

# Stock Idea

Sector: IT & ITeS

August 14, 2020

## Tech Mahindra



Pressing all the right buttons

Sharekhan

by BNP PARIBAS



Powered by Sharekhan's 3R Research Philosophy



## 3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■

+ Positive = Neutral - Negative

## Reco/View

Reco:	Buy
CMP:	Rs. 696
Price Target:	Rs. 850

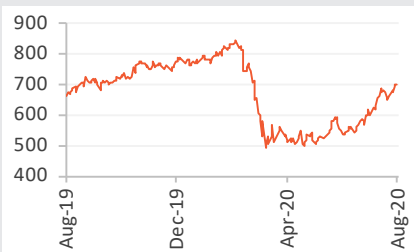
## Company details

Market cap:	Rs. 67,243 cr
52-week high/low:	Rs. 845/470
NSE volume: (No of shares)	48.7 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	62 cr

## Shareholding (%)

Promoters	35.8
FII	40.5
DII	14.0
Others	9.7

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	16.1	38.1	(16.6)	5.6
Relative to Sensex	12.3	12.0	(8.4)	4.2

Sharekhan Research, Bloomberg

## Summary

- Initiate coverage on Tech Mahindra (Tech M) with Buy rating and price target of Rs. 850, given potential 5G opportunity and anticipated rise in margins.
- Our positive stance underpins company's comprehensive capabilities in telecom space, improving capabilities in enterprise business and a better-go-to market strategy.
- Tech M has successfully transformed itself from a telecom-centric player to one with a wide portfolio of differentiated offerings in the enterprise segment.
- Key levers for margin improvements are (1) reduction in subcontracting expenses, (2) higher offshore mix, (3) better profitability of acquired entities and (4) exit from non-profitable operations.

Over the past decade, Tech Mahindra (Tech M) has successfully transformed itself from a telecom-focused player to a company with a wide portfolio of differentiated offerings in the enterprise segment. The company has improved its positioning in the enterprise business through a calibrated approach with respect to acquisitions (in terms of deal size, digital capabilities, exposure to verticals, etc), better go-to-market strategy and smart deal structuring with an outcome-based approach. Further, Tech M is well-placed to capitalise opportunities from three mega-trends i.e 5G, connected devices and telecom-media convergence, given its early investments in network capabilities, investments in IPs and platforms and investments/partnerships (Intel, Rakuten, AltioStar and among others) to develop an ecosystem play. Though COVID-19 has impacted network deployment, demand from consumers and supply chain management due to labour concerns, we believe that the fundamentals of the 5G business case remain largely intact. Further, the rise of the virtual workstation has created huge demands on robust communication networks, which has advanced the need for more robust 5G technologies and this would lead to significant boost IT spends in telecom space.

## Our Call

**Valuation: Attractive valuation:** Tech M is well-placed to benefit from the expansion of 5G value chain, across networks and IT services. We remain positive on Tech M on account of (1) an improving business mix, (2) potential 5G opportunity from higher exposure to telecom, (3) rising average deal sizes/number of deals in last seven quarters (though deal wins were weak in Q1FY2021, deal pipeline was highest in the last three years), and (4) differentiated/leadership positioning in certain segments of the enterprise business. The management guided sequential revenue growth from Q2FY2021 with improvement in margin. At CMP, the stock is trading at a reasonable valuation of 14x/11x of its FY2021E/FY2022E earnings. Hence, we initiate coverage on Tech M with a Buy rating and price target of Rs. 850.

## Key risk

(1) any ineffective integration may impact financial performance and distract management and management bandwidth; (2) rupee appreciation or/and adverse cross-currency movements might affect earnings; (3) Delay/loss of accounts in the enterprise segment; (4) Delay in pick-up of 5G-related spends.

## Valuation

Particulars	Rs cr				
	FY19	FY20	FY21E	FY22E	FY23E
Revenues	34,742.1	36,867.7	37,022.5	40,276.0	44,189.3
OPM (%)	18.2	15.5	15.0	16.7	17.6
Adjusted PAT	4,297.6	4,250.5	3,594.1	4,486.2	5,377.6
% YoY growth	13.1	-1.1	-15.4	24.8	19.9
Adjusted EPS (Rs.)	47.7	45.9	40.8	51.0	61.1
P/E (x)	14.6	15.2	17.0	13.7	11.4
P/B (x)	3.0	2.8	2.5	2.3	2.0
EV/EBITDA (x)	9.3	10.6	10.6	8.3	6.8
RoNW (%)	22.0	19.2	15.7	17.8	19.2
RoCE (%)	24.0	20.5	16.6	19.0	21.1

Source: Company; Sharekhan estimates

\* We now convert Tech Mahindra (Tech M) into a Stock Idea; it was earlier a 'Viewpoint' under our coverage

## Executive Summary

### 3R Research Positioning Summary

#### ■ Right Sector:

Higher spending on digital transformation would drive the Indian IT services industry's growth for next few years.

#### ■ Right Quality:

Tech Mahindra is India's fifth-largest IT services company. It is positioned as a leading player in the telecom space, while successfully realigning its focus on the enterprise vertical.

#### ■ Right Valuation:

The stock trades at a reasonable valuation (of 14x FY2022E EPS) given 5G opportunity, anticipated growth in enterprise segment and consistent payout.

### Valuation and return potential

- ◆ US\$ revenue/earnings expected to grow at 8.2%/22% CAGR over FY2021-23E.
- ◆ Stock trades at 14x/11x its FY2022E/FY2023E earnings; three-year mean multiple is 15x on one-year forward earnings basis.
- ◆ We initiate coverage on Tech Mahindra with a Buy rating and price target of Rs. 850 (based on 17x of FY2022E).

### Catalysts

#### Long-term triggers

- ◆ Strong play-out of 5G ecosystem
- ◆ Consistent margin discipline
- ◆ Improving large deal wins rate

#### Medium Term Triggers

- ◆ Vendor consolidation in telecom space
- ◆ Recovery in demand environment
- ◆ M&A activity in newer areas

#### Key Risks:

- ◆ Delayed pick-up in 5G related IT spends
- ◆ Client concentration
- ◆ Integration of acquired entities

### Earnings and Balance sheet highlights

- ◆ Tech Mahindra's US Dollar Revenue (USD) clocked a CAGR of 7% since 2015, ahead of the worldwide IT services spending growth.
- ◆ Diversifying business is a strategic focus area. It recently
- ◆ EBIT margin expanded to 15.5% in FY2020 from 14.4% in FY2017. FCF to PAT conversion stood at 246% in Q1FY21. Consistent payout, a way above its dividend policy of 20% of net profit.

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**Why we like IT services – higher digital adoption by enterprises to drive growth**

*The Indian IT industry is expected to accelerate from current level in the next few years given higher demand in areas such as digital channels, collaboration and workplace transformation, online learning and workforce analytics.*

**Industry overview**

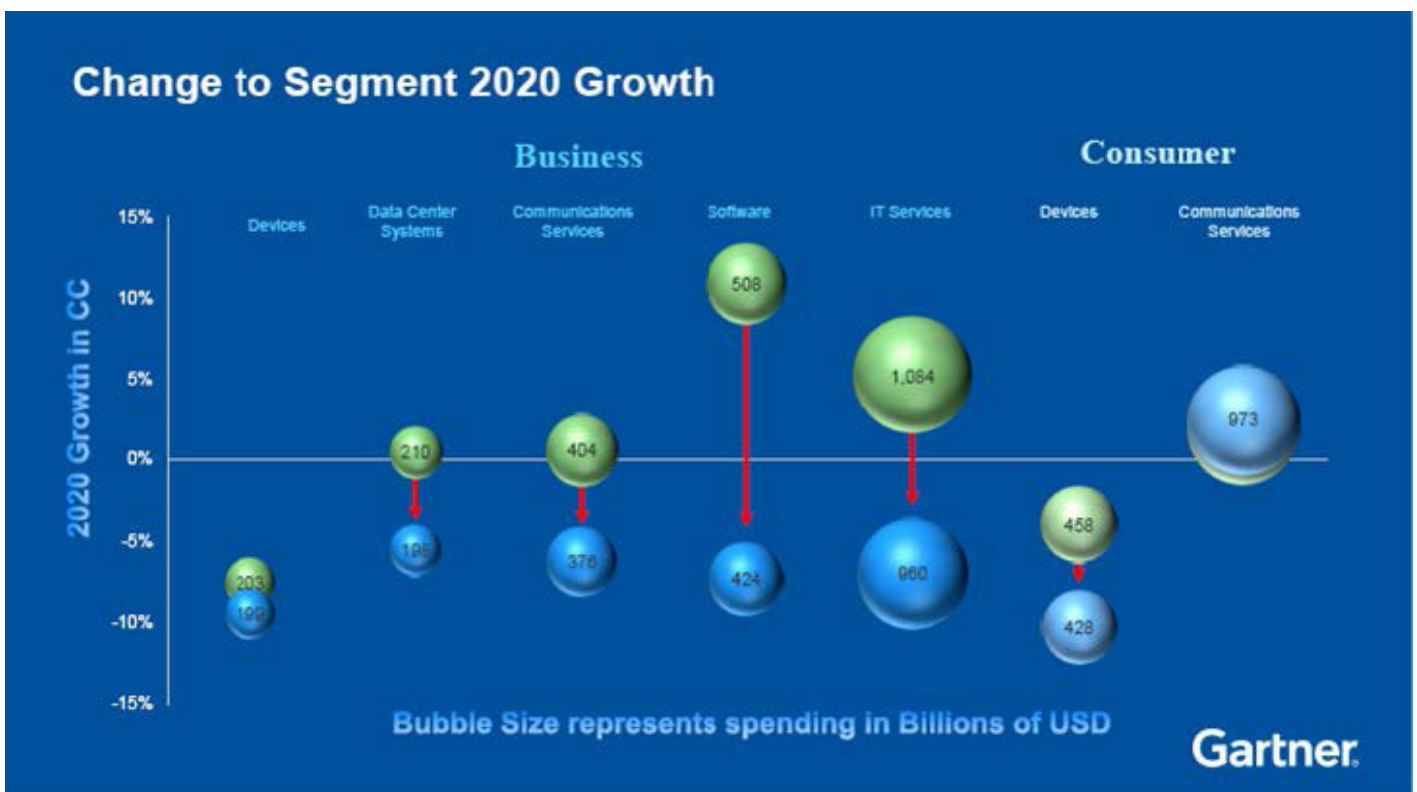
**Technology intensity rising steadily**

The implications from the outbreak of COVID-19 have accelerated digital activities among large global enterprises, leading to a rise in spending on workplace transformation and collaboration tools, cybersecurity and higher cloud migration. As technology is seen as a source of competitive differentiation in every industry and we believe that technology spend is expected to increase once the situation normalises. Further, higher online activity is driving higher technology spends in developed markets, which would drive outsourcing growth in India as the Indian IT industry has remained far more resilient as compared to global competitors and captive units of large enterprises and talent diversity.

While the coronavirus pandemic severely impacted demand for products and services across the globe, the Indian IT industry ensured continuity of critical client services by managing supply-side concerns and enabling work-from-home (WFH), increasing productivity, ensuring client business continuity and addressing security-related concerns.

Telecom spending is expected to be less impacted overall, as demand for broadband remains extremely strong, due to remote working, virtual team meetings and isolation measures. Gartner expects flattish growth in spending in the communication services segment for CY2020.

Revision to Garner’s IT spending forecast across segments

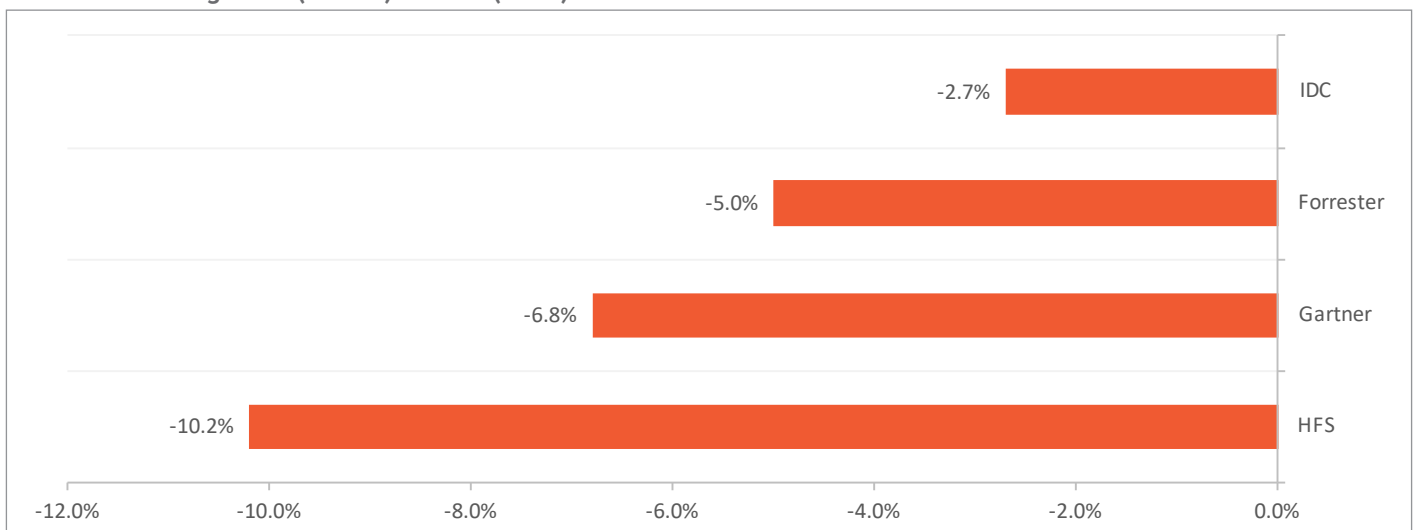


Source: Gartner

IT companies' managements indicated a rise in demand for digital engagements among large enterprises, though they also acknowledged reduction in discretionary spends in near-term and reduction in budgets of directly impacted verticals. Despite a recessionary environment, most managements of IT companies also indicated higher spending on transformational works in the BFSI vertical, led by large stimulus programs in developed markets and increasing fund distribution activities. However, directly-impacted verticals such as airlines, transportation, tourism, hospitality, non-grocery retail would hold their IT projects owing lower revenue and expect pricing discounts from vendors.

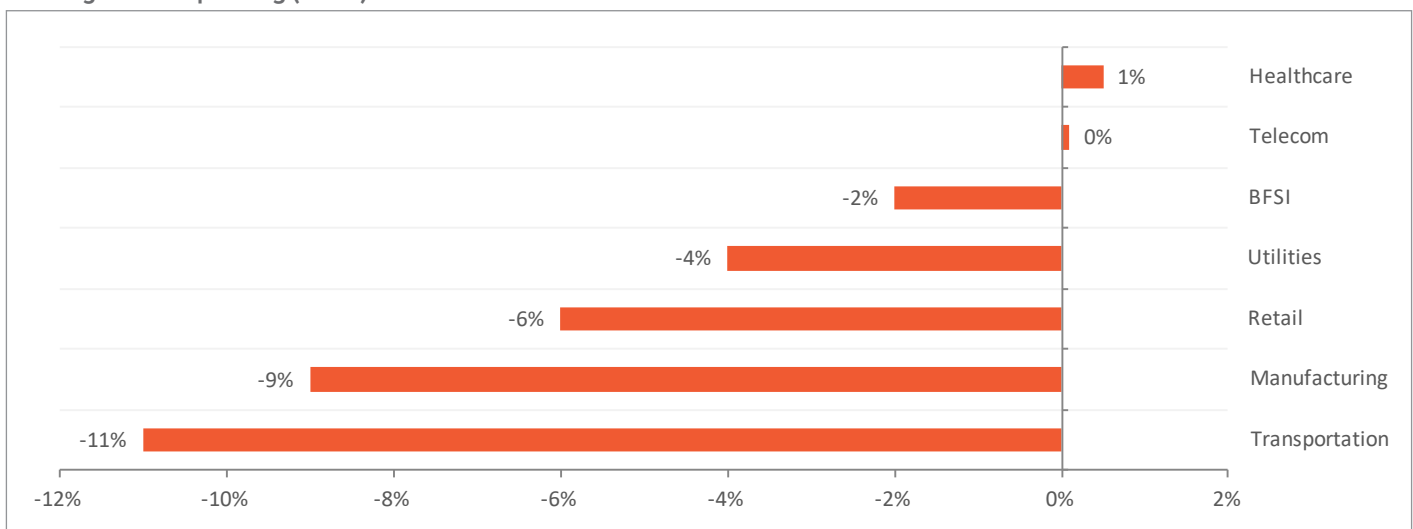
International Data Organisation (IDC) expects worldwide IT spending to decline by 2.7% in constant currency (CC) terms in CY2020 as COVID-19 forces global organisations to respond with contingency planning and spending cuts in the short term. IT spending on hardware, software and IT services is likely to decline by more than real GDP, as commercial IT buyers and consumers cut capital spending to adjust with declining revenues, profits, market valuations and employee headcount. Industry analysts have estimated IT services to decline in the range of 2-10% for CY2020 and subsequent recovery in CY2021 (except HFS' estimates).

**Global IT services growth/ (decline) forecast (CY20)**



Source: IDC, Forrester, Gartner, HFS, Sharekhan Research

**Industry-wise IT spending (CY20)**



Source: Industry, Sharekhan Research

The rising need for rapid access to data and automation will enhance focus on network equipment and communications, speeding up deployment of 5G networks and adoption of 5G equipment. The communications industry is one of the largest spenders on IT and Network Services, with evolving nature of spends as new technology is introduced. Historically, IT spends on communications have been cyclical.

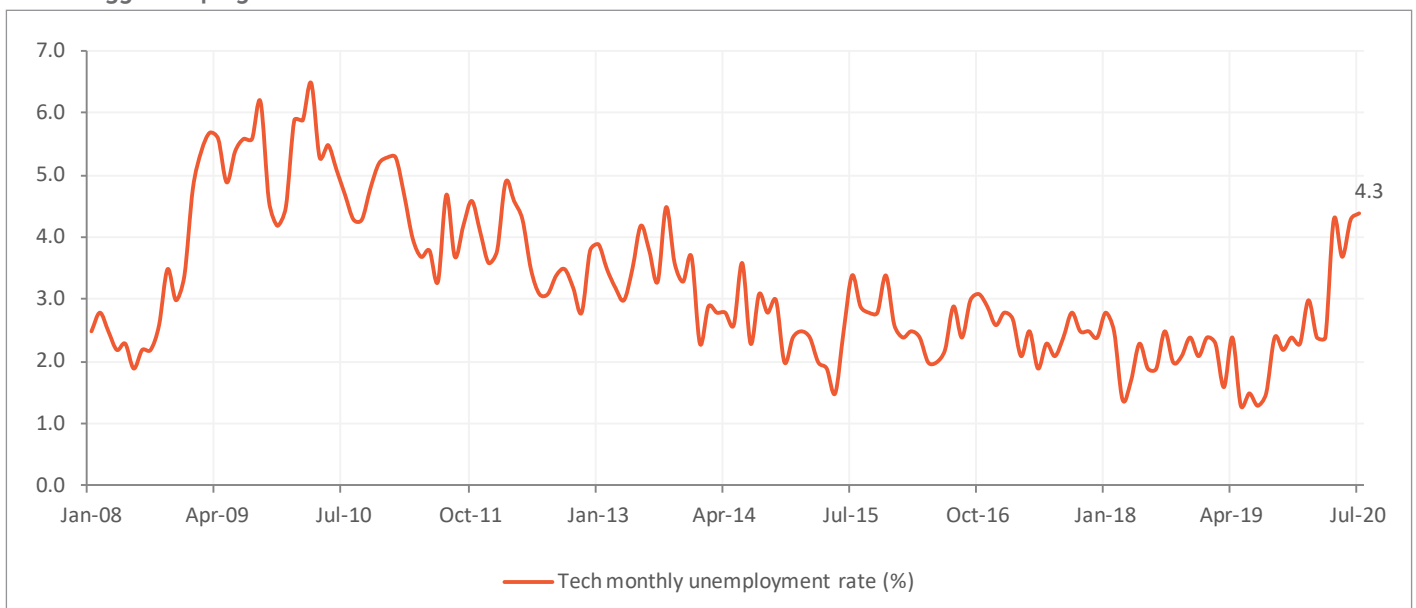
Unlike during the global financial crisis (GFC), we believe that the worst for the Indian IT industry is over. After a decline in revenue q-o-q in Q1FY2021, most managements of Indian IT companies have indicated that revenues would stabilise in Q2FY2021 and have hinted at a gradual recovery in revenue growth from Q3FY2021E onwards.

Globally too, both the US and UK were significantly affected by the pandemic. US GDP contracted by 32.9% in June 2020, while UK's GDP contracted by 20.4%. Though job losses are common during a recessionary phase, the unemployment rate in the technology space in the US has been low at 4.3%.

Industry analysts such as Gartner estimate that IT services spending would grow at around 5-8% over CY2021-24E compared to average of 4.2% achieved in CY2010-19. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients and increase in online adoption across verticals.

We believe the impact of COVID-19 on tech companies is relatively low on account of (1) low tech unemployment in the US, (2) increased spends by transformation initiatives (large deal wins across verticals), and (3) emergence of a new operating model for directly impacted verticals.

