re-rated (including Tier II) during this results season, TechM is still trading at 12.6x FY22E EPS. We believe the sector re-rating is likely to sustain given the phenomenal resilience and adaptability demonstrated during the quarter. Accordingly, we see some headroom for the P/E multiple of TechM to catch up. We value the stock at ~14x FY22E EPS.

Quarterly Performance**(INR b)**

Y/E March	FY20				FY21E				FY20	FY21E	Est.	Var.
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	(% / bp)
Revenue (USD m)	1,247	1,287	1,353	1,295	1,207	1,242	1,274	1,305	5,182	5,028	1,185	1.9
QoQ (%)	-1.6	3.2	5.1	-4.3	-6.8	2.9	2.6	2.4	4.3	-3.0	-8.5	173bp
Revenue (INR b)	87	91	97	95	91	94	97	99	369	381	90	1.1
YoY (%)	4.6	5.1	7.9	6.7	5.2	4.1	0.3	4.5	6.1	3.5	4.0	119bp
GPM (%)	25.0	25.8	26.3	25.3	24.3	25.0	25.4	25.5	25.6	25.1	24.6	-30bp
SGA (%)	13.6	13.0	14.1	15.3	14.2	14.0	14.1	13.9	14.0	14.1	15.6	-138bp
EBITDA	13	15	16	13	13	14	15	16	57	58	12	9.4
EBITDA Margin (%)	15.2	16.5	16.2	14.2	14.3	15.2	15.5	15.8	15.5	15.2	13.2	108bp
EBIT	10	12	12	9	9	10	11	11	43	42	8	13.2
EBIT Margin (%)	11.5	12.8	12.2	10.0	10.1	11.0	11.3	11.6	11.6	11.0	9.0	107bp
Other income	3	2	3	2	4	2	2	2	10	9	2	97.0
ETR (%)	25.7	16.9	24.6	20.2	25.5	25.5	25.5	25.5	22.0	25.5	24.8	76bp
PAT	10	11	11	8	10	9	9	10	40	37	7	31.9
QoQ (%)	-15.3	17.2	2.0	-29.8	20.9	-9.8	5.9	4.2			-8.3	2923bp
YoY (%)	6.8	5.6	-4.7	-29.0	1.4	-22.0	-19.0	20.3	-6.2	-7.2	-23.1	2450bp
EPS (INR)	11.0	12.8	13.0	9.1	11.1	10.0	10.6	11.0	45.9	42.6	8.4	32.0

Key Performance Indicators

Y/E March	FY20				FY20				FY20	FY21
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenue (QoQ CC %)	-1.0	4.1	4.3	-3.3	-6.3				5.6	
Costs (% of revenue)										
COGS	71.2	70.4	69.7	70.5	71.5	70.8	70.4	70.3	70.5	70.7
SGA	13.6	13.0	14.1	15.3	14.2	14.0	14.1	13.9	14.0	14.1
Depreciation	3.7	3.8	4.0	4.2	4.2	4.2	4.2	4.2	3.9	4.2
Margins (%)										
Gross Margin	25.0	25.8	26.3	25.3	24.3	25.0	25.4	25.5	25.6	25.1
EBITDA margin	15.2	16.5	16.2	14.2	14.3	15.2	15.5	15.8	15.5	15.2
EBIT Margin	11.5	12.8	12.2	10.0	10.1	11.0	11.3	11.6	11.6	11.0
Net Margin	11.1	12.4	11.9	8.5	10.7	9.3	9.6	9.8	10.9	9.8
Operating Metrics										
Headcount (k)	126	132	131	125	123				125	
Util excl. trainees (%)	82.0	83.0	85.0	84.0	82.0				83.5	
Attrition (%)	21.0	21.0	20.0	19.0	17.0				19.0	
Offshore rev. (%)	34.7	34.6	34.7	34.8	36.0				34.7	
Deal TCV (USD m)	475	1490	1230	505	290				3,700	
Key Verticals (QoQ %)										
Communication	-3.2	1.0	8.9	-8.4	-8.6				5.3	
Enterprise	-0.8	5.0	2.6	-1.5	-5.5				3.5	
Key Geographies (QoQ%)										
North America	0.9	5.2	4.9	-5.7	-3.8				6.0	
Europe	-5.0	-0.2	6.3	-6.1	-9.2				-4.0	



Key highlights from management commentary

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Exhibit 1: TME reports strong performance, while other verticals decline

Verticals	Contribution to rev (%)	Growth (QoQ %)
Telecom	40.0	-8.6
Manufacturing	16.8	-11.1
Tech Media Entertainment	9.0	13.1
BFSI	15.7	-4.4
Retail Transport Logistics	7.3	-6.2
Others	11.2	-9.5

Exhibit 2: Americas fared relatively well, while other geographies report sharp declines

Geographies	Contribution to rev (%)	Growth (QoQ %)
Americas	49.2	-3.8
Europe	25.8	-9.2
Rest of World	24.9	-10.0

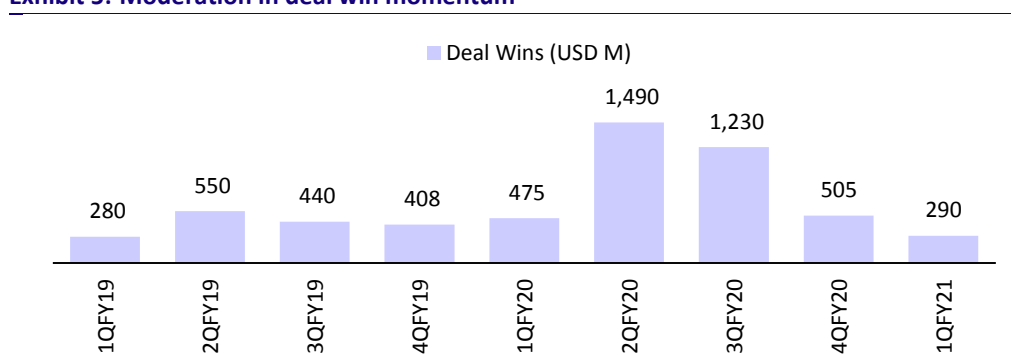
Exhibit 3: Company witnesses sequential decline across client buckets

	Contribution to rev (%)	Growth (QoQ %)
Top 5	22	-4.2
Top 6-10	9	-12.6
Top 11-20	12	-11.2

Exhibit 4: BPO reports sharp decline during quarter

	Contribution to rev (%)	Growth (QoQ %)
BPO proportion	8.1	-12.9
Services (Rest)	91.9	-6.2

Source: Company, MOFSL

Exhibit 5: Moderation in deal win momentum


Source: MOFSL, Company

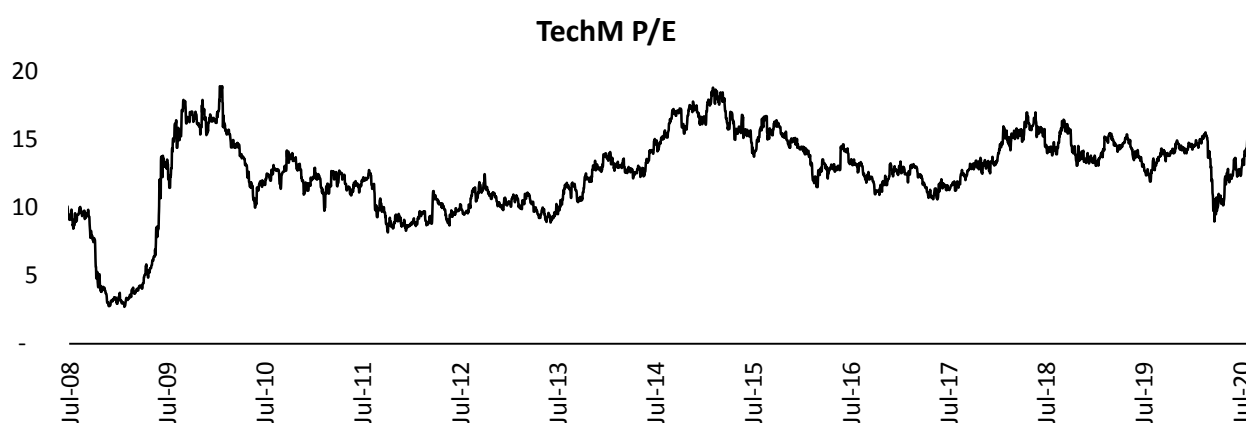
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Exhibit 6: Revisions to our estimates

	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
INR/USD	75.9	77.0	76.0	77.0	-0.2%	0.0%
USD Revenue - m	5,028	5,533	4,748	5,227	5.9%	5.9%
Growth (%)	(3.0)	10.0	(8.4)	10.1	540bps	0bps
EBIT margin(%)	11.0	12.8	9.7	10.7	130bps	210bps
PAT (INR B)	37	46	32	39	17.1%	17.1%
EPS	42.6	52.4	36.3	44.7	17.3%	17.2%