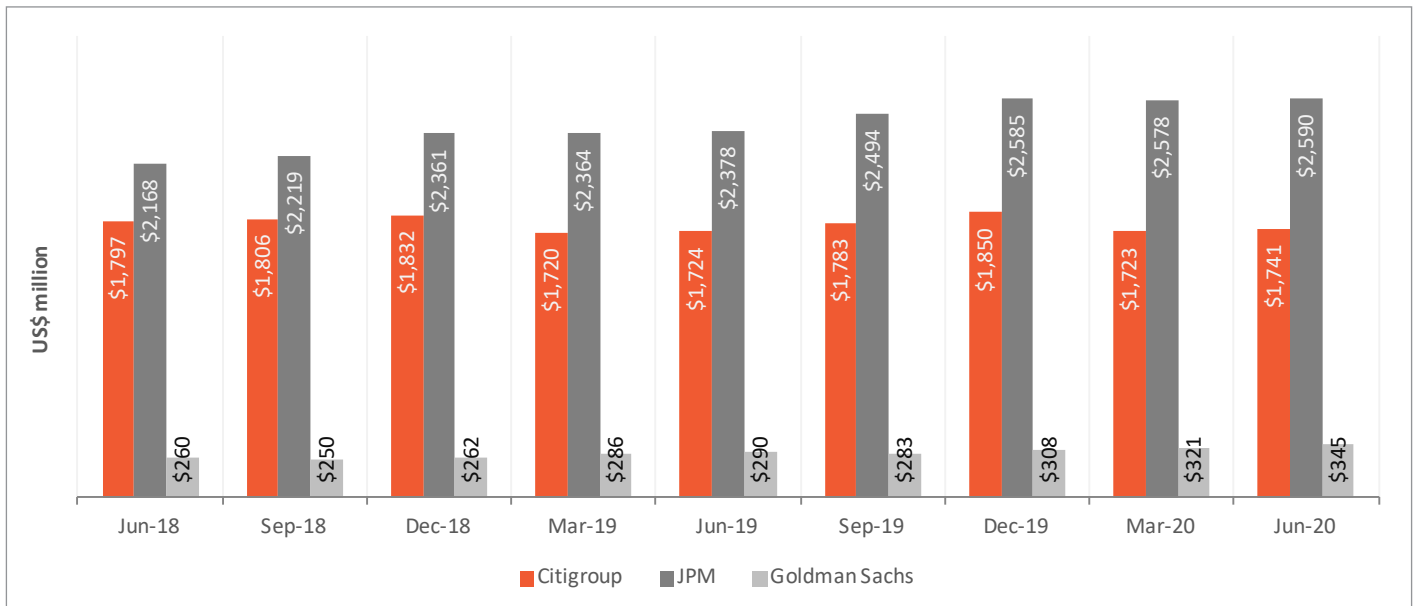
**Technology unemployment continues to remain low**



Source: US BLS, Sharekhan Research

The Banking, Financial Services and Insurance (BFSI) portfolio has been resilient for Indian IT companies, supported by increase in tech spend despite slowdown in enterprise revenue. BFSI tech spends are expected to be driven by (1) by investments in digital channels and platforms, (2) infrastructure modernisation or migration to hybrid cloud and (3) investments in security. Recent stimulus measures have improved the liquidity at large banks, which would support the demand for technological spends.

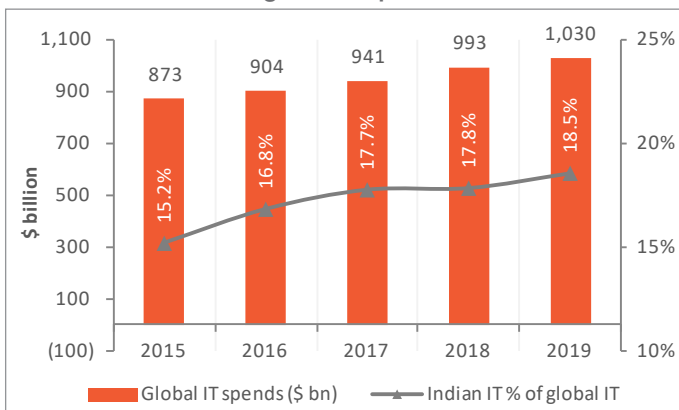
**Increase in BFSI technology spends despite slowdown**



Source: Companies, Sharekhan Research

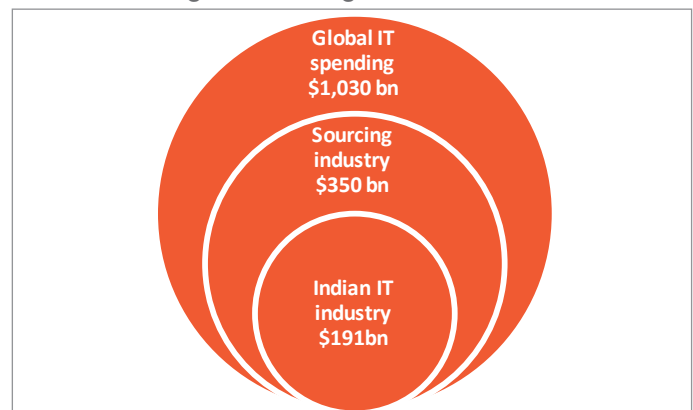
**Overview of Indian IT industry:** The IT-BPM industry is estimated to reach \$350 billion in revenues by 2025 from currently estimated revenue of \$191 billion. Of the US\$ 191 billion revenue, exports constitute ~77%, while domestic revenue contributes ~23%. Export revenue of ~\$147 billion is estimated to have grown by ~8% in FY2020.

**Indian IT forms ~19% of global IT spend**



Source: Gartner; Nasscom, Sharekhan Research

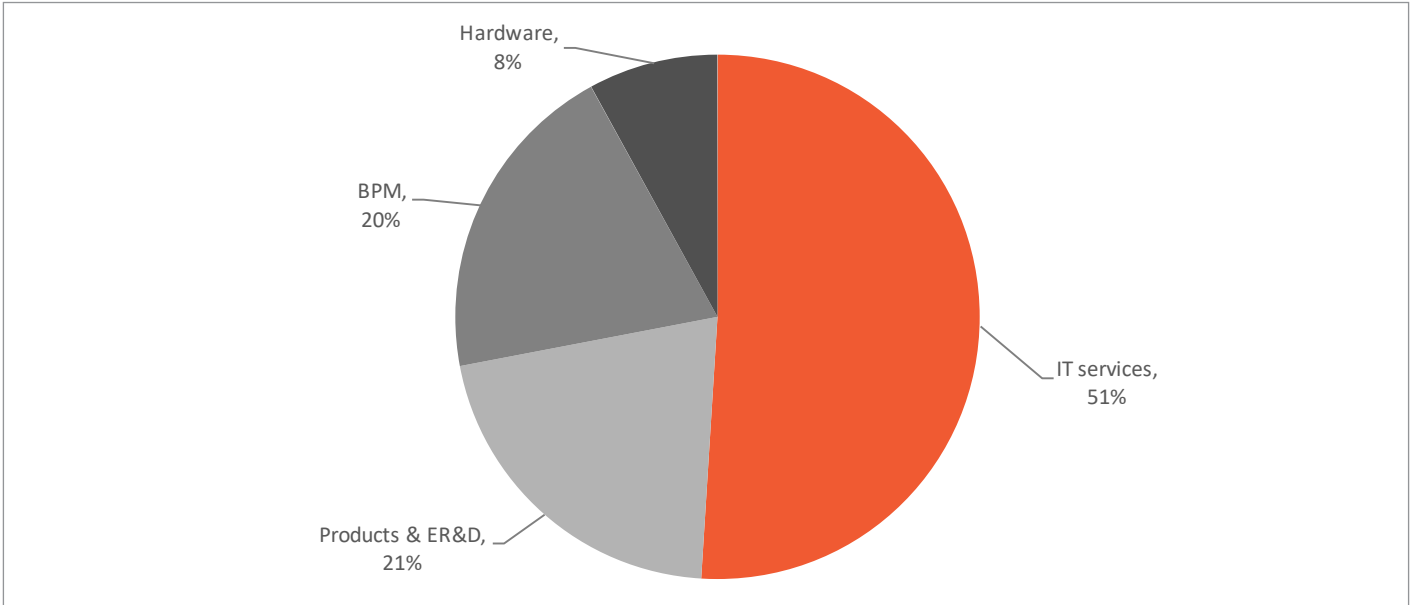
**India – a leading IT outsourcing destination**



Source: Gartner; Nasscom, Sharekhan Research

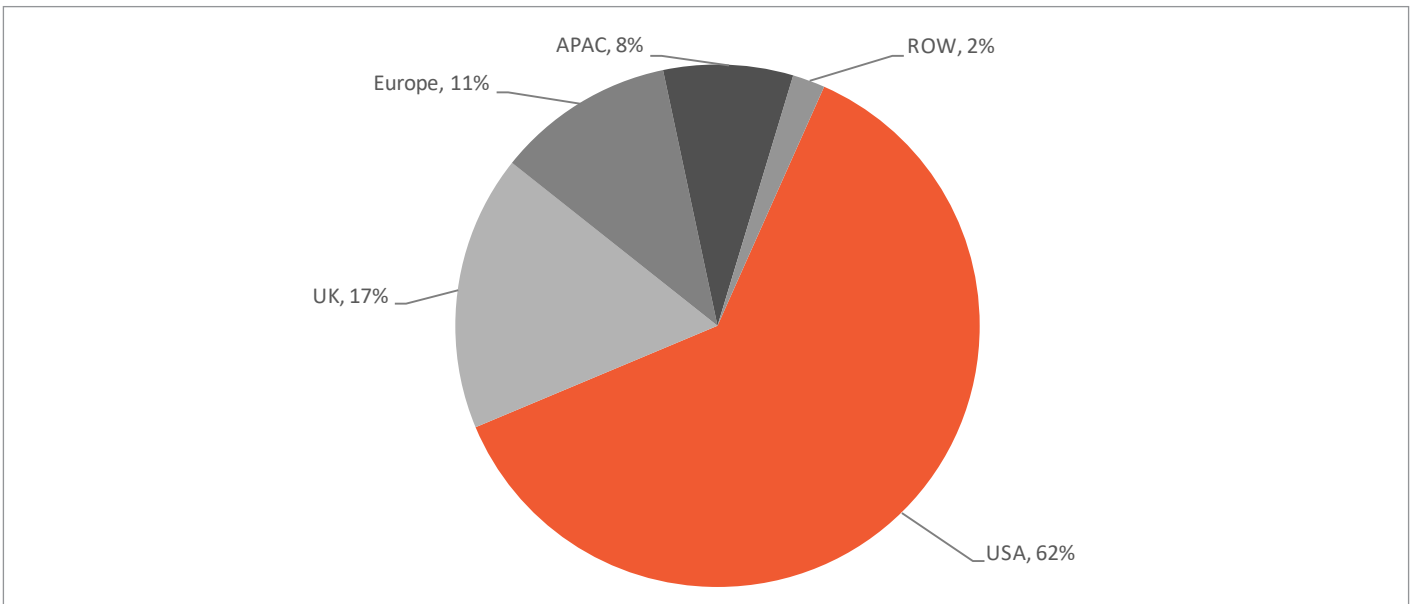
Indian IT industry is engaged with IT services, Engineering R&D, products and Business Process Management services. On region front, the US accounts for the largest chunk of India IT services revenue, followed by the UK, Europe, APAC, etc.

**Sector-wise breakup of Indian IT revenue**



Source: Gartner; Nasscom, Sharekhan Research

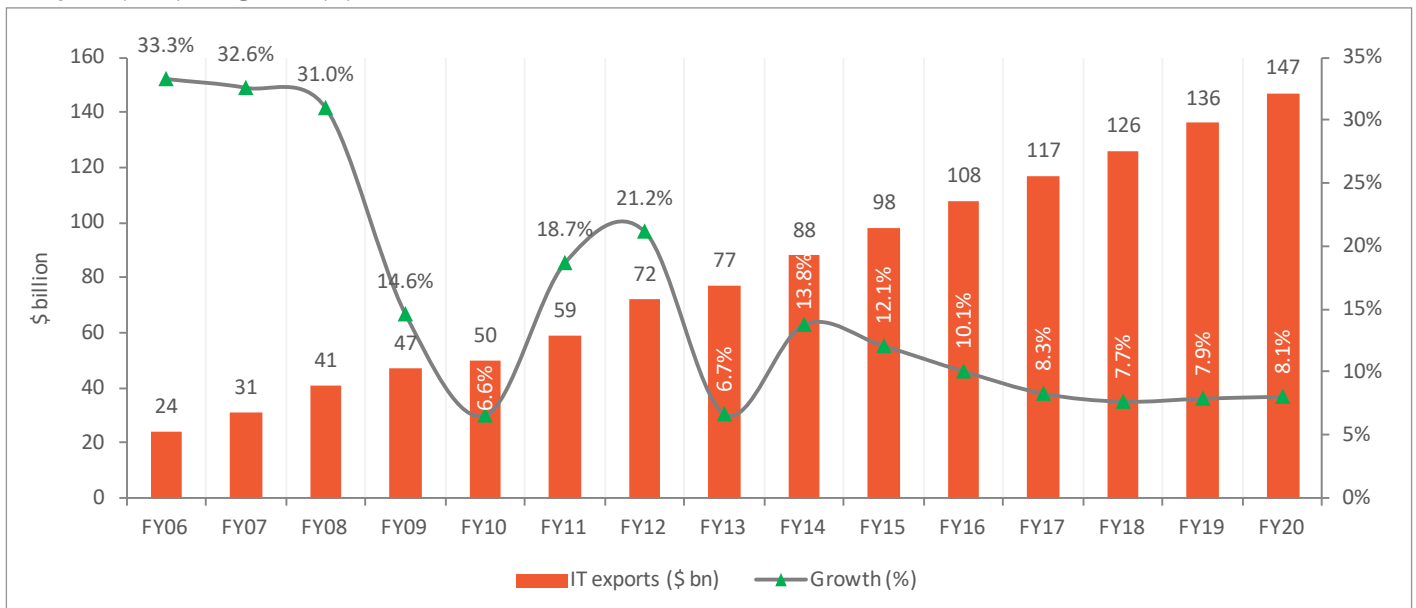
**Geography-wise breakup of Indian IT revenue**



Source: Gartner; Nasscom, Sharekhan Research

The Indian IT industry has delivered a consistent track record of market-share gains versus global IT companies, across market cycles and technological trends (ERP, IMS and digital/cloud). This reflects the strong competitive advantage of Indian IT companies. End-to-end service offerings, talent availability and strong relationships with marquee clients has helped the Indian IT industry to gain market share in global sourcing every year. The Indian IT industry has grown from \$4 billion in 1999 to current level of \$191 billion, accounting for ~55% of the global outsourcing market.

IT exports (\$ bn) and growth (%)



Source: Nasscom, Sharekhan Research

We believe that the demand for IT services would remain intact given the consumption of software as a percentage of GDP is increasing. A strong talent base, proven track record, portfolio depth across verticals and execution capabilities amid a challenging period supports our expectations of a continued gain in market share going ahead.

### Higher adoption of digital transformation to drive technology spending

India will remain the preferred destination for talent supply in the IT space and create a gradual shift of digital business from onsite locations. In CY2019, global spending on IT services grew by 4.8% y-o-y to \$1.04 trillion. Growth has led by a shift to digital technologies, adoption of DevOps and as-a-service models. Business Process Management (BPM) grew by 4.5% y-o-y driven by a greater focus on robotic process automation, as customers automate repetitive tasks and focus on strategic work.

Global economic growth is projected to shrink sharply from 3.3% in 2019 to -3% in 2020, much worse than during the global financial crisis. The COVID-19 outbreak has significantly affected economic activity in all major markets and caused material deterioration of demand. In the near term, enterprises are expected to reduce current investments, restructure IT budgets, request for price concessions, cut costs and conserve cash, which would affect global technology spending. However, most managements of Indian IT companies have indicated that the decline in revenue has bottomed out and they expect gradual recovery from Q2-Q3FY2021E onwards.

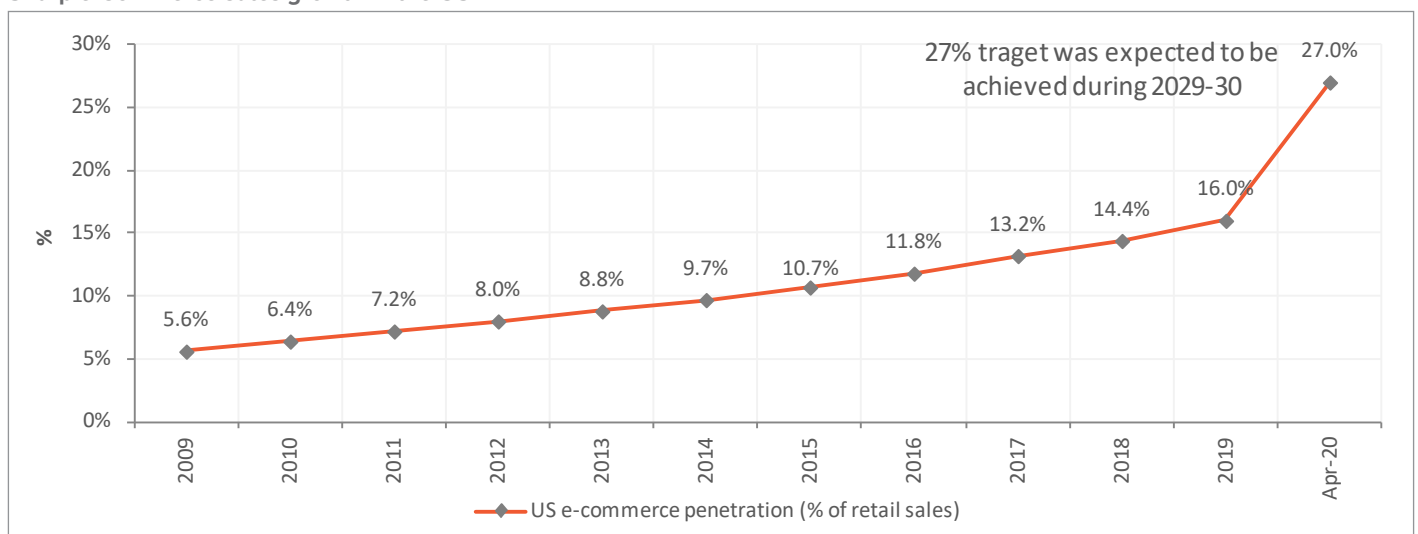
Over the last few years, Indian IT services companies have moved successfully to new areas of technology spending. IT services spending has been primarily focused on core transformation, industrialisation of digital services, cloud migration and adoption of artificial intelligence. Digital vertical currently constitutes 35-40% of the industry's revenues. Though there would be a reduction in technology spending in CY2020, we believe that

the Indian IT industry is expected to accelerate from current levels of ~3-7% over CY2011-19) given higher demand around digital channels, collaboration and workplace transformation, online learning and workforce analytics.

Enterprises are increasingly moving from large databases to cloud. This would enable the companies to become more agile and asset-light, which would help them to scale up. Further, it would significantly reduce costs incurred in having everything on-premises.

IT services space grew by 3-7% over 2011 to 2019, while a growth of 5-8% is expected over CY2021-24E. Growth in IT services would be driven by three factors - first, increased cloud migration; second, investments for better customer experience through online channel (Note that e-Commerce penetration in the US sharply rose from 16% at the end of 2019 to 27% as of April-end. The scale of adoption would drive technology spending as it requires seamless customer experience). The third area would be core transformation.

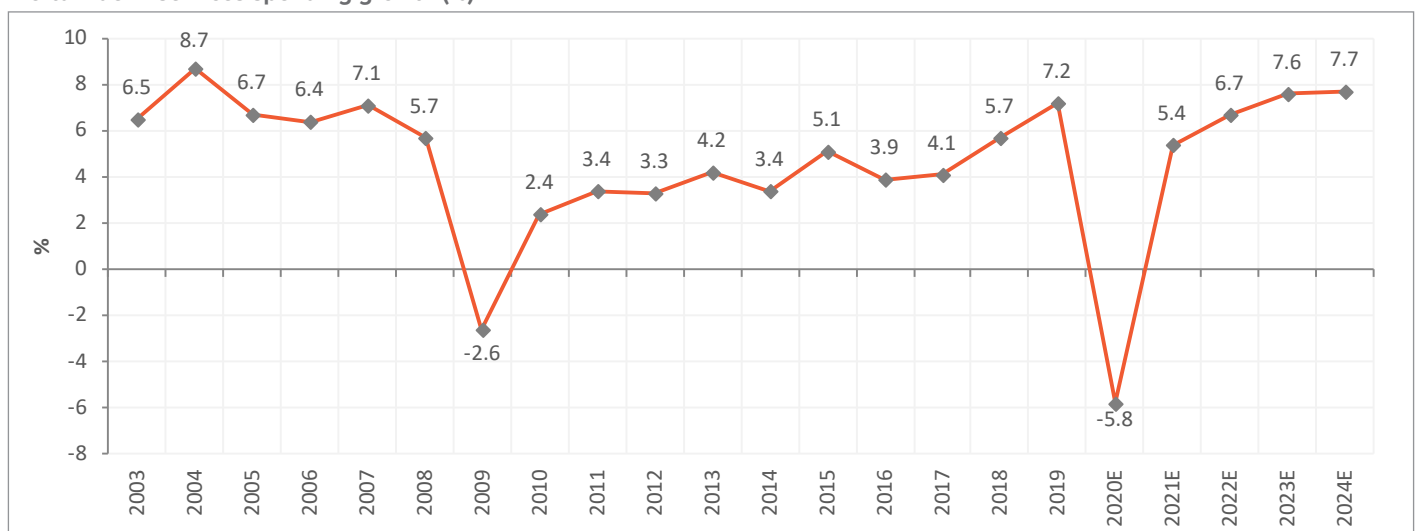
**Sharp e-Commerce sales growth in the US**



Source: Shawspring Research, Bank of America, US Department of Commerce  
\*E-commerce penetration (% of retail sales) witnessed a sharp increase in the last 8 weeks

Industry analysts such as Gartner estimate that IT services spending would grow at around 5-8% over CY2021-24E compared to average of 4.2% achieved in CY2010-19.