Source: MOFSL, Company

Exhibit 7: Over long term, one-year forward P/E multiple averaged to ~13x

Source: MOFSL, Bloomberg

Exhibit 8: Operating metrics

	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21
Revenue by Geography (%)									
Americas	48.2	47.0	47.4	46.4	47.6	48.5	48.4	47.7	49.2
Europe	30.0	29.6	28.9	28.6	27.6	26.7	27.0	26.5	25.8
Rest of World	21.9	23.4	23.7	24.9	24.8	24.9	24.6	25.8	24.9
Vertical Split (%)									
Telecom	39.6	41.5	41.1	42.7	42.0	41.1	42.6	40.8	40.0
Manufacturing	20.1	20.1	20.5	20.2	19.4	18.0	17.3	17.7	16.8
Tech Media Entertainment	7.2	7.3	7.0	7.5	7.6	8.1	7.6	7.4	9.0
BFSI	13.6	13.5	13.4	13.1	12.8	13.0	13.2	15.3	15.7
Retail Transport Logistics	6.1	6.5	6.7	6.4	6.2	7.0	7.2	7.3	7.3
Others	13.4	11.2	11.3	10.2	11.9	12.8	12.2	11.5	11.2
Onsite-Offshore Mix (%)									
Onsite	66.6	64.5	65.5	65.2	65.3	65.4	65.3	65.2	64.0
Offshore	33.4	35.5	34.5	34.8	34.7	34.6	34.7	34.8	36.0
Client Metrics									
No. of active clients	926	930	935	938	941	946	964	973	981
% of repeat business	98.5	97.4	94.6	88.7	97.7	94.8	91.2	86.1	97.0
No. of Million \$ clients									
USD1m+	396	407	416	425	429	437	446	446	451
USD5m+	154	157	157	156	160	155	164	160	161
USD10m+	86	86	88	83	81	80	83	85	81
USD20m+	47	45	46	50	49	49	50	49	48
USD50m+	16	17	18	20	21	22	22	22	21
Client concentration (%)									
Top 5 Clients	21.9	23.3	22.6	22.8	21.4	21.6	22.3	21.4	22.0
Top 6-10	10.6	9.4	9.0	9.2	9.3	9.9	8.7	9.6	9.0
Top 11-20	13.7	12.9	12.4	13.1	12.9	12.1	11.1	12.6	12.0
Headcount									
Software professionals	72,462	72,534	71,785	71,477	74,093	72,597	73,039	71,515	71,020
BPO	34,700	39,407	43,439	43,081	45,000	52,193	50,886	46,816	45,554
Sales and support	6,390	6,450	6,618	6,524	6,680	6,732	6,874	6,905	6,842
Total	1,13,552	1,18,391	1,21,842	1,21,082	1,25,773	1,31,522	1,30,839	1,25,236	1,23,416
IT Attrition (LTM %)	19	20	21	21	21	21	20	19	17
IT Utilization (%)	81	81	82	82	80	82	84	83	82
IT Utilization (excl. trainees)	84	83	83	82	82	83	85	84	82
DSO - incl. unbilled	108	112	107	102	110	114	112	112	107
Borrowings (USD m)	363.2	353.3	316.0	288.5	296.1	311.4	288.9	326.7	280.0
Cash and Cash Equivalent (USD m)	1,228.7	1,089.8	1,251.8	1,401.4	1,216.0	1,066.5	1,154.0	1,164.3	1,378.0
Capital Expenditure (USD m)	27.7	21.3	31.6	29.2	29.4	31.1	31.8	26.9	26.0

Source: Company, MOFSL

Financials and valuations

Income Statement							(INR b)	
Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
Sales	225	265	291	308	347	369	381	426
Change (%)	19.4	17.9	10.0	5.6	12.9	6.1	3.5	11.7
COGS	151	183	206	215	234	260	270	297
SGA expenses	33	39	44	45	50	52	54	57
Total Expenses	184	222	250	261	284	311	323	354
EBITDA	41	43	42	47	63	57	58	72
% of Net Sales	18.3	16.1	14.4	15.3	18.2	15.5	15.2	17.0
Depreciation	6	8	10	11	11	14	16	18
Other Income	1	4	6	12	4	10	9	8
PBT	36	39	39	49	56	53	51	63
Tax	9	8	10	11	13	12	13	16
Rate (%)	26.5	20.9	25.4	22.4	22.4	22.0	25.5	25.5
PAT	26	31	29	38	44	41	38	47
Minority interest	0	0	0	0	0	-1	0	1
PAT before EO	26	31	28	38	43	43	37	46
Change (%)	-10.6	18.0	-7.4	33.9	13.1	-1.1	-11.9	22.9
Extraordinary Items (EO)	0	0	0	0	0	-2	0	0
Reported PAT	26	31	28	38	43	40	37	46
Change (%)	-13.2	16.7	-7.4	33.9	13.1	-6.2	-7.2	22.9