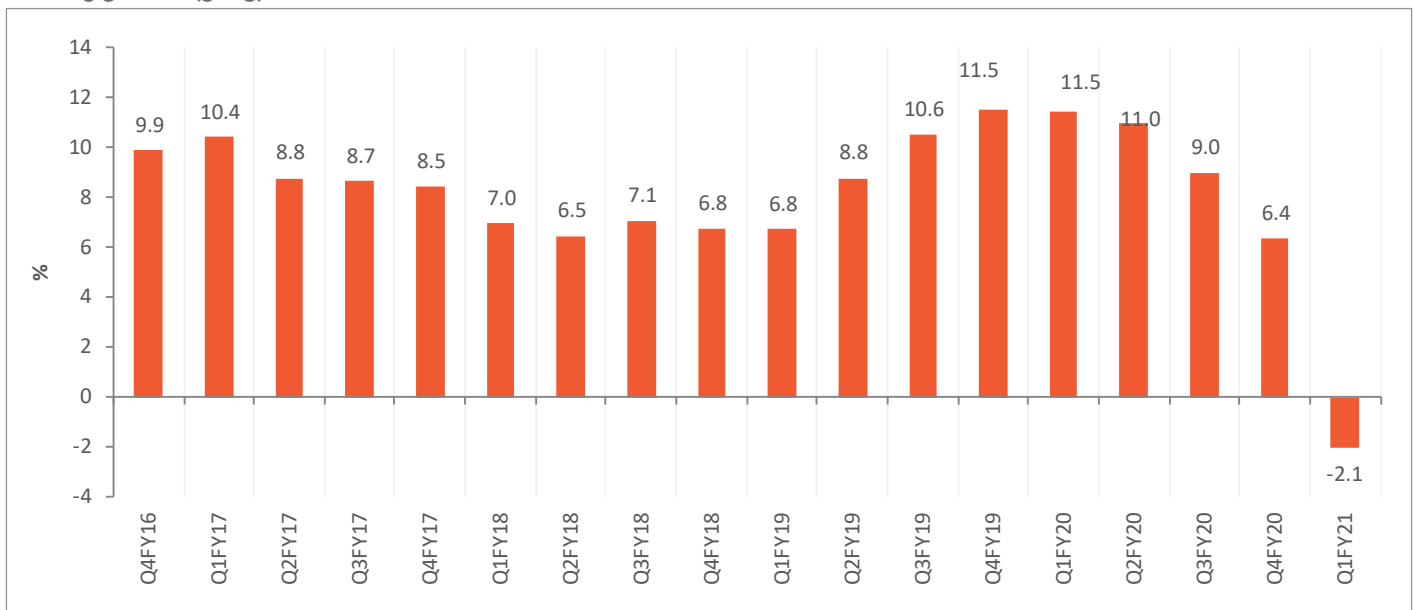
**Worldwide IT services spending growth (%)**



Source: Gartner, Sharekhan Research  
# growth rate in \$ terms till 2008 and in CC terms from 2009

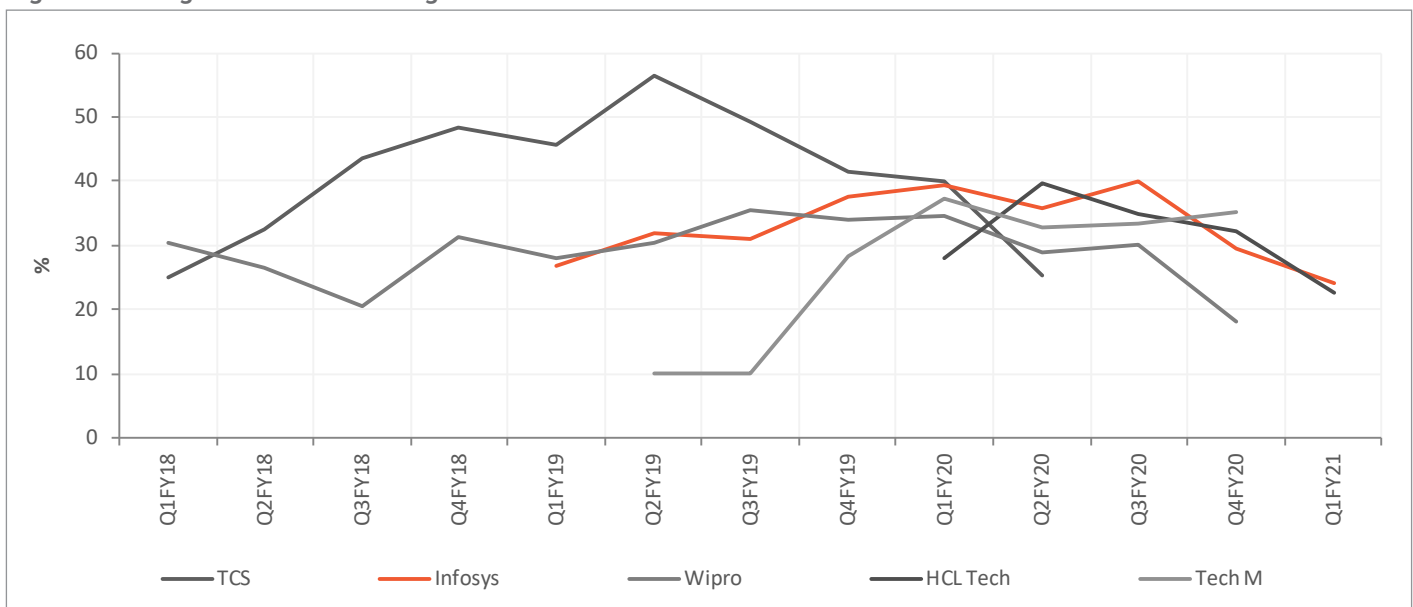
Tier-I IT companies' growth recovered from mid-single digits to double digits in the beginning of CY2019 on the back of acceleration in IT spending in digital technologies. Growth slowed in the last three quarters owing to a fall in spending in some verticals (including BFSI, retail, etc), client specific issues and supply-led challenges in the view of COVID-19. We expect fall in revenue declines to moderate/stabilise in Q2FY2021, followed by gradual recovery from Q3FY2021. We model strong acceleration of revenue growth for tier-I IT companies from FY2022E on the back of pent-up demand given underinvestment in technologies by enterprises in FY2021 and acceleration in spending around cloud migration, digital transformation, workplace transformation and virtualisation.

**Industry growth\* (y-o-y) moderated**



Source: Company; Sharekhan Research  
\*Industry includes TCS, Infosys, Wipro & HCL Tech

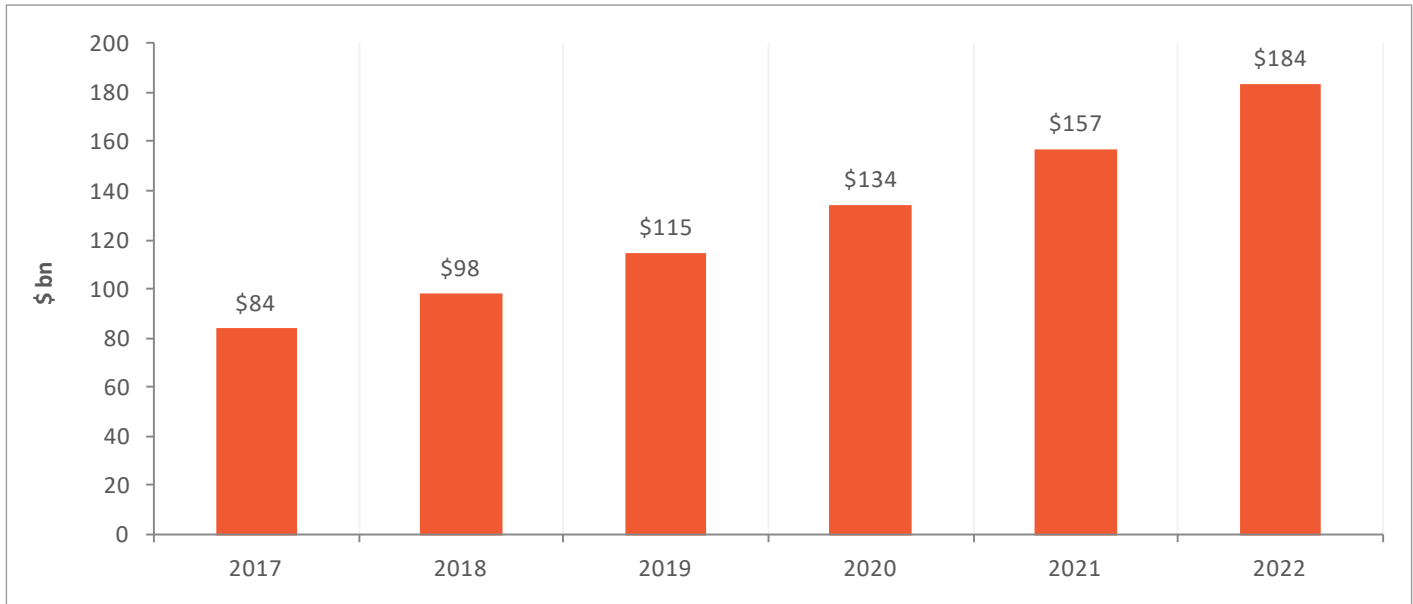
**Digital revenue growth has been strong**



Source: Company; Sharekhan Research

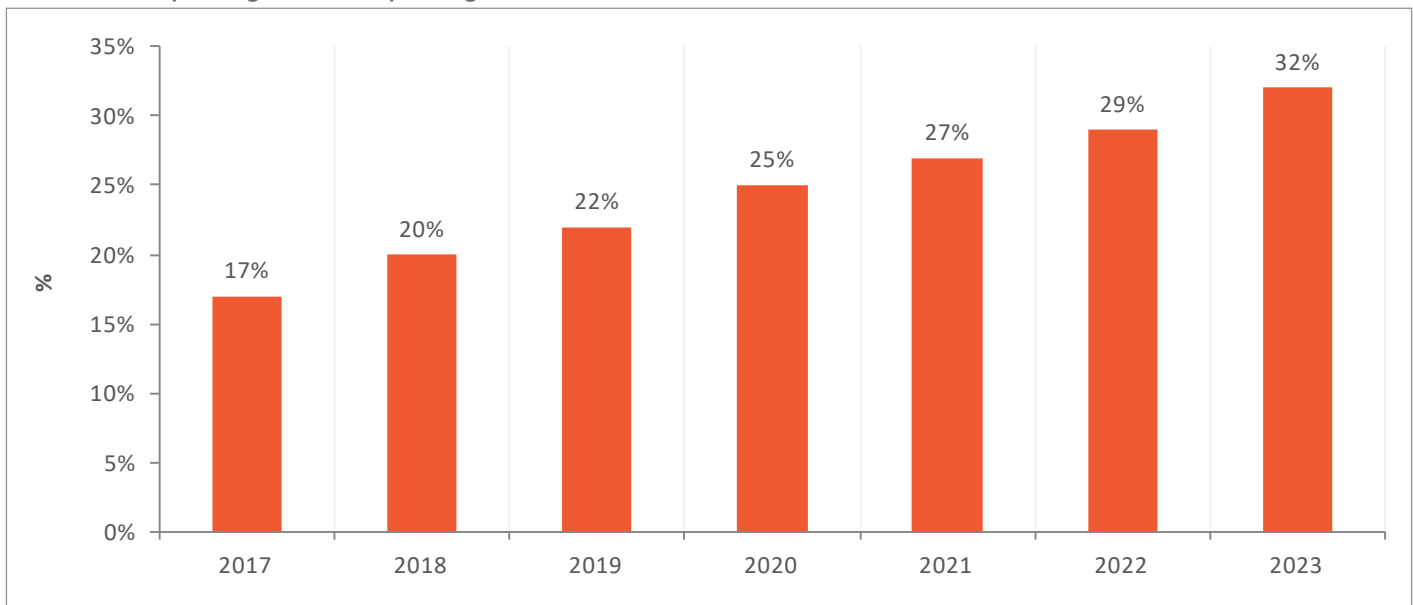
Gartner estimates that the cloud consulting and integration (C&I) services will double from \$98 billion in 2018 to \$184 billion in 2022 (17% CAGR) with migration at 70% of the market size. Overall cloud spending as a percentage of IT spending is rising rapidly.

**Cloud C&I services to double over 2017-22**



Source: Gartner, Sharekhan Research

**Overall cloud spending as % of IT spending**



Source: Gartner, Sharekhan Research

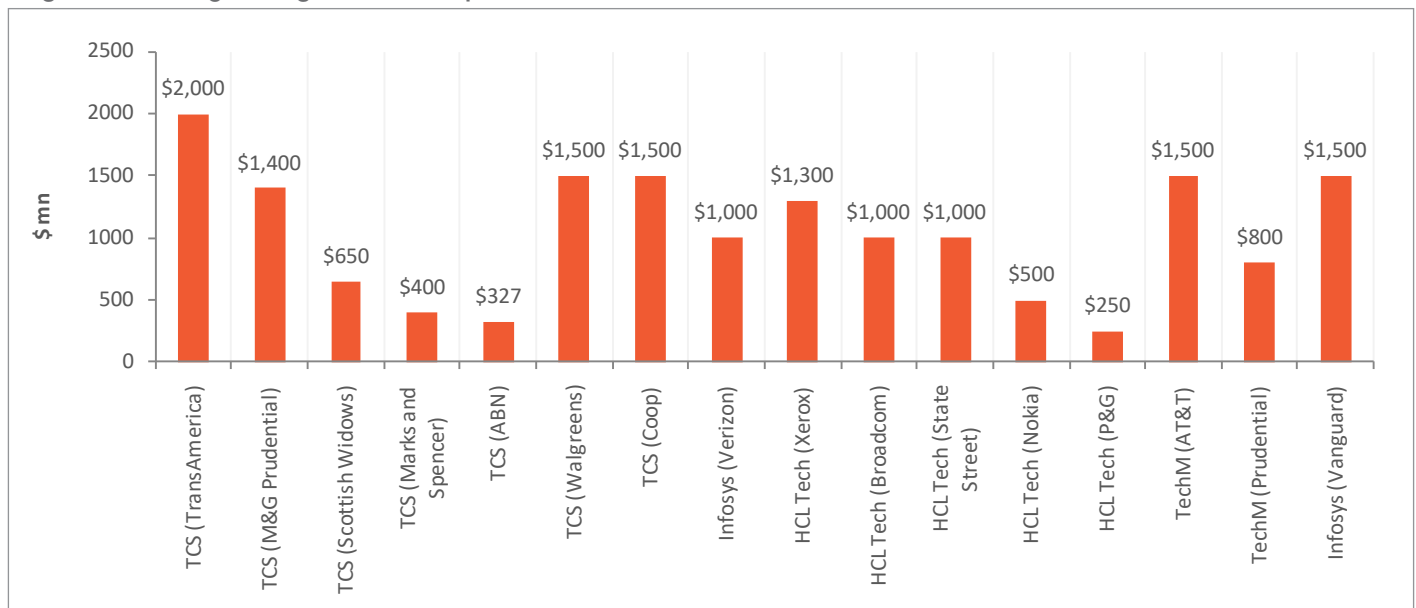
Artificial Intelligence (AI) has dramatically penetrated every industry vertical. The estimated value created by AI is projected to be at over \$13 trillion by 2030. IT vendors like Tech Mahindra have been preparing its workforce to lead and ride this wave of disruption by creating AI-powered solutions and platforms to address industry pain points.

### Large deal wins provide revenue visibility

Most Indian IT companies have seen deal wins rise in FY2020 despite a tough macro-environment including lower interest rates, Brexit, trade war and among others. Further, the leading Indian IT companies have emerged as preferred transformation partners among large enterprises. Large deal wins by IT companies indicates the availability of mega-deals and higher adoption of digital transformation. Continuous improvement in large deal wins and preferred digital transformation partner status give us comfort on secular growth of the industry, going ahead.

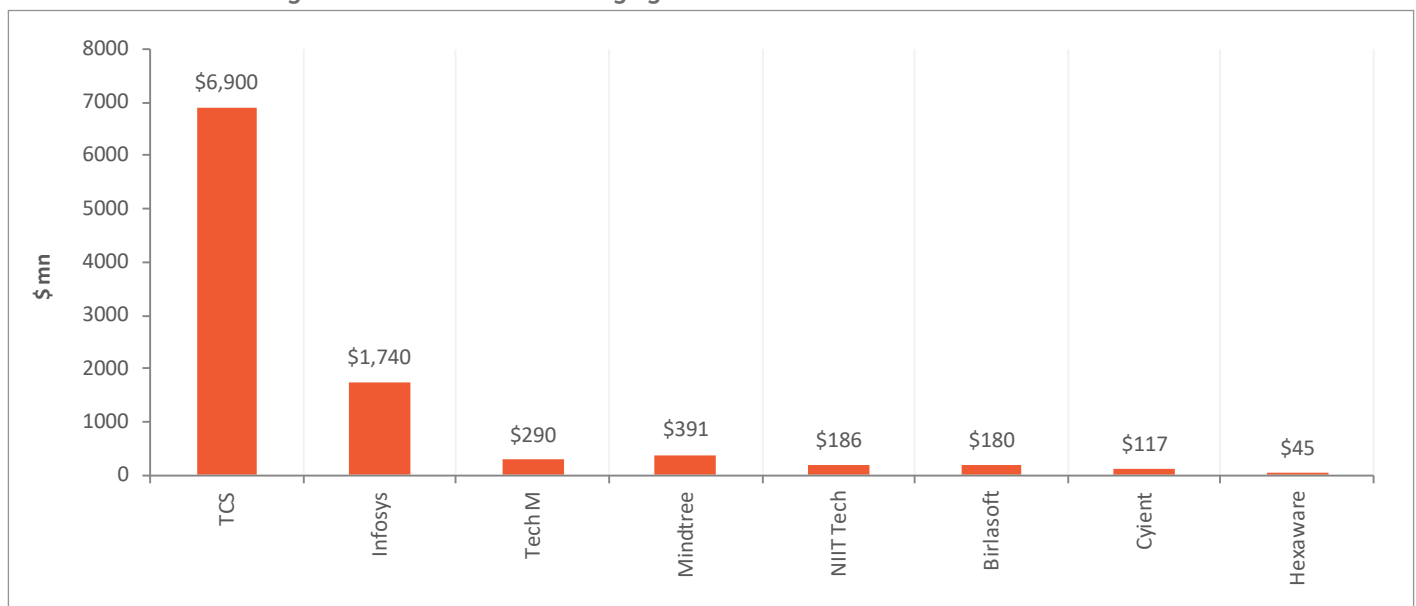
Mega deal wins began with TCS in 2017 and this trend has been seen for most leading Indian IT companies. Tech Mahindra secured two mega deals during Q2FY2020 and Q3FY2020.

### Large deals won by leading Indian IT companies



Source: Company; Sharekhan Research

### Deal wins remained strong in Q1FY2021 amidst challenging environment



Source: Company; Sharekhan Research

### Rise in demand to fast-forward adoption of 5G

The COVID-19 outbreak and the rise in remote operations across the globe have increased Internet usage, which has created huge demand for robust communication networks. Industry reports reveal that the overall average daily fixed broadband consumption per user in the US increased approximately 3 GB from January 2020. Further, enterprises will consider 'remote working' readily amid social distancing norms in the long run. We believe that a rise in remote working scenarios underpins the need for more robust 5G technologies in the US and this would significantly boost IT spends in the telecom space.

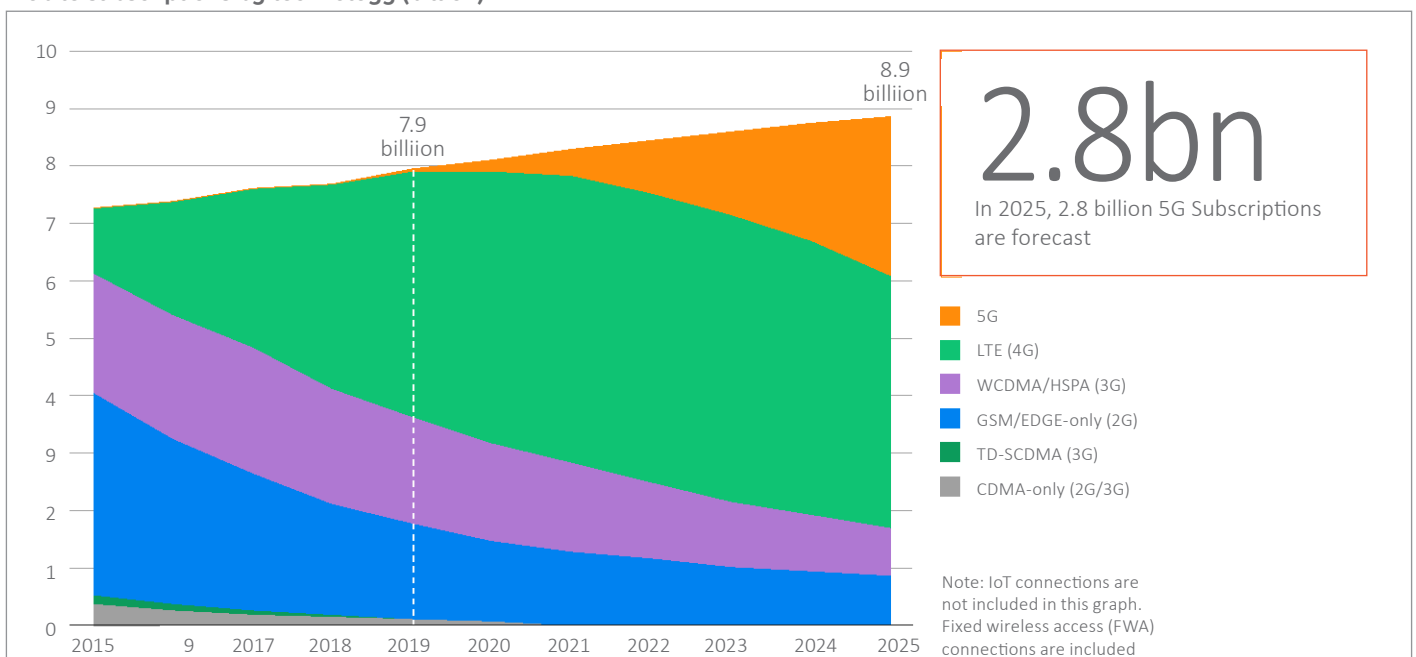
Further, 5G is likely to transform many routine activities into a connected world on the back of higher network speeds. The 5G technology will enable new business opportunities to potentially open up for telecom operators and will enable the offering of activities like Internet of Things (IoT), augmented reality, autonomous/connected cars, smart homes/cities, etc.

The 5G roll out is expected to bring huge opportunities for Indian IT companies (especially Tech Mahindra) as enterprises are expected to accelerate their spending around building architecture for 5G to gain momentum. Apart from telecom, we see opportunities for 5G adoption in manufacturing, healthcare, digital BSS (business support system that enables rapid delivery, monetization, and management of data services for fixed and mobile telecom), customer experience transformation, cloud transformation, network services and synergy between OEMs (original equipment manufacturers) and ODMs (original design manufacturers) segments.

Impending rollout of 5G networks by telecom players globally could create a \$667.9 billion market opportunity by 2026. We expect Indian IT companies would participate early given higher share of the software component in a 5G network and capability additions (versus 4G/3G cycle).

Despite uncertainty caused by COVID-19, service providers continued to switch on 5G, and 90+ operators have already announced commercial 5G service launches. Ericsson expects the global number of 5G subscriptions to top 190 million by the end of 2020 and 2.8 billion by the end of 2025. 5G will account for 30% of all mobile subscriptions by 2025.

**Mobile subscriptions by technology (billion)**



Source: Ericsson Mobility report; Sharekhan Research

Unlike earlier technologies, 5G would be largely about vertical applications such as connected vehicles/transport systems, factory automation and scale IoT connectivity on account of increased network speeds.

**Download speed**

Generation	2G	3G HSPA+	4G	5G
Max Speed	0.3Mbps	42Mbps	150Mbps	1-10Gbps
Average Speed	0.1Mbps	5Mbps	10Mbps	50Mbps and above

Source: Digital Trends June 2020

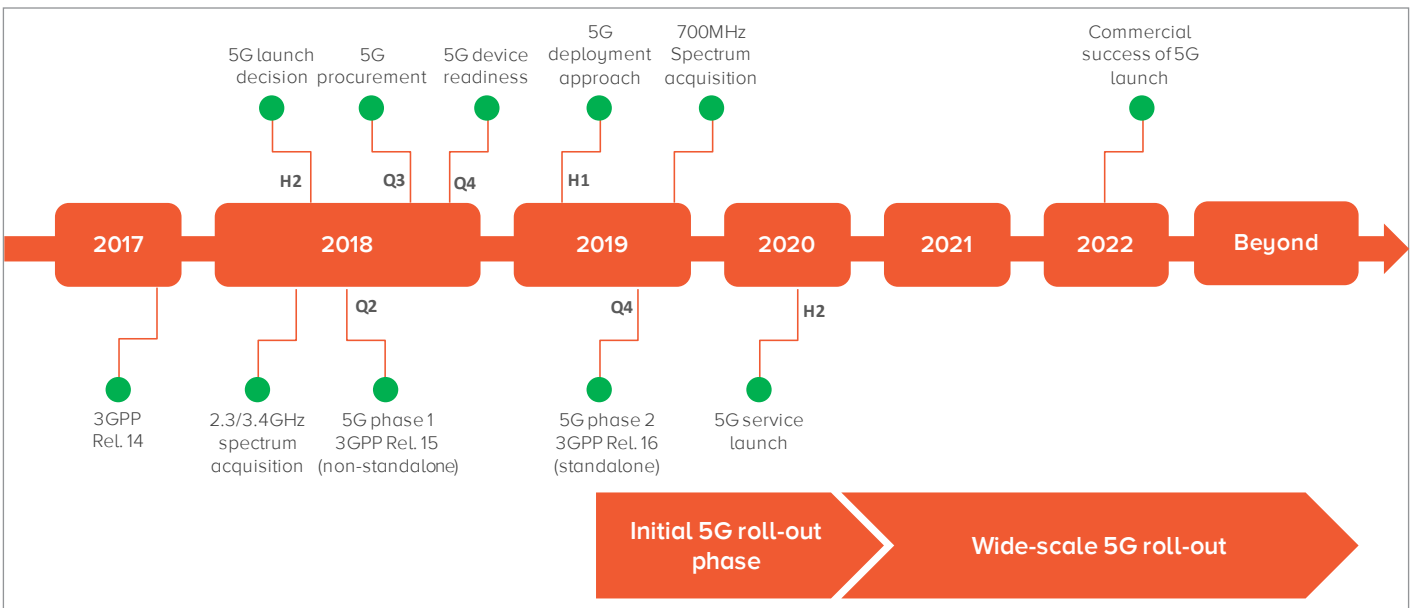
**Latency time**

Generation	3G	4G	5G
Latency	100-500ms	20-30ms	<10ms

Source: Raconteur

The roll-out of 5G by communication service providers (CSPs) has been delayed by 5-7 months due to a mix of reasons – COVID-19 impact, restrictions on Huawei and delays in spectrum auctions. Large dependence on enterprises and CSPs for 5G adoption coupled with high capex of 5G investments could lead to staggered rollout of 5G across countries.

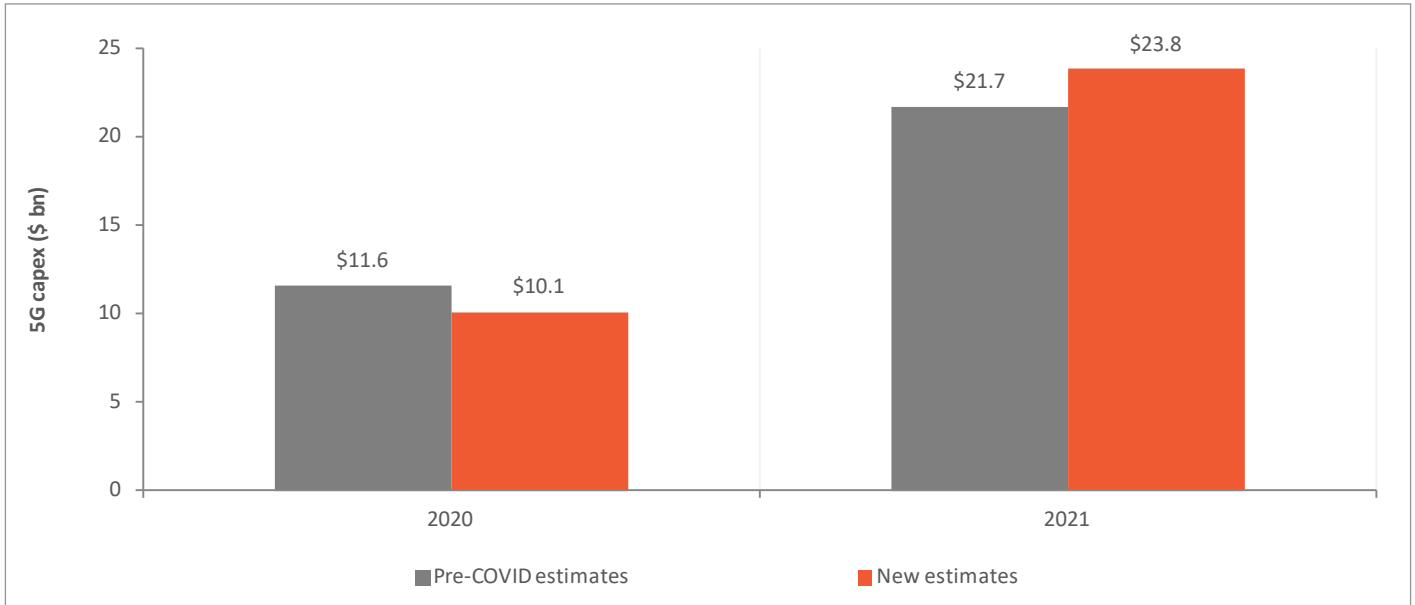
**Timeline for 5G!!**



Source: Analysys Mason, Sharekhan Research

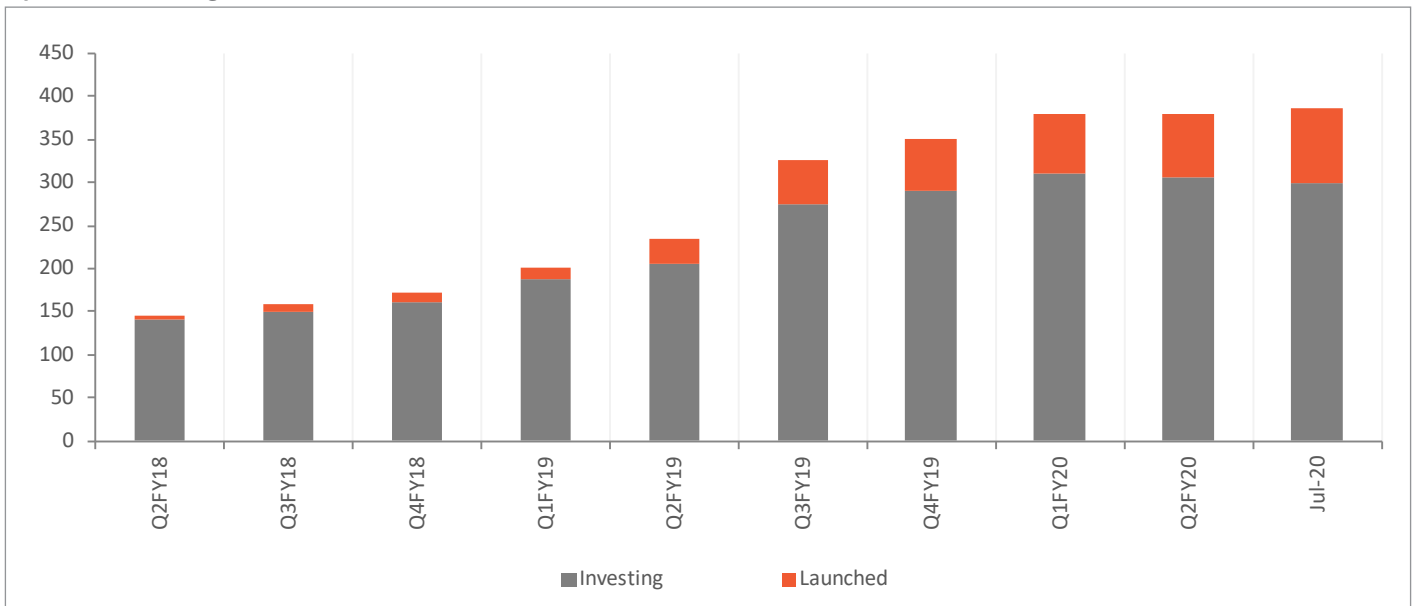
Though COVID-19 has impacted network deployment and demand from consumers and supply chain management due to labour concerns, we believe that fundamentals of the 5G business case remain largely intact. Hence, 5G roll-outs will be disrupted in the short term, including delays in spectrum auctions and standards. It is estimated that 5G capex will start to bounce back in Q4CY2020. However, mobile capex is expected to decline sharply further and some non-5G investment will be permanently lost as operators intensify their efforts to capitalise on their existing assets.

**Worldwide 5G-related network capex (2020-21)**



Source: Analysis Mason, Sharekhan Research

**Operators investing in 5G & launched commercial services**



Source: GSA, Sharekhan Research

## 5G network status update

- ◆ There are 92 commercial 5G networks in 38 countries
- ◆ Nearly 392 operators in 126 countries/territories have announced about their investments in 5G
- ◆ 115 operators had announced they had deployed 3GPP compliant technology in their live networks.
- ◆ Of those, a total of 92 operators in 38 countries/territories had launched one or more 3GPP-compliant 5G services.
- ◆ 37 operators had launched 3GPP-compliant 5G FWA or home broadband services

Around 181 5G trials in the 28 member states of the European Union as of December 2019, and 222 trials including Russia, San Marino, Norway, Turkey and Switzerland.

### Major European 5G trails

Country	Date of Announcement	Operators	Manufacturers
Austria	Feb-18	T-Mobile	Huawei
	Dec-16	3	ZTE
	Jul-18	3	ZTE
Belgium	Apr-18	Proximus	Huawei
	Jun-17	Telenet	ZTE
	Nov-16	Proximus	Huawei
	Sep-18	Orange	Nokia
	Feb-20	Proximus	-
France	Jul-18	Bouygues Telecom	-
	May-18	SFR	Nokia
	Feb-18	Bouygues Telecom	Huawei
	Feb-18	Orange	-
	Jan-19	Bouygues Telecom	Ericsson, Qualcomm
	Feb-19	Orange	Samsung
Germany	Jun-20	Deutsche Telekom	-
	Apr-16	Telefonica	Ceragon, Ericsson, Huawei, NEC, Tech Mahindra, wipro
Switzerland	Dec-19	Swisscom	Ericsson
	Nov-18	Swisscom	Ericsson, Qualcomm
	Mar-18	Swisscom	Ypsomed
Russia	Mar-20	MTS	Ericsson
	Sep-16	MTS	Samsung
	Sep-19	Beeline	Huawei
	Sep-19	Tele2	-

Source: 5gobservatory.eu, Sharekhan Research

As per industry reports, the 5G technology is now live in 24 markets globally. The cutting edge network tech is capable of supporting speeds up to 100x faster than LTE/4G and delivering latency of just a few milliseconds. Further, it is being able to connect many more devices per cell site. South Korea, China, and the United States are the countries that lead the world in building and deploying 5G technology. Telecommunications operators including AT&T Inc., KT Corp, and China Mobile have been racing to build the 5G wireless technology. Countries like Sweden, Turkey, and Estonia have taken significant steps to make 5G networks commercially available to their citizens.

### The 5G ecosystem is taking shape

5G in the US	
<b>Verizon</b>	<ul style="list-style-type: none"> <li>As of June 2020, 5G offered in 35 locations (mostly cities)</li> <li>Managed to obtain speeds of upto 1.4Gbps in Chicago</li> <li>Coverage is patchy because of Verizon's use of low-area mmWave Tech (28Ghz and 39Ghz spectrums)</li> </ul>
<b>T-Mobile</b>	<ul style="list-style-type: none"> <li>Uses 28Ghz mmWave frequencies but the broader expansion also includes sub-600Mhz frequencies which cover more area</li> <li>In December 2019, company made a big launch and claims to cover 1 million sq miles of US and reach 60% Americans</li> <li>5G Mobile lineup offered: Samsung Galaxy S20 series, LG V60 ThinQ and OnePlus 8 5G</li> <li>After the merger with Sprint, T-mobile brought 5G to all 50 states</li> </ul>
<b>Sprint</b>	<ul style="list-style-type: none"> <li>Beginning in April 2020, Sprint customers began getting access to T-Mobile 5G</li> </ul>
<b>AT&amp;T</b>	<ul style="list-style-type: none"> <li>Currently, AT&amp;T offers true 5G in 190 markets</li> <li>Initially, the carrier burned consumer confidence by hyping 5Ge or 5G Evolution which was just a souped up 4G service</li> </ul>
5G in the UK	
<b>EE</b>	<ul style="list-style-type: none"> <li>First carrier to launch 5G in UK on May 30 2019</li> <li>As of June 2020, coverage available in 80 towns and cities</li> <li>Just like US, 5G covers some but not all areas in each city</li> <li>Company promised 1Gbps speed but 200-400Mbps range was observed</li> <li>EE has 12 5G mobile devices on offer</li> </ul>
<b>Vodafone</b>	<ul style="list-style-type: none"> <li>Launched 5G on July 2019 in seven cities</li> <li>As of June 2020, offers 5G in 44 places</li> <li>5G roaming offered in select locations which other carriers in UK don't offer</li> <li>7 5G smartphones offered</li> </ul>
<b>Three</b>	<ul style="list-style-type: none"> <li>As of June 2020, offers 5G in parts of 66 locations</li> <li>Offers 5G as standard in all of its plans</li> </ul>
<b>O2</b>	<ul style="list-style-type: none"> <li>Launched in October 2019</li> <li>As of June 2020, offers 5G in 60 locations</li> </ul>

5G in Australia	
Telstra and Optus	<ul style="list-style-type: none"> <li>Telstra launched 5G in May 2019 with 10 major cities with a patchy network</li> <li>Coverage is steadily increasing for both Telstra and Optus</li> </ul>
Vodafone	<ul style="list-style-type: none"> <li>Has said that it will have “widespread availability” of 5G at some point in 2020</li> </ul>
5G in South Korea	
SK Telecom Co., KT Corp. and LG Uplus Corp	<ul style="list-style-type: none"> <li>South Korea rolled out the world’s first commercial 5G network on April 3, 2019, with the nation’s three carriers</li> <li>The Korean government recently said that local operators had already deployed over 115,000 5G base stations across the country.</li> <li>The three major telecom operators had agreed to invest \$3.4 billion in their 5G networks during the first half of this year</li> <li>As of July 2020, the total 5G subscribers in the country was near 7 million</li> <li>The country has also tested Vo5G and plans to deploy standalone 5G service</li> <li>World’s first 5G augmented reality (AR) glass was launched in South Korea in August 2020</li> </ul>
5G in Brazil	
Claro	<ul style="list-style-type: none"> <li>Claro announced that it will start offering 5G services in limited areas</li> <li>Claro launched its 5G network using a combination of 700MHz, 1800MHz and 2.5GHz spectrum.</li> <li>Testing of DSS (Dynamic Spectrum Sharing by Ericsson) technology began in October 2019</li> <li>Brazilian telecommunications regulator Anatel expects to hold an auction to award 5G spectrum by the end of 2020</li> <li>Ericsson has announced investment of \$240 million in building a 5G assembly line in Brazil</li> <li>Because of US pressure on Brazil, Huawei has delayed its plans for Brazil</li> </ul>
5G in Japan	
Docomo/Softbank Mobile/KDDI	<ul style="list-style-type: none"> <li>Rakuten Mobile, expects to cover all the country’s population with its mobile service in 2021</li> <li>DOCOMO targets nationwide 5G coverage by 2023</li> <li>Three carriers plan 5G services launch by end-2020 (Docomo, Softbank Mobile, KDDI dominate the market)</li> </ul>
5G in Canada	
Bell Canada/ Rogers communication/ Telus	<ul style="list-style-type: none"> <li>Bell Canada launched 5G in June 2020 and expects to add 28 additional markets this year</li> <li>Rogers communication has launched 5G in Canada with Ericsson</li> <li>Speeds upto 1.7Gbps is promised by Bell Canada</li> <li>The government confirmed that the auction for 3.5Ghz band is now scheduled to start on June 15, 2021.</li> <li>Provider Telus has also launched 5G with the help of Nokia, Ericsson and Samsung</li> </ul>

Source: Sharekhan Research

Unlike earlier standards, 5G standards include performance metrics for the number of simultaneously connected devices. 5G is expected to accelerate the adoption of the Internet of Things (IoT) and the Industrial Internet of Things (IIoT) given its high connection density, low latency and low device power consumption. This could create a significant market opportunity for the Indian IT services companies.

Trends and opportunity in Telecom vertical



Source: Company, Sharekhan Research

Delivering reliable new/transformational services in the 5G network requires a new network management approach. Network slicing helps telecom companies incorporate and optimise multiple parameters such as bandwidth and latency with service delivery by assigning only one type of service per slice, e.g. video on demand or connected homes. Hence, telecom players or service providers need to have systems in place to monetise different customised services they provide to their clients.

IT services for communications services Providers, worldwide – Tech M is a leader



Source: Gartner

**Medium-term catalysts:** 5G roll-out, recovery in demand, vendor consolidation in telecom space

**Long-term triggers:** Improving pace of large deal wins, higher adoption of 5G ecosystem

**Why we like Tech Mahindra – well invested to benefit from increasing spends in telecom domain**

*Tech Mahindra (Tech M) is positioned as a leading player in the telecom vertical and is well-positioned to capture 5G-related spending from telecom service providers. Further, a focused acquisition strategy to strengthen its digital offerings and large deal wins provide growth visibility going ahead.*

**Investment arguments**

**Best-placed to derive opportunities from 5G; expect material benefits from 5G in FY2022**

With a leadership position in the communications space (accounts for ~40% of total revenue) and preferred partner for leading players in the communications service space, Tech M is well-placed to capture 5G-related spends from telecom service providers and OEMs. Given its end-to-end solutions in the telecom space, we believe Tech M is one of the strong contenders in winning large deals in telecoms. Further, its partnerships/investments with software-defined network (SDN)/network function virtualization (NFV) vendors (AltioStar/LCC) and early rollouts with Rakuten will provide cross-sell and up-sell opportunities. We believe that telcos are likely to have big opportunities to monetise their 5G investments by offering new services such as IoT, IIoT, customised services and content, for which they would like to pick best-in-class hardware, software and services for their 5G networks. Given Tech M’s strong relationships with global telecom players, the company would be a key beneficiary from the upcoming 5G roll-out.