Balance Sheet							(INR b)	
Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
Share Capital	5	5	4	4	4	4	4	4
Reserves	118	141	160	184	198	214	235	266
Net Worth	122	146	164	188	203	218	240	271
Minority Interest	2	2	5	5	5	4	5	5
Loans	7	11	14	24	20	25	21	21
Other LT liabilities	4	5	10	5	3	28	29	29
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	148	176	205	235	243	287	307	338
Applications								
Assets	40	43	68	79	73	89	86	78
Investments	25	3	4	2	5	5	5	5
Other non-current assets	5	23	25	42	40	48	47	47
Curr. Assets	123	150	163	181	216	232	264	317
Debtors	70	80	78	90	99	116	105	117
Cash & Bank Balance	32	52	54	78	97	88	124	161
Other Current Assets	21	18	31	13	19	27	35	39
Current Liab. & Prov	51	48	56	70	91	87	96	109
Net Current Assets	72	102	108	111	124	145	168	208
Application of Funds	148	176	205	235	243	287	307	338

Financials and valuations

Ratios

Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
Basic (INR)								
EPS	27.8	35.4	32.5	43.2	49.2	46.3	42.9	52.7
Diluted EPS	27.0	34.5	32.0	42.7	48.8	45.9	42.6	52.4
Cash EPS	33.6	43.1	43.0	54.9	61.6	59.2	60.9	72.8
Book Value	127.1	164.3	185.0	211.8	230.1	235.6	273.1	308.0
DPS	6.0	12.0	9.0	14.0	14.0	15.0	15.0	15.0
Payout %	22.2	34.8	28.2	32.8	28.7	32.7	35.2	28.6
Valuation (x)								
P/E	23.9	18.8	20.4	15.4	13.5	14.3	15.5	12.6
Cash P/E	19.8	15.4	15.4	12.1	10.8	11.2	10.9	9.1
EV/EBITDA	14.9	12.8	13.1	11.4	8.0	9.6	8.3	6.1
EV/Sales	2.7	2.1	1.9	1.7	1.5	1.5	1.3	1.0
Price/Book Value	5.2	4.0	3.6	3.1	2.9	2.8	2.4	2.2
Dividend Yield (%)	0.9	1.8	1.4	2.1	2.1	2.3	2.3	2.3
Profitability Ratios (%)								
RoE	24.5	22.8	18.3	21.5	21.2	18.5	15.6	17.0
RoCE	19.7	17.2	13.4	14.2	18.5	13.1	11.5	13.5
ROIC	26.6	23.2	19.0	21.3	33.3	20.1	21.1	29.2
Turnover Ratios								
Debtors (Days)	113	110	98	107	104	115	101	100
Fixed Asset Turnover (x)	5.6	6.2	4.3	3.9	4.7	4.1	4.4	5.5
Leverage Ratio								
Debt/Equity Ratio(x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Cash Flow Statement

(INR b)

Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
CF from Operations	43	50	46	57	71	71	70	84
Change in Working Capital	-9	-5	5	17	11	-22	14	1
Other adjustments	-11	-13	-11	-11	-13	-12	-13	-16
Net Operating CF	35	45	41	63	69	38	72	69
Net Purchase of FA	-11	-9	-8	-21	-6	-30	-13	-9
Free Cash Flow	24	36	33	42	63	7	58	59
Net Purchase of Invest.	-10	2	-23	0	0	0	0	0
Net Cash from Invest.	-21	-7	-31	-21	-6	-30	-13	-9
Inc./ (Dec) in Equity	1	0	0	0	0	0	0	0
Proceeds from LTB/STB	-3	0	-4	9	-10	24	-5	-3
Dividend Payments	-2	-6	-12	-14	-15	-15	-15	-15
Cash Flow from Fin.	-5	-6	-16	-6	-24	9	-21	-18
Net Cash Flow	9	33	-6	36	39	17	38	41
Opening Cash Balance	36	32	52	54	78	97	88	124
Add: Net Cash	9	33	-6	36	39	17	38	41
Closing Cash Balance	32	52	54	78	97	88	124	161

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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