Tech M believes that its investments/partnerships with AltioStar/LCC differentiate it from other IT services vendors. We also believe that Tech M’s early investments in network capabilities through LCC, investments in IPs and platforms and investments/partnerships (Intel, Rakuten, AltioStar and among others) to develop an ecosystem would help the company to capture opportunities with the roll-out of 5G.

Though a higher exposure to the telecom business shields Tech M’s revenues to some extent given limited impact on telecom players from COVID-19, we believe rollouts of 5G has got delayed as enterprises have been conserving cash due to COVID-19-led business disruption, spectrum action delays and logistics issues continue on account of labour unavailability.

**COVID-19 hits both supply-side and demand-side elements for 5G**

Supply-side/ Demand-side	Affected by COVID-19			Remarks
<b>Network deployment</b>	Spectrum	Manpower	Network equipment	Near-term impact, investment would bounce back given higher demand for broadband
<b>Consumer demand</b>	Mobile	fixed-wireless access	New user addition	Directly linked with the economic slowdown, however, WFH would drive new users
<b>Enterprise demand</b>	Mobile	fixed-wireless access	IoT	Management of Tech M believes it is delayed by 5-6 months; long-term opportunities

Source: Sharekhan Research

Tech Mahindra's management indicated that most service providers remain committed towards 5G or other network investments. Work-from-home (WFH) solutions and network digitalisations will be the major focus areas for large global network service providers.

The management believes that 5G opportunity would come from three areas - (1) communication service providers, (2) enterprises, (3) ecosystems. 5G for ecosystems primarily includes business opportunities in the area of design and new applications. The company has started participating in this area including functional design, electronic design styling for handsets. The bigger opportunity remains in CSPs and enterprise 5G spends. 5G roll-out of CSPs has been delayed by 5-7 months due to – 1) COVID-19 impact, 2) restrictions on Huawei and 3) delays in spectrum auctions. Enterprise adoption of 5G can also be delayed by a lack of 5G applications, though the deal pipeline build-up is very strong. The management expects material opportunity from 5G in FY2022. However, there could be possibilities of staggered roll-out of 5G across countries and verticals owing to huge capex requirements for 5G investments and high dependence on CSPs and enterprises for 5G adoption.

The 5G opportunity could be a growth catalyst as there could be large investments on application upgrades and modernisation. Further, Tech M has capabilities in radio frequency planning, design, engineering services, network rollout and post implementation network optimisation and support. Hence, we believe Tech M could be the biggest beneficiary among Indian IT companies from 5G network services spends given its comprehensive capabilities.

#### Acquisitions adding capabilities

Acquisition	Date	Revenues (\$ mn)	Amount paid (\$ mn)	Remarks
Target Group	May-16	65	150	Provides a large addressable market of \$45-60 bn in UK BFSI
The Bio Agency	Jun-16	17	60	Digital strategy and customer experience services
HCI Group	Mar-17	114	110	Presence in Healthcare BPO in US & UK
IP Acquisition	Sep-17	45	140	Virtualization and Cloud domains
Comviva IT	Dec-17	100	50	Enhances capabilities in the mobile VAS domain
AltioStar Networks	Jan-18		15	Presence in UK, Germany, India, Mexico, Argentina and Israel.
Inter-Informatics	Aug-18	11	6	Presence in engineering services
Dynacommerce	Feb-19	10	18	Acquisition in Digital Transformation and Customer experience
K-Vision	Mar-19	5	2	Provides network services for mobile communications to telecom operators in Japan.
Infotek Software and Vitraan	Apr-19	6	2	Presence in the radio-frequency identification (RFID) segment
Objectwise consulting	Jun-19	10	2	Helps customers implement PEGA software
Mad*Pow	Jul-19	15	25	Adds capabilities in customer experience and digital transformation
BORN	Oct-19	50	95	Adds capabilities in customer experience and enterprise commerce
Cerium Systems	Jan-20	15	49	Add capabilities in areas of semiconductor design
Zen3 Infosolutions	Feb-20	50	64	Adds capabilities in Artificial Intelligence & Machine Learning, Cloud, Data & Data analytics

Source: Company, Sharekhan Research

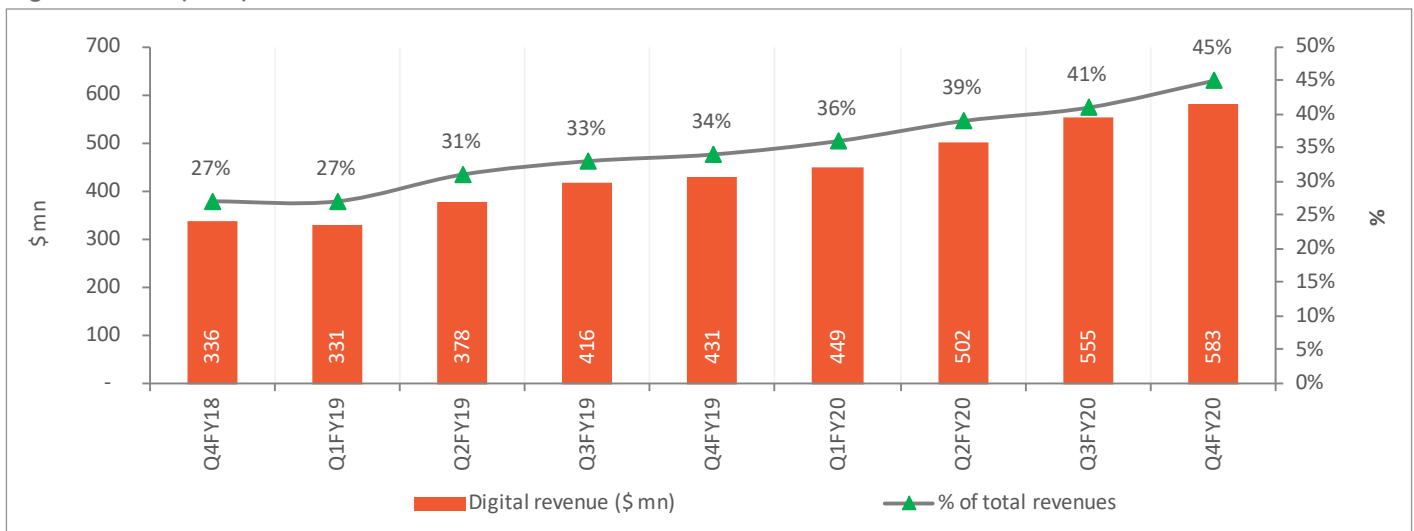
### Strategic focus remains on diversifying the business into non-telecom area

Tech M has been focusing on diversifying its offerings from just a telecom vertical to other verticals (financial, manufacturing, healthcare, etc) over the last decade through mergers & acquisitions, securing large deals and building capabilities in other verticals like other top tier-I IT vendors. As a balanced business is required to create higher quality earnings momentum, the company has pivoted its service portfolio by securing a spate of large deals particularly in enterprise verticals (healthcare, insurance, manufacturing and financial services) and to new technologies and new markets with an increase in pace of acquisitions.

The company has been acquiring companies to fill gaps in its portfolios. The company has acquired companies to expand into new capabilities, geographies and expand wallet share within existing accounts.

Digital business revenues stood at 45% of total revenues in Q4FY2020 versus 27% in Q4FY2018. The management stated that investment in building capabilities in the digital space is currently driving growth. The company has not disclosed the digital revenue contribution to total revenues in Q1FY2021.

Digital revenue (\$ mn) and as % of total revenues



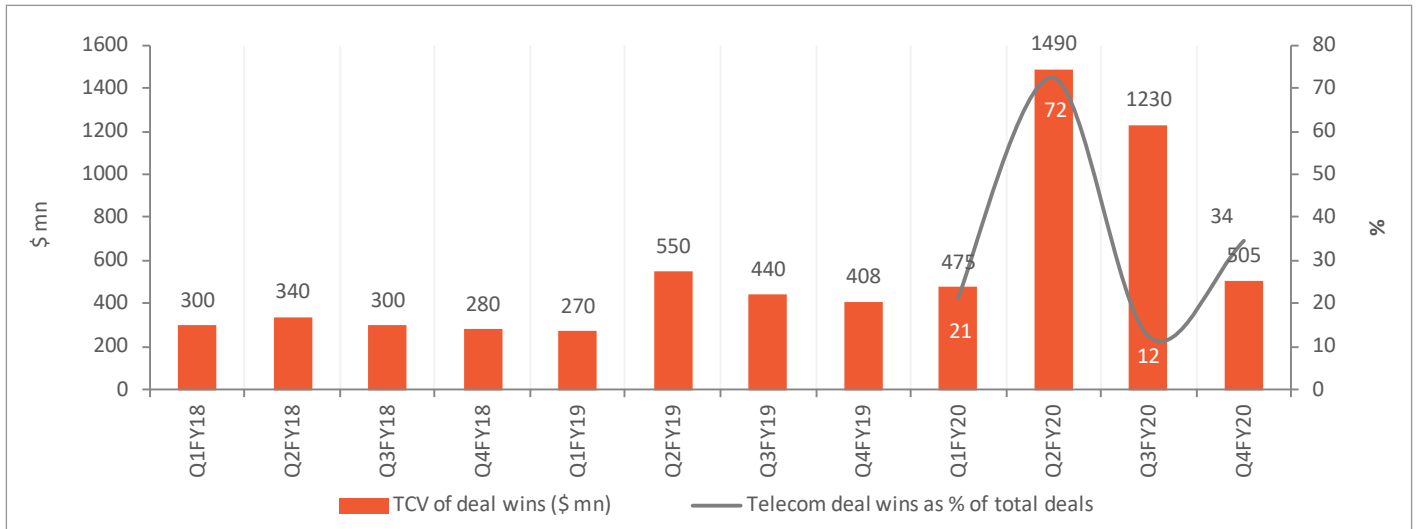
Source: Company; Sharekhan Research

### Large deal wins and healthy deal pipeline provide revenue visibility

Tech M's total contract value (TCV) for large deal wins increased by 2.3 times to \$3.7 billion in FY2020 on the back of the mega deal wins (\$1 billion deal win from AT&T and \$800 million deal win from Prudential) during Q2FY2020 and Q3FY2020. We believe that the Increase in number of deals in the last few quarters has been led by building capabilities in the enterprise business, enhancing capabilities through acquisitions in areas such as customer experience, cloud & analytics, better go-to-market strategies for sales, ability to integrate solutions across verticals, outcome-based approach to structure deals and prioritise growth over profitability.

TCV of large deals was strong at \$505 million (a normalised number post a sharp rise in deal TCV in Q2FY2020 and Q3FY2020) during Q4FY2020, while the company reported multi-quarter low deal with a TCV of \$290 million in the wake COVID-19. Deal wins were lower in both telecom (\$105 million) and enterprise vertical (\$185 million). The management indicated that the deal decisions picked up toward the end of quarter. The management indicated that the company has a strong deal pipeline (highest in past three years) particularly in Europe and expects to close deals in next few quarters. The company expects improvement in TCVs of large deals in Q2 and Q3 as spending in BFSI, HLS and hi-tech verticals remains strong. Further, spending in the manufacturing vertical is picking up. Management guided for a q-o-q revenue growth in Q2FY2021 with improvement in margins.

**Deal decisions picked up in June month, highest deal pipeline in three years**

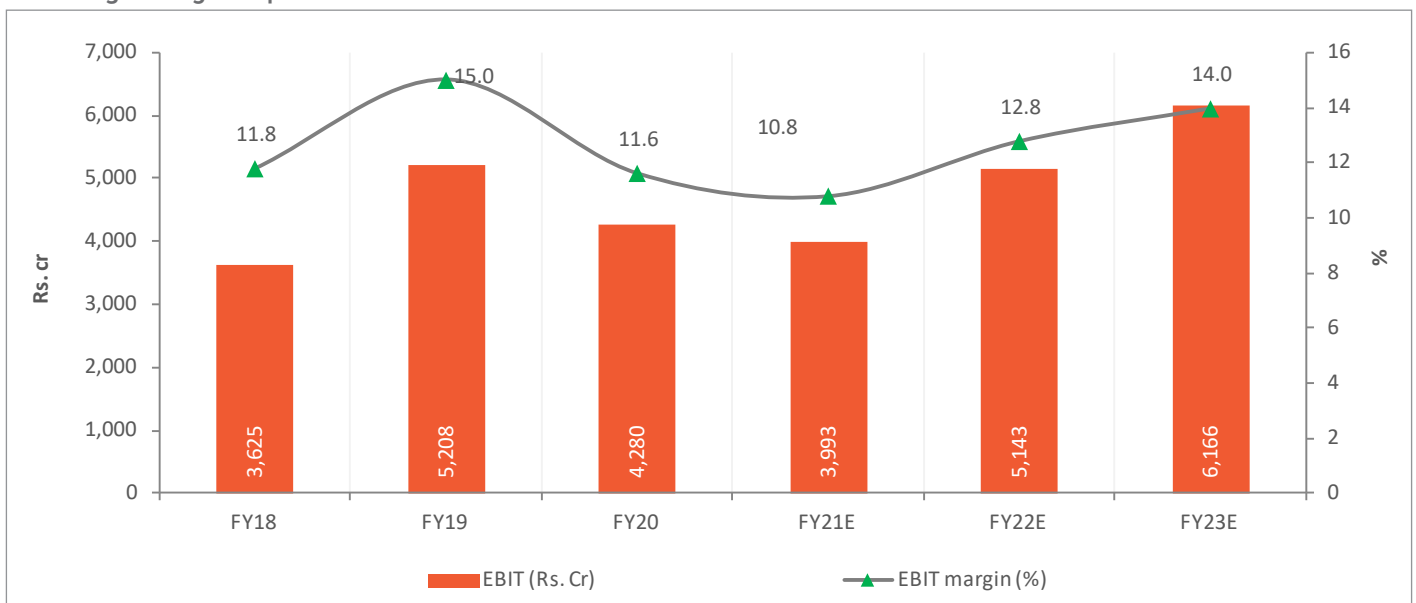


Source: Company; Sharekhan Research

**Margin to improve going forward; levers are intact**

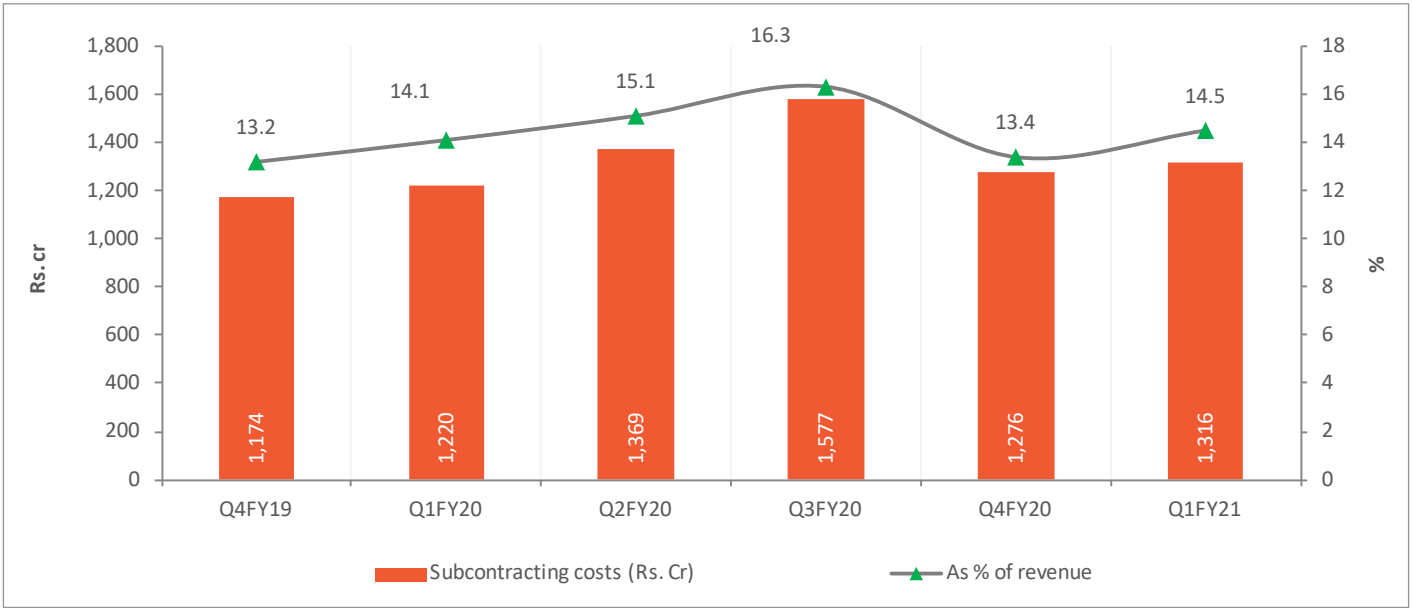
The management indicated that its cost optimisation measures along with focus on structural changes (integrate the back offices and to build shared services units for all the operating units) would improve the margin trajectory in the remaining quarters of FY2021E. Levers for margin improvements are (1) reduction in sub-contracting expenses, (2) improvement of margin profile of two large deals (start reaching steady state), (3) higher offshore mix of revenues, and (4) improving profitability of acquired entities such as Pininfarina, BIO, etc and (5) exiting non-profitable operations. Note that underperformance of acquired entities has caused for margin decline for Tech M in Q1FY21 and FY2020 as well. Tech Mahindra may exit certain non-profitable operations and/or the company restructure the operations of certain acquired entities. We forecast EBIT margins would be at 10.8%, 12.8% and 14% for FY2021, FY2022 and FY2023E respectively, implies an increase of 240 bps over FY2020-23E.

**EBIT margin likely to improve**



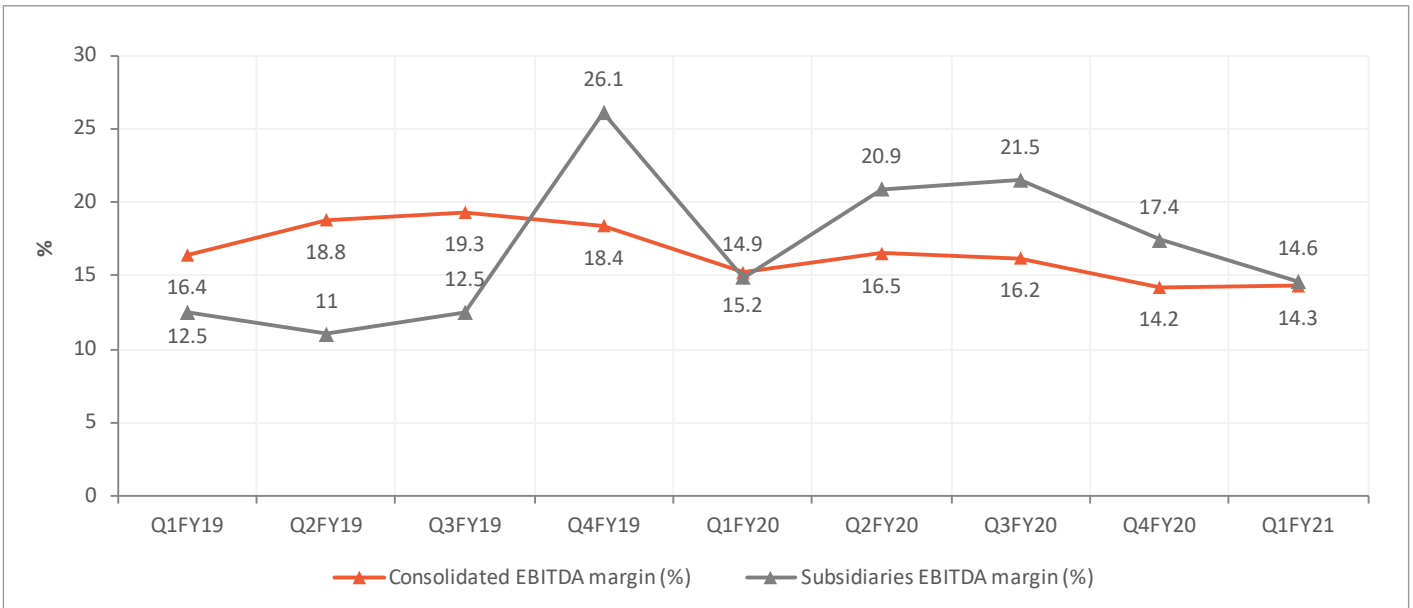
Source: Company; Sharekhan Research

**Sub-contractor costs increased due to integration**



Source: Company; Sharekhan Research

**Expect margin expansion in portfolio companies**



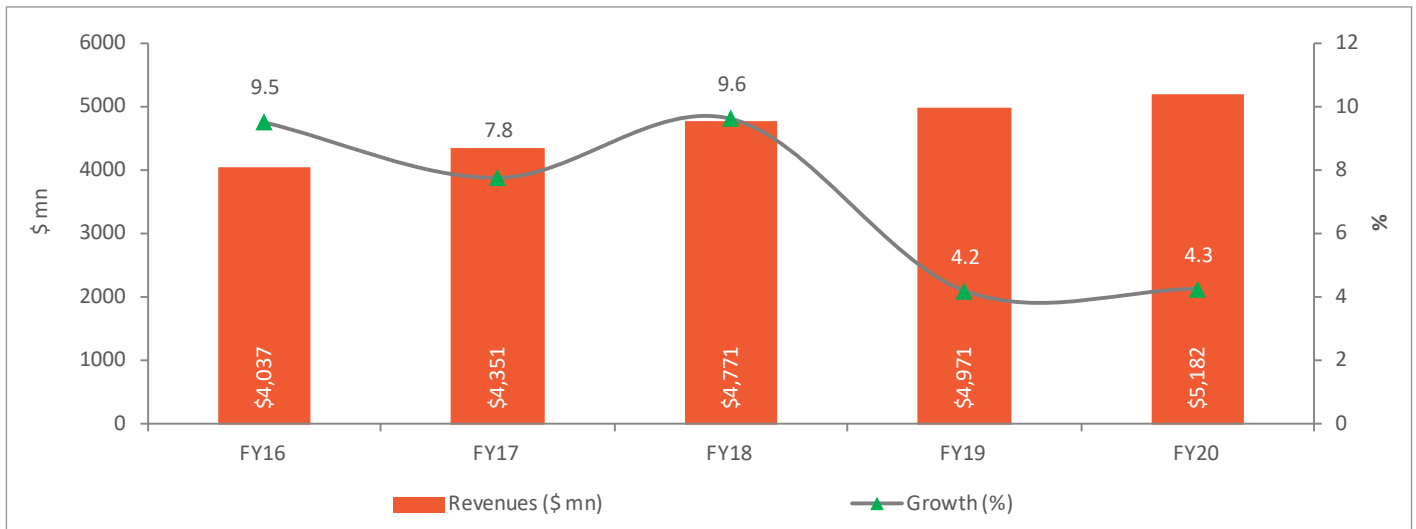
Source: Company; Sharekhan Research

## Financial Analysis

Revenue grew by 5.6% y-o-y in constant currency (CC) terms in FY2020, led by 4.7%/6.8% y-o-y growth in enterprise/communication business. Communication business growth accelerated in FY2020 after three consecutive years of subdued performance. EBITDA margin stood at 15.5%, for the year, down 270 bps. Adjusted net profit for the year stood at Rs. 4,250.5 crore, down 1.1%. Net new deal wins for FY2020 stood at \$3.7 billion (led by two large deals in Q2/Q3 FY2020), up 2.3x y-o-y.

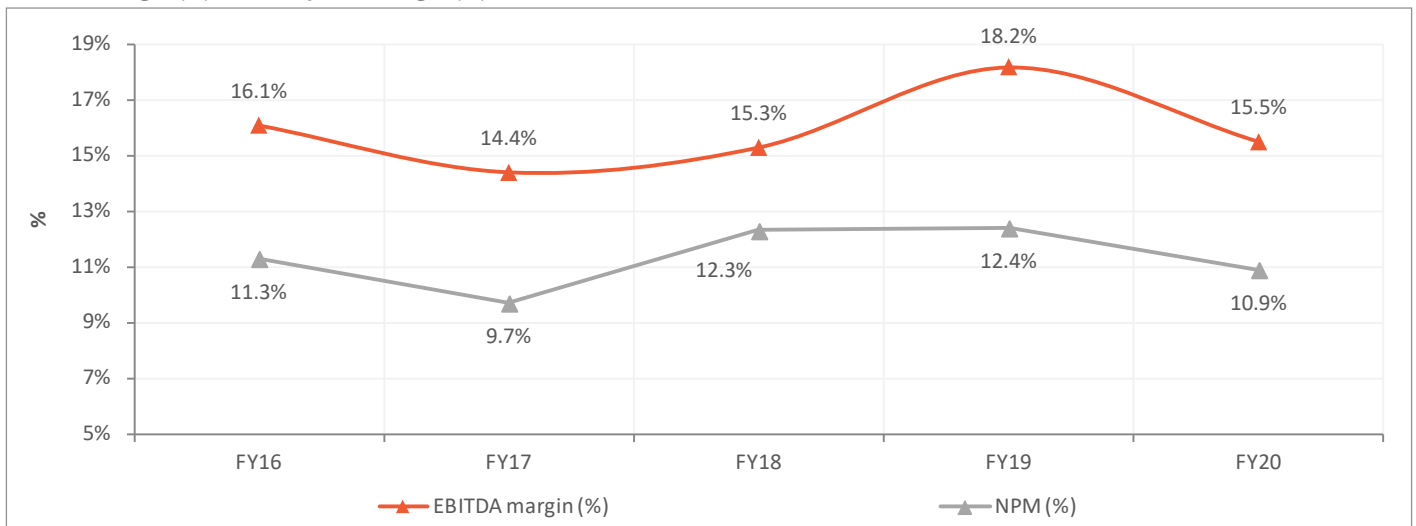
Communications vertical has grown by 6.8% in CC terms, driven by spends on modernisation and pre-5G work. The company announced a strategic collaboration with AT&T, to accelerate its network application, shared systems modernisation and movement to cloud. The Enterprise business grew by 4.7% in CC terms. The company signed around \$800 million deal (one of the largest Enterprise deal in its history) from Jackson National Life Insurance. The company's digital offerings were strengthened by acquiring Born Group, Mad\*Pow, Zen3 and Cerium.

Revenue (\$ mn) and growth (%)



Source: Company; Sharekhan Research

EBITDA margin (%) and net profit margin (%)



Source: Company; Sharekhan Research

Since FY2015, BFSI and other verticals (including healthcare and lifesciences) contributed most of the incremental revenue (51% of total incremental revenue) for Tech M. Both verticals contributed 25.7% of total revenue. Communication vertical grew 5% in USD term after three consecutive years of muted performance.

Revenue mix by vertical (%)

Particular	FY15	FY16	FY17	FY18	FY19	FY20
Communication	52.0	52.0	47.8	43.3	41.2	41.6
Manufacturing	18.4	17.0	18.7	19.2	20.2	18.1
TME	7.8	7.4	6.7	6.5	7.2	7.7
BFSI	9.6	10.1	12.6	13.7	13.4	13.6
Retail, Trans. & Logistics	6.2	6.4	6.9	6.8	6.4	6.9
Others (includes healthcare)	6.0	7.1	7.2	10.6	11.5	12.1

Source: Company

Revenue growth by vertical (%)

Particular	FY15	FY16	FY17	FY18	FY19	FY20
Communication	27	10	-1	-1	-1	5
Manufacturing	16	1	19	13	10	-7
TME	-7	4	-2	6	15	11
BFSI	18	15	34	19	2	6
Retail, Trans. & Logistics	13	13	16	8	-2	12
Others (includes healthcare)	19	30	9	61	13	10

Source: Company

Tech M generated the highest quarterly free cash flow (FCF) of \$317 million in Q1FY2021, aided by strong collections and tax refund (\$16 million). Free cash flow to PAT conversion stood at 246%. This helped the company reduce debt by \$50 million during the quarter. Cash & cash equivalents increased by around \$200 q-o-q to \$1,378.4 million.

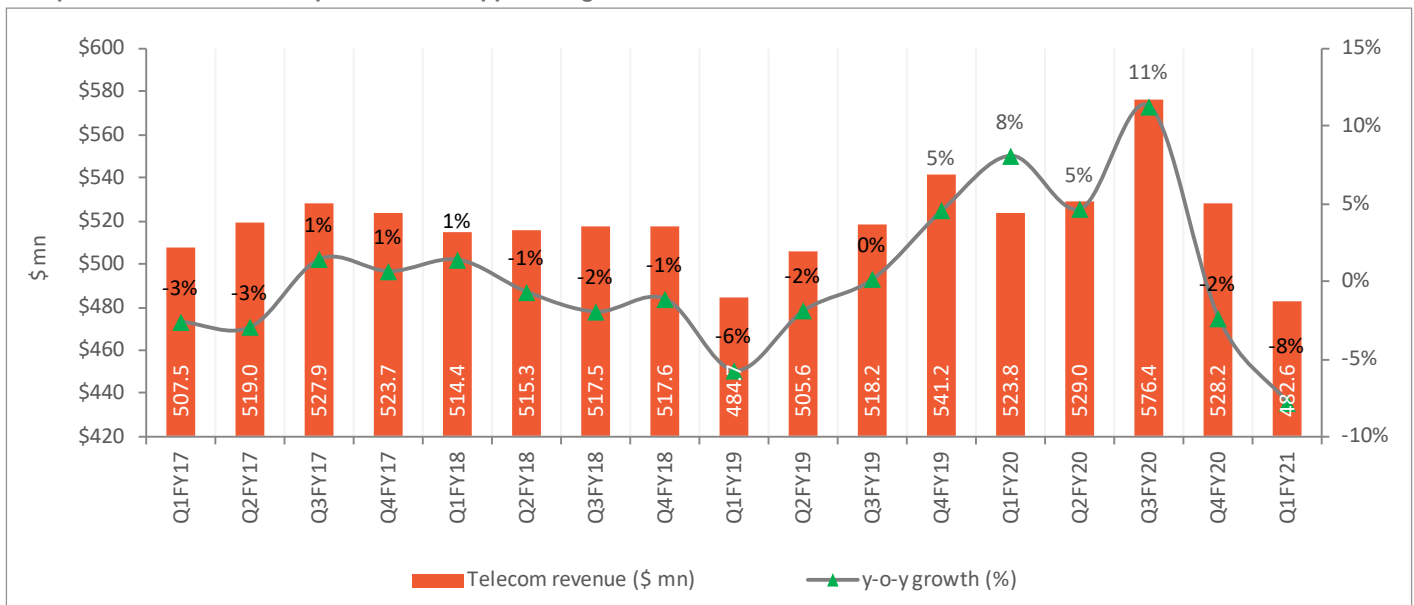
## Communication

Tech M's range of solutions for communications service providers (CSPs), telecommunications equipment manufacturers (TEMs) and independent software manufacturers (ISVs) make it a preferred partner for leading telecommunications and cable service providers. The company is helping organisations to be future-ready for the 5G revolution by helping with respect to network modernisation. It is enabling 5G for enterprises, while driving CX transformation.

Communication is the largest vertical, contributing 41.6% of Tech M's total revenue in FY2020 versus 41.2% in FY2019. The segment registered a healthy revenue growth of 5% y-o-y. The segment has clocked a CAGR of 0.5% in the last 5 years.

The management highlighted that the pick-up in network business has been delayed due to slow decision making and higher uncertainties owing to COVID-19. Network services revenues during Q1FY2021 were impacted due to (1) lockdowns impacting field work, (2) delayed WFH approvals from a few clients and (3) seasonality. Tech M expects gradual recovery in network services.

### Sharp decline in revenue, expect material opportunity from 5G in FY2022E



Source: Company; Sharekhan Research

### Enterprise segment

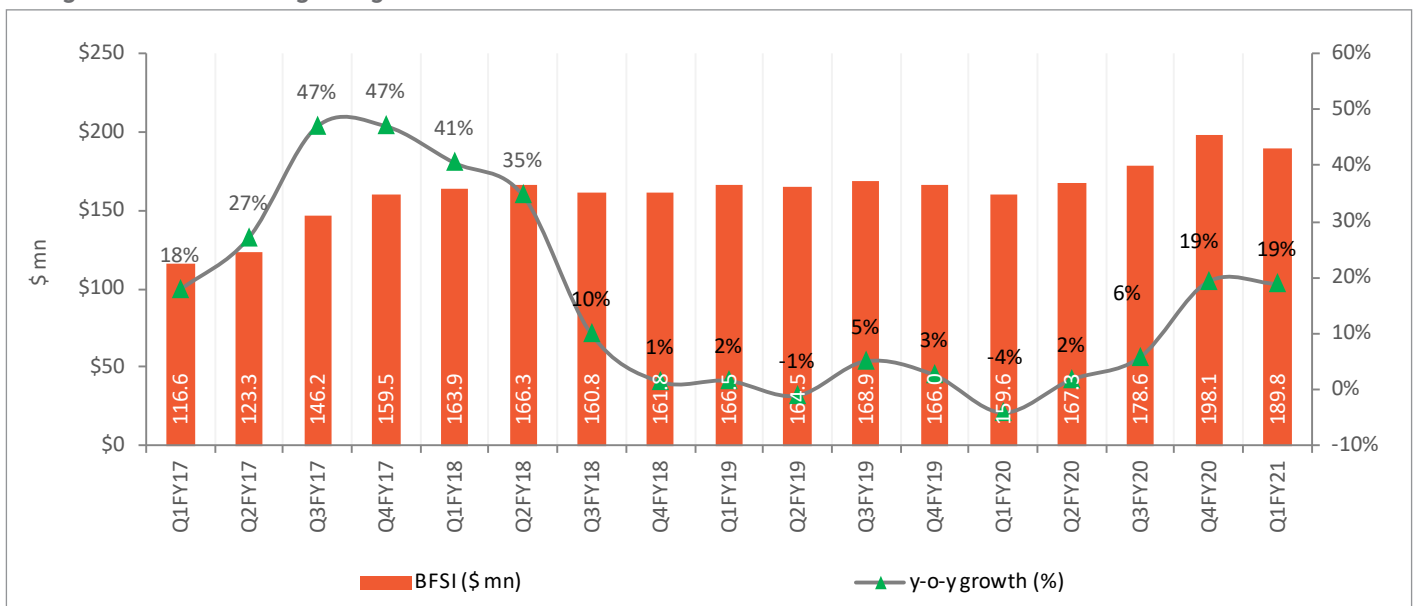
This business now constitutes ~60% of revenues. The management believes that BFSI, hi-tech and retail online business has been doing relatively good in the enterprise segment. It sees high growth in healthcare and life science (HLS) provider space. The company would continue to prioritise the areas in the enterprise segment where the decision making is fast. The company will continue to invest in building at scale digital service lines to participate in digital transformation opportunities. Strong growth in the hi-tech vertical was led by spending in US tech companies. Tech M stated that Google, Microsoft, Oracle and other technology unicorns are among its hi-tech clients.

### Banking, Financial Services and Insurance (BFSI)

The BFSI sector is experiencing rapid adoption of digital technologies to make the whole spectrum more customer-centric, personalised, digitalised and accessible. The company has been providing services to BFSI clients to the sub-sectors retail banking, lending and leasing, card management, asset and wealth management, investment banking, and stock exchanges.

The BFSI segment is the third largest vertical, contributed 13.6% of total revenue in FY2020 versus 13.4% in FY2019. The segment registered a healthy revenue growth of 6% y-o-y. The segment has clocked a CAGR of 11.6% in the last 5 years. The impact was moderate in BFSI during Q1FY2021, as the weakness was offset by ramp-up of the large deal in insurance sub-segment.

**BFSI growth remains strong led by recent deal wins**



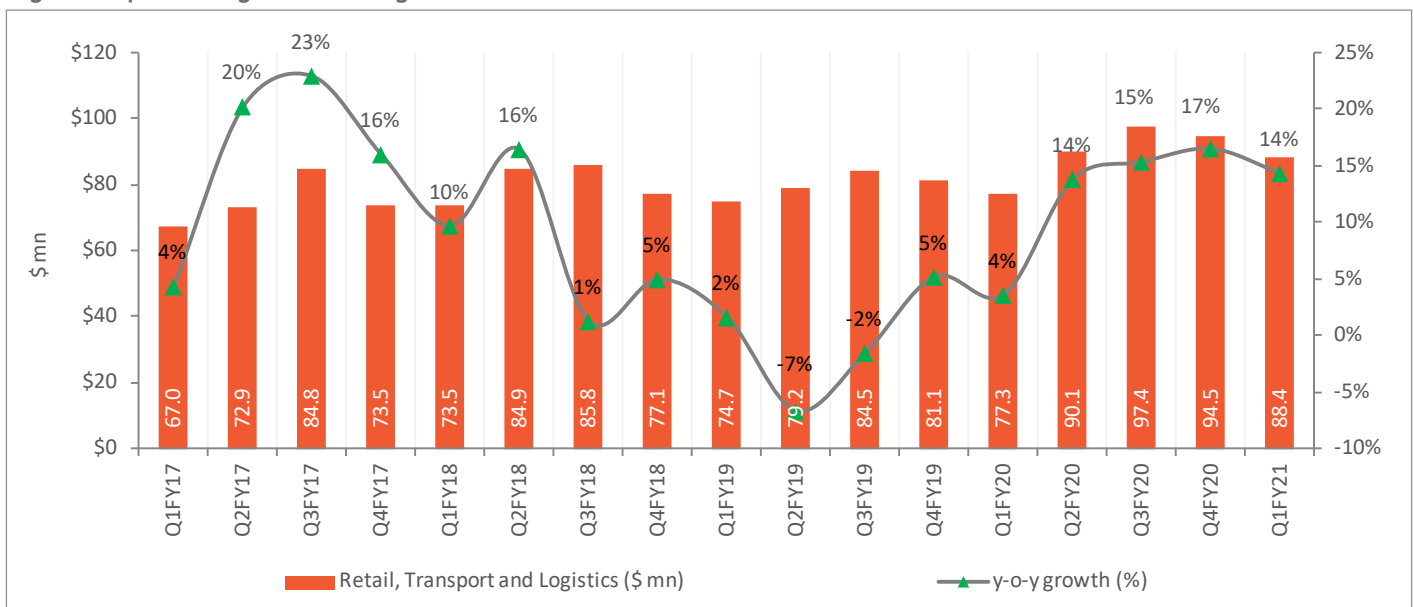
Source: Company; Sharekhan Research

## Retail, Transport and Logistics

Focusing on digital transformation services, the company helps on store re-imagining, digital operations management, intelligent supply chain, while creating personalised phygital (the combination of digital and real-life experiences) experiences through products, devices and services. Tech M has been working with market leaders in the transport and logistics industry, conceiving specific industrial solutions and partnerships with pioneering players.

Retail and logistics segment contributed 6.9% of total revenue in FY2020 versus 6.4% in FY2019. The segment registered a healthy revenue growth of 12% y-o-y. The segment has clocked a CAGR of 6.7% in the last 5 years.

### Higher adoption of digital drive the growth



Source: Company; Sharekhan Research

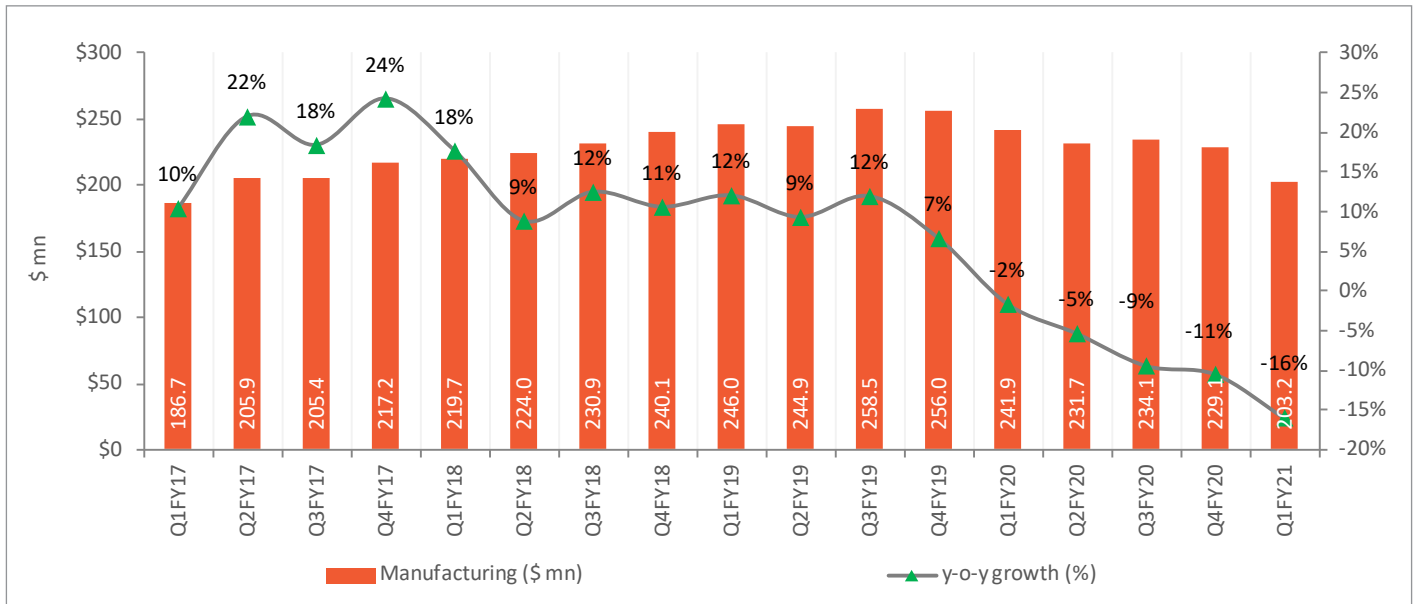
## Manufacturing

With manufacturing-rich DNA and innovative value-added services, Tech M caters services and solutions to broad customer base across diverse industries such as Aerospace & Defence, Automotive, Discrete and Process industries. The company’s deep knowledge of mechanical and electrical engineering, know-how of sales and service processes, and hands-on exposure to the factory shop floor facilitate the bringing of digital offerings into core business domains.

The manufacturing segment is the second largest vertical, contributed 18.1% of total revenue in FY2020 versus 20.2% in FY2019. The segment registered a revenue decline of 7% y-o-y. The segment has clocked a CAGR of 6.4% in the last 5 years.

The manufacturing sector is redefining its supply chain. Management sees manufacturing picking up as well. So, management expects gradual improvement from Q2/Q3 onwards.

### Manufacturing sector is redefining its supply chain



Source: Company; Sharekhan Research

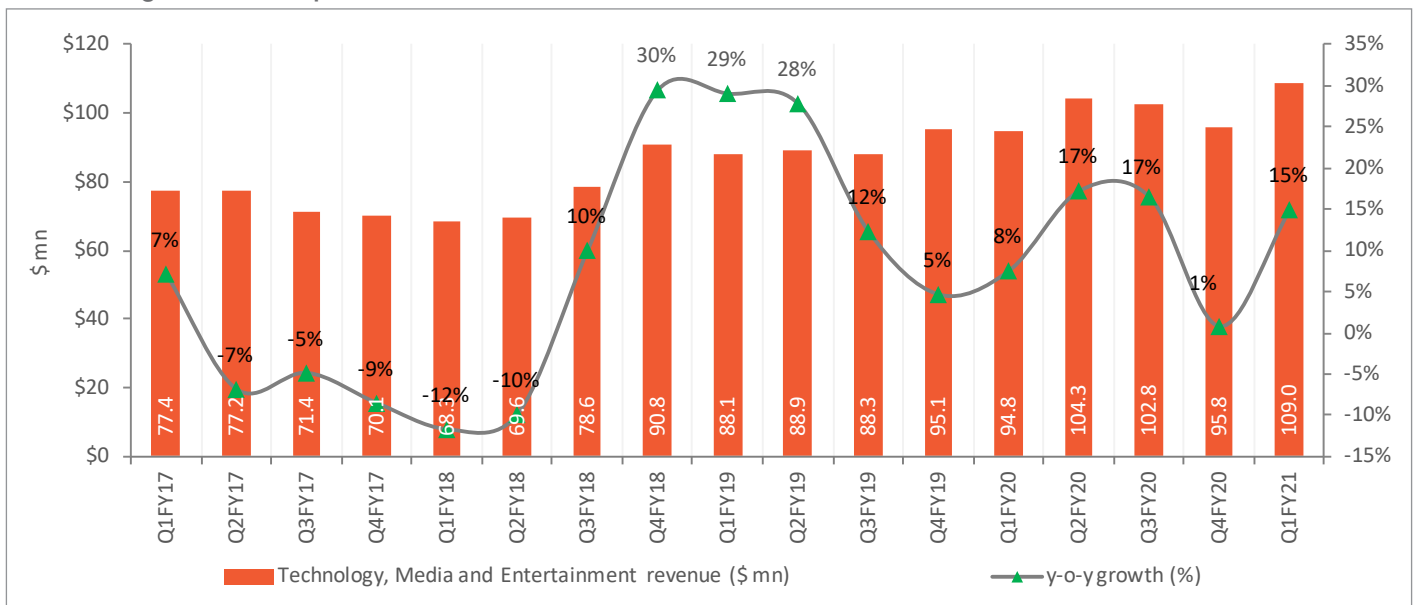
### Technology, Media and Entertainment (TME)

Tech M's hi-tech vertical serves the software and internet sector, which has disrupted the way products and services are delivered to end-users. The company also serves the semi-conductor industry in areas of storage, IDMs, fabless and equipment manufacturers. Tech M serves customers from the film, gaming, sports, publishing and news industries - from vision to implementation.

The TME segment is the fifth largest vertical, contributed 7.7% of total revenue in FY2020 versus 7.2% in FY2019. The segment registered a revenue growth of 11% y-o-y. The segment has clocked a CAGR of 6% in the last 5 years.

Strong growth in the hi-tech vertical was led by spending in US tech companies. Tech M stated that Google, Microsoft, Oracle and a few technology unicorns are among its hi-tech clients.

#### Caters to large US tech companies



Source: Company; Sharekhan Research

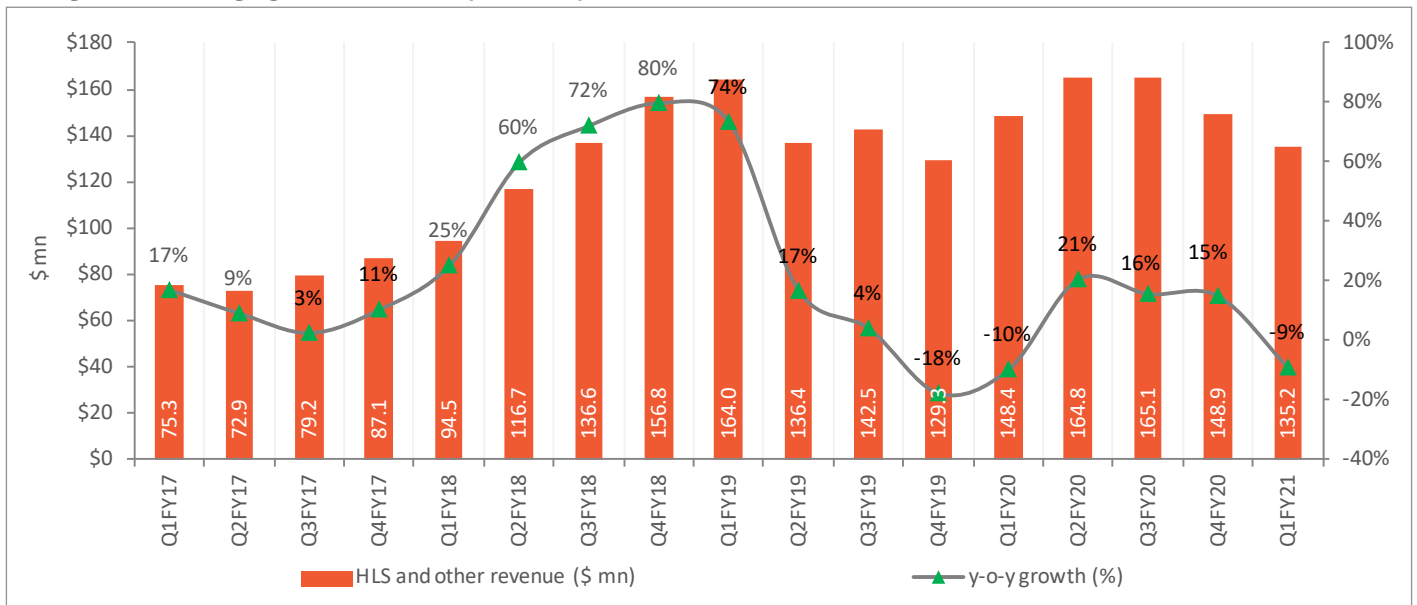
### Healthcare, Life Sciences (HLS), Government and Others

Tech Mahindra partners with leading global companies in the healthcare provider, pharmaceutical, biotechnology and medical device sectors. Tech M helps to reimagine businesses processes and deliver remarkable patient experiences. The company has harnessed the power of digital and information technology to improve citizens' lives with solutions that it provides to public sector companies and government enterprises.

The HLS and others segment is the fourth largest vertical contributed 12.1% of total revenue in FY2020 versus 11.5% in FY2019. The segment registered a revenue growth of 10% y-o-y. The segment has clocked a CAGR of 16.9% in the last 5 years.

The company continues to see high growth in the HLS provider space and the company recently won a large deal in this space.

#### Management sees high growth in the HLS provider space



Source: Company; Sharekhan Research

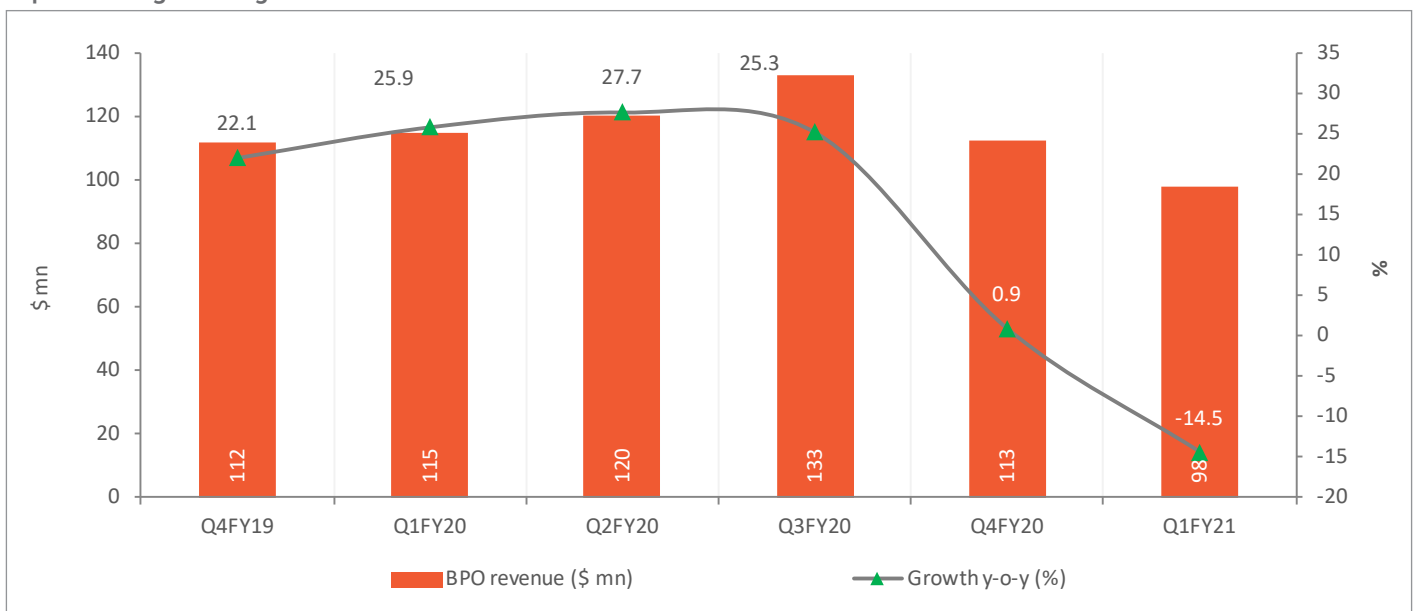
### Management expects a faster recovery in BPO business

COVID-19 had a material impact on BPO business owing to both supply-side constraints and weak demand. The company focuses on extreme automation in this business. Management sees 1) shift in voice to chat or digital channels, 2) mix non front office side has been growing in term of contribution (25% of BPO business). Tech M is working on platform offerings to create consumption-based models.

Tech M's BPO business has achieved industry-leading growth in last couple of years, registering growth of 18% and 19% in FY2019 and FY2020 respectively. Growth was largely driven by market share gains.

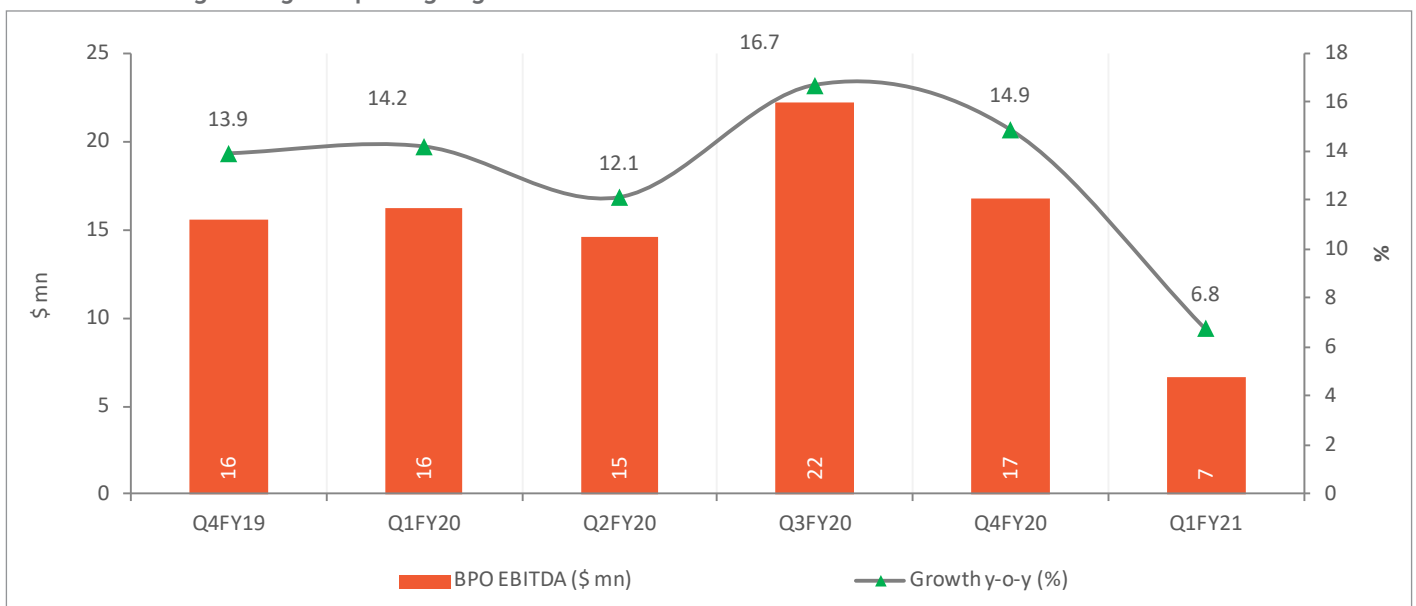
After a sharp decline in Q1FY2021, the management expects a faster recovery in the BPO segment from Q2FY2021 on the back of recovery in demand environment and reduction in supply constraints. Further, we believe margin would also improve led by cost efficiencies, higher automation and revenue recovery.

#### Expects strong recovery in BPO from Q2



Source: Company; Sharekhan Research

#### BPO EBITDA margin likely to improve going ahead



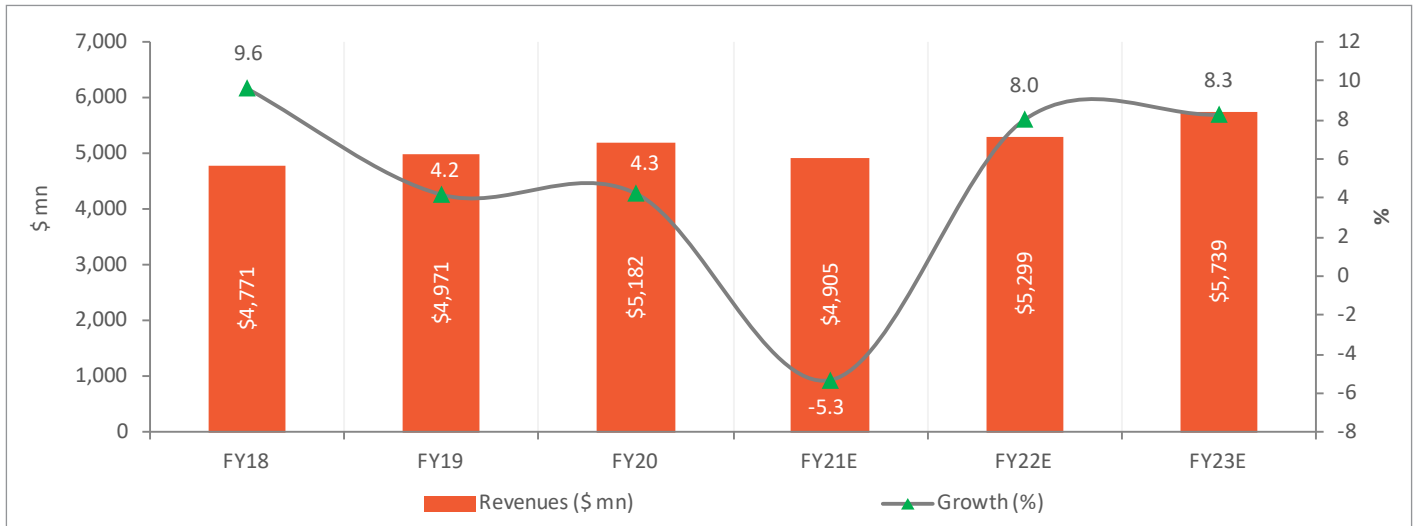
Source: Company; Sharekhan Research

### Growth and margins- Our assumptions

Tech M delivered 7% growth over FY2015-20, which is ahead of the average growth of IT services spending. Tech M's communication vertical reported 6.8% CC growth in FY2020 after three consecutive years of decline. During last couple of year, the company has able to improve its capabilities in the enterprise segment and go-to-market strategy as well, reflects from the rise in deal wins in last 6-7 quarters.

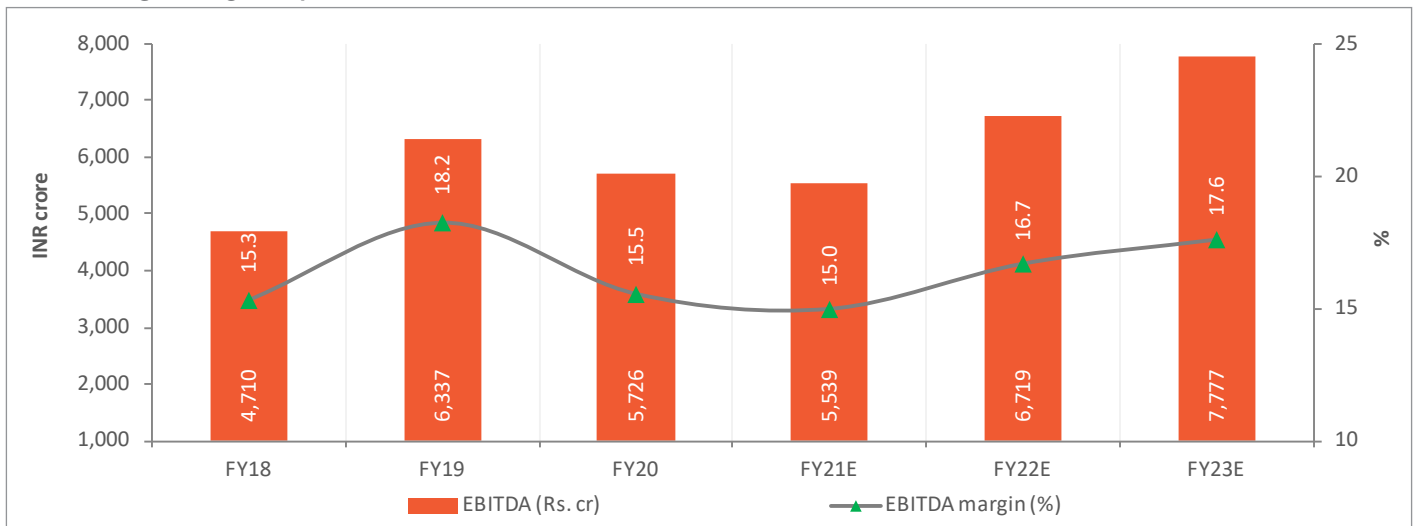
Management guided revenue would grow on a q-o-q basis from Q2FY2021 with continuing improvement in margins. However, FY2021E is expected to be weak year in terms of revenue growth owing to supply-side challenges in network management during H1FY2021. We expect strong revenue recovery in FY2022E on the back of anticipation of kick-start of spending relating to 5G and potential improvement in enterprise segment growth. Operating profitability is expected to improve on subsequent quarters led by increase in offshore revenues, improving profitability of some acquired entities and reduction of subcontracting expenses. We expect US\$ revenue and earnings to grow at a CAGR of 8.2% and 22.3 % over FY2021-23E, led by 5G opportunity and anticipated margin expansion.

#### USD revenues and growth y-o-y (%)



Source: Company; Sharekhan Research

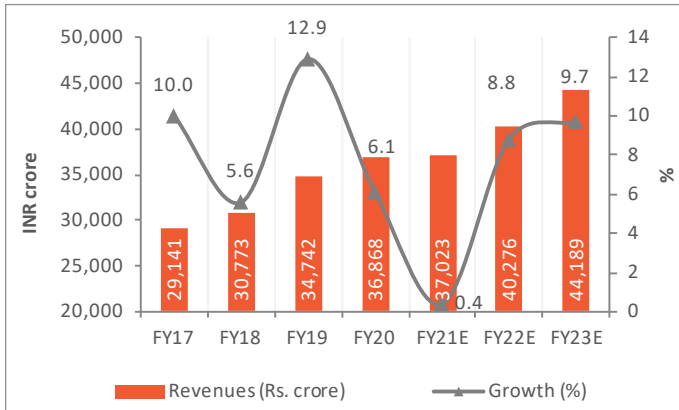
#### EBITDA Margin likely to improve



Source: Company; Sharekhan Research

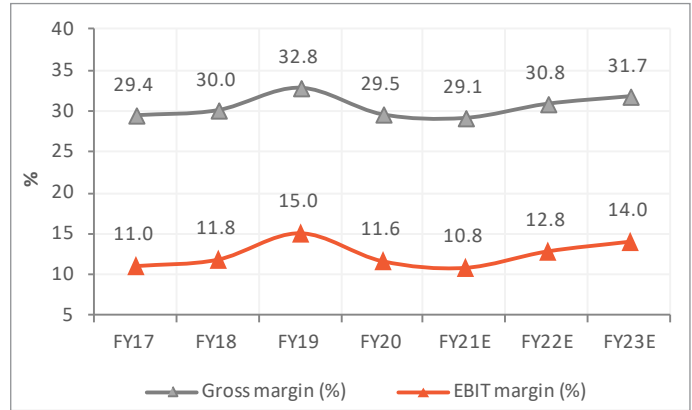
Financials in charts

Revenue (Rs. crore) trends and estimates



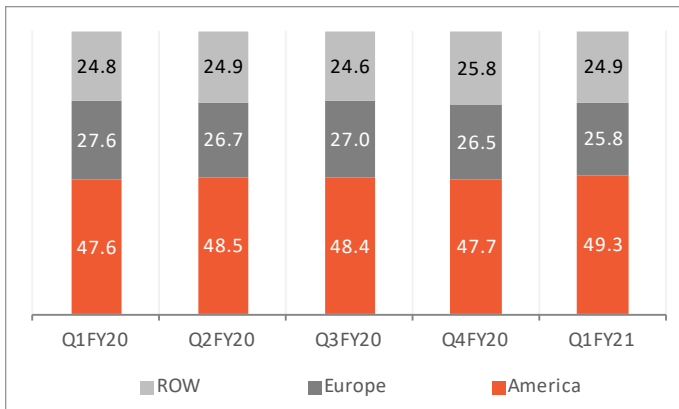
Source: Company, Sharekhan Research

Gross and EBIT margin trends and estimates



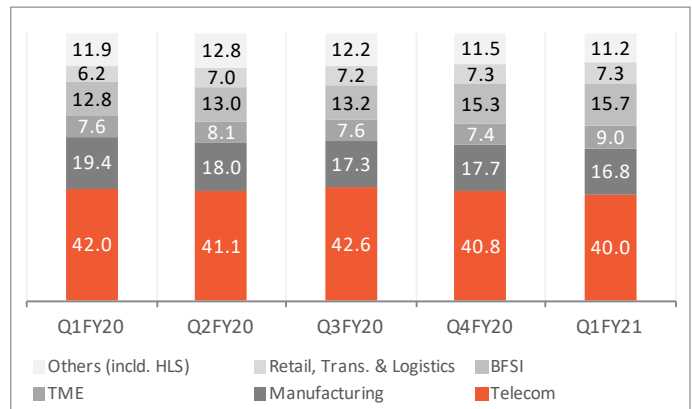
Source: Company, Sharekhan Research

Geography-wise contribution



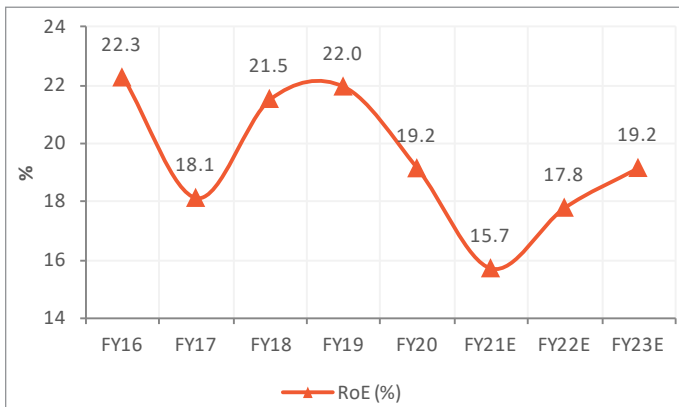
Source: Company, Sharekhan Research

Vertical-wise contribution



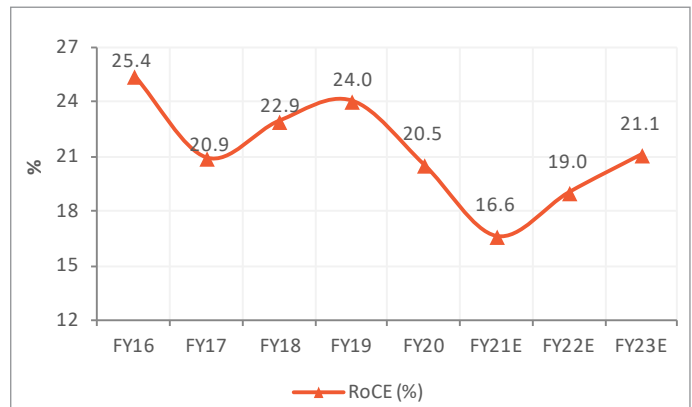
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

## Valuation – the risk-reward remains favourable

*Improving mix of digital revenues, sharp improvement in deal wins, revenue defensibility on the back of higher contribution of telecom revenue and 5G opportunities keep us constructive on the stock.*

### ■ Sector View – Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimates IT services spending would grow by 5-8% over CY2021-24E compared to average of 4.2% achieved in CY2010-19. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients and increase in online adoption across verticals. The implications from the outbreak of pandemic have accelerated the digital activities among large global enterprises, leading to increase in spending on workplace transformation and collaboration tools, cyber-security and higher cloud migration. Further, the increasing need for rapid access to data and automation will enhance the focus on network equipment and communications, speeding up 5G network deployments and adoption of 5G equipment.

### ■ Company Outlook – Well placed to capture 5G opportunity

With 40% of revenues arising from telecom segment, Tech Mahindra is well-placed to capture 5G-related spending from telecom service providers and OEMs. We believe Tech M is well positioned to be a key beneficiary from 5G roll out given its early investments in network capabilities through LCC, investments in IPs and platforms and investments/partnerships (Intel, Rakuten, AltioStar and among others) to develop an ecosystem. We remain positive on the company considering a strong demand environment in telecom, strategic focus on digital acquisitions, improving large deal win rate and continuous focus to diversify business.

### ■ Valuation – Attractive valuation

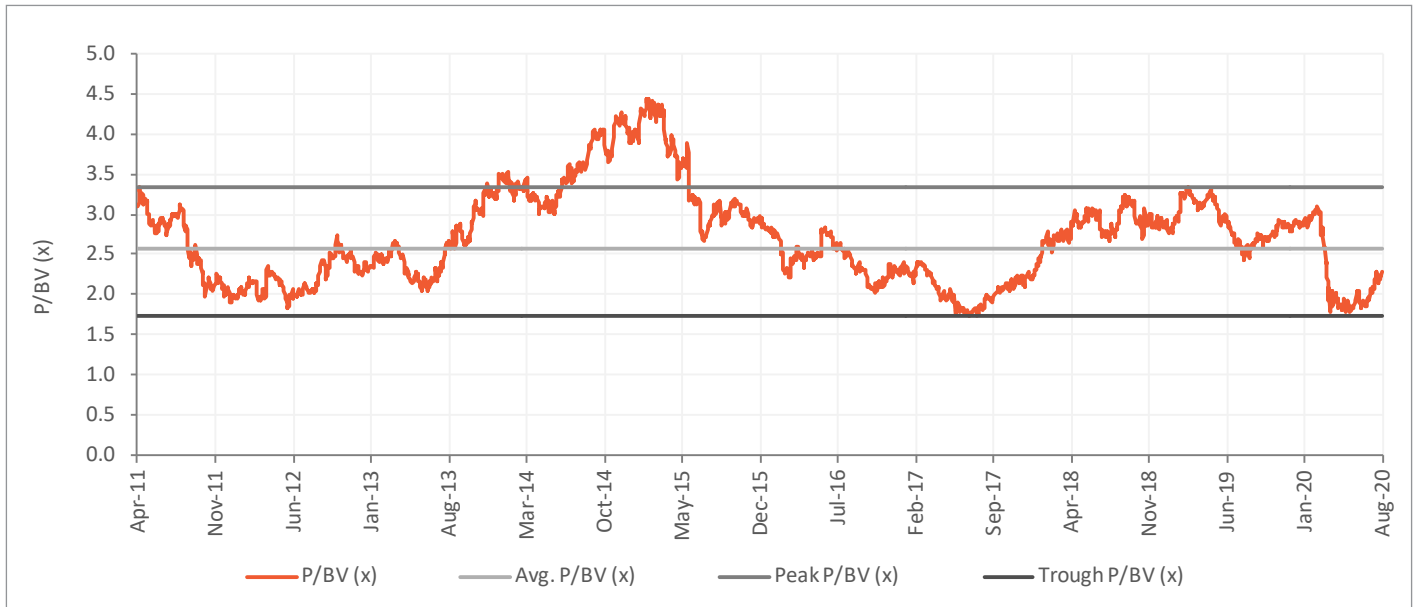
Tech Mahindra is well invested to capitalise the benefit across networks and IT services from the expansion of 5G value chain. We remain positive on Tech M on account of (1) improving mix of business, (2) potential 5G opportunity from higher exposure to telecom, (3) rising average deal sizes/number of deals in last seven quarter (except Q1FY2021, but highest deal pipeline in the last three years) versus earlier, and (4) differentiated and leadership positioning in certain segments of enterprise business. Management guided sequential revenue growth from Q2FY2021 with improvement in margin. At CMP, the stock is trading at a reasonable valuation of 14x/11x of its FY2021E/FY2022E earnings. Hence, we initiate coverage on Tech M with Buy rating and price target of Rs. 850.

#### One-year forward P/E (x) band



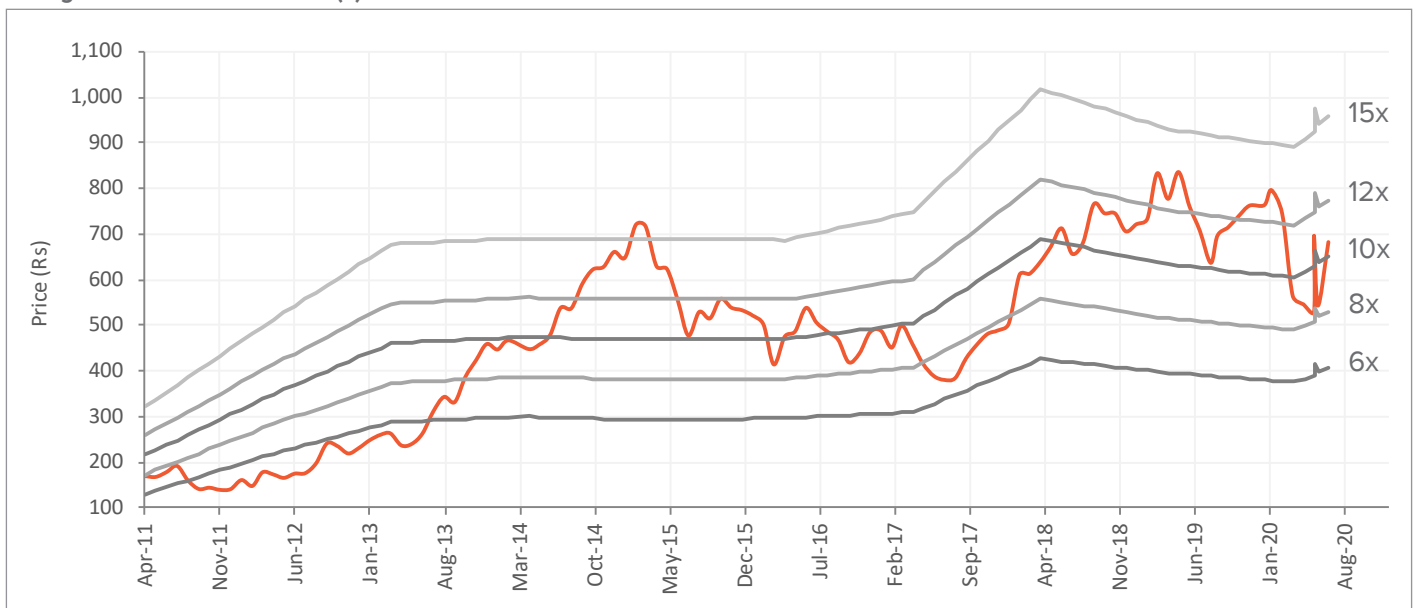
Source: Sharekhan Research

One-year forward P/BV (x) band



Source: Sharekhan Research

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

Peer comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HCL Tech	709	271	192,412	17.0	15.7	5.3	4.9	3.4	3.1	20.9	20.4
Infosys	954	426	406,124	23.8	21.4	15.7	14.1	3.3	3.2	25.9	28.5
TCS	2,242	375	841,454	28.0	24.7	20.4	18.5	10.1	9.9	35.9	40.6
Wipro	277	571	158,005	17.2	15.8	4.8	4.2	2.8	2.6	13.9	14.0
Tech M	696	97	67,243	17.0	13.7	10.6	8.3	2.5	2.3	15.7	17.8

Source: Sharekhan Estimates

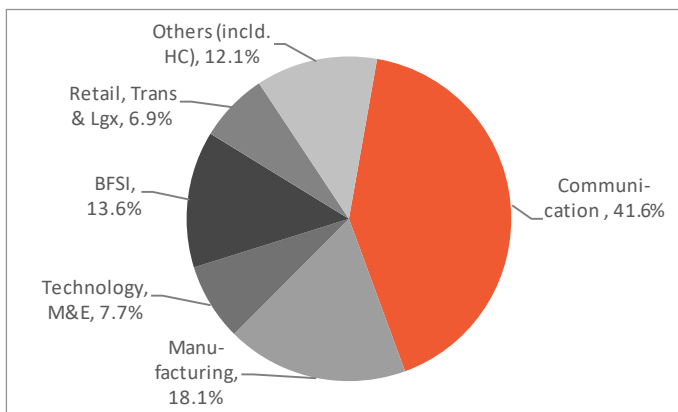
## Company background

Tech Mahindra (Tech M) was started as a joint venture between Mahindra & Mahindra and British Telecom Plc under the name of Mahindra British Telecom (MBT). British Telecom was initially a partner of 30% with Mahindra but later on gradually sold its entire share to investors by the year 2012. The company has developed a niche in telecom vertical by providing end-to-end services to telecom OEMs and service providers. With primarily focus on the telecommunications industry, the company is one of the world's leading communications service providers. Tech M's wireless network services encompass the complete lifecycle of networks starting from design, planning and engineering, rollout, operations and maintenance, alongside optimisation services. The company provides managed and professional services to businesses in the wireless networks segment.

During 2008-09, the company bought Satyam Computer Services through a subsidiary. This acquisition helped the company to enter into the enterprise solutions space with diversifying its exposure to other verticals like BFSI, Manufacturing, retail, etc. The company is also engaged in providing business process outsourcing (BPO) services to customers across the globe. The company's integrated engineering solutions (IES) unit caters multiples sectors such as aerospace and defence, automotive, industrial, telecom, Hi-tech, healthcare and transportation sectors.

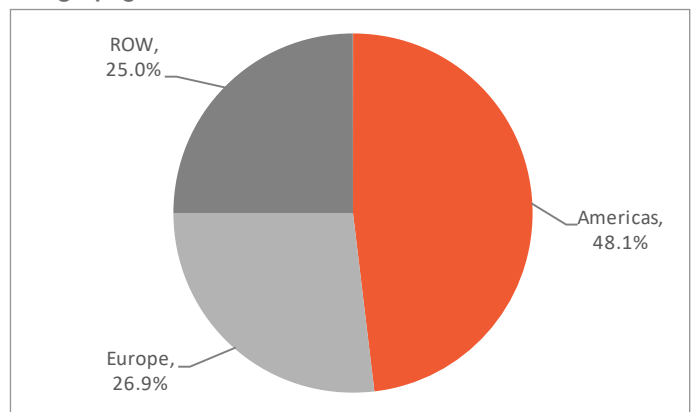
Tech M supports its clients across sectors, with tailored solutions. Further, the company delivers technology solutions across 90+ countries in Americas, Europe, Middle-East, Latin America, Africa and Asia-Pacific. On region-wise, the company is well balanced across regions, with 48.1% share from the Americas, 26.9% share from Europe and 25% from the Rest of the World. The communications vertical contributed 41.6% to its total revenues, while manufacturing and BFSI vertical contributed 18.1% and 13.6% to total revenues, respectively. The company's 3-4-3 strategy focuses on three mega-trends, four technology bets, and three outcomes for its customers.

**Vertical-wise revenue mix in FY2020**



Source: Company, Sharekhan Research

**Geography-wise revenue mix in FY2020**



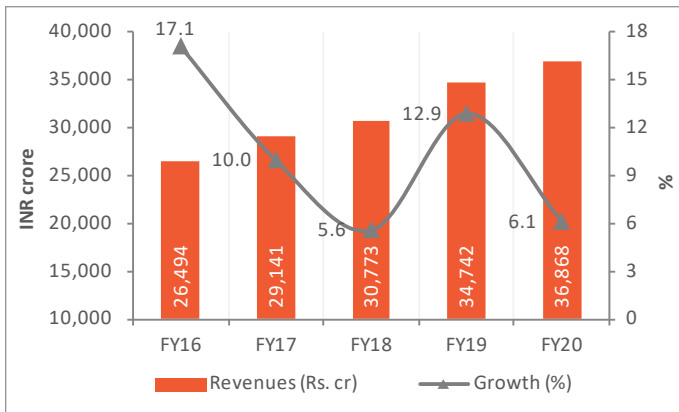
Source: Company, Sharekhan Research

Tech M is currently a leading global enabler of digital transformation, consulting and business re-engineering services and solutions. With ~125,000 employees and revenues of \$ 5.2 billion (in FY2020), Tech Mahindra is fifth largest Indian IT services company in India. It has around 973 active clients across 90+ countries, including several Fortune 500 companies.

Tech M's Makers Lab develops new-age solutions by leveraging next generation technologies like Artificial Intelligence (AI), Machine Learning (ML), Robotics, Internet of Things (IoT), Augmented Reality (AR)/ Virtual Reality (VR), 5G – Network of the future. With 50+ technology platforms and solutions, the company helps customers achieve faster time-to-market and incremental innovation capabilities.

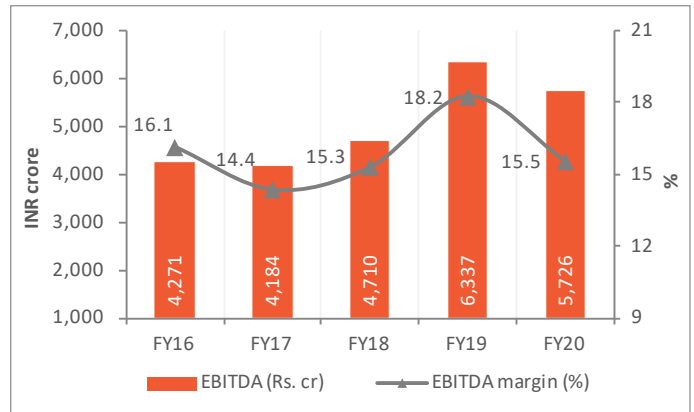
Tech M's senior management team comprises seasoned global leaders in the industry. These leaders are equipped with experience and expertise of diverse geographies and areas of specialisation.

**Revenue (Rs. Cr) & growth (%)**



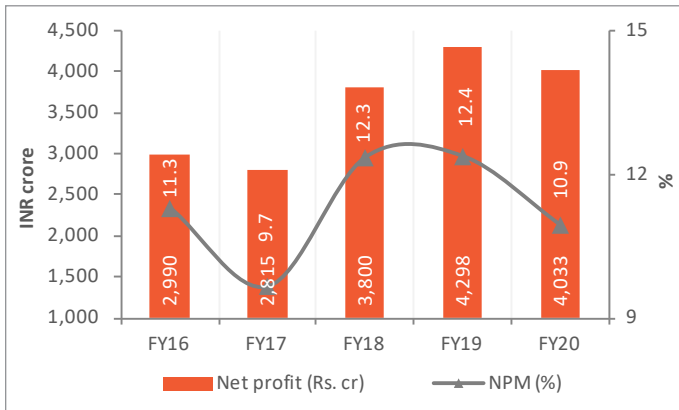
Source: Company, Sharekhan Research

**EBITDA (Rs. Cr) and margin (%)**



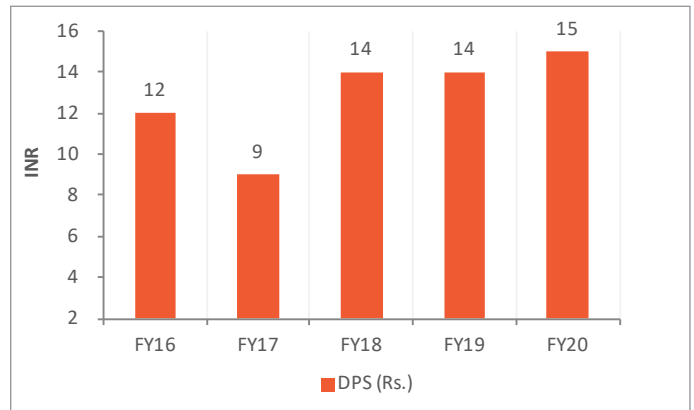
Source: Company, Sharekhan Research

**Net profit (Rs. Cr) and margin (%)**



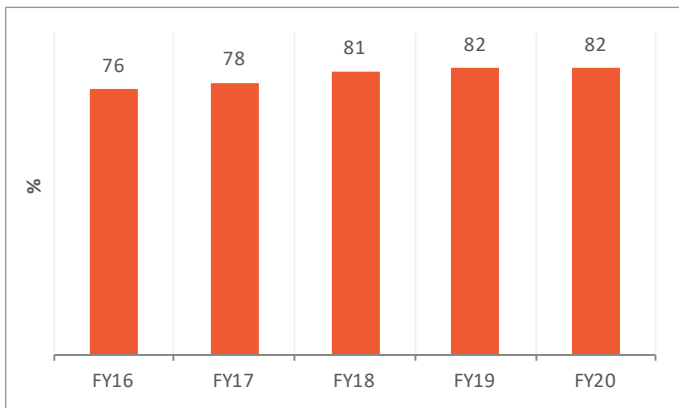
Source: Company, Sharekhan Research

**Dividend per share (Rs.)**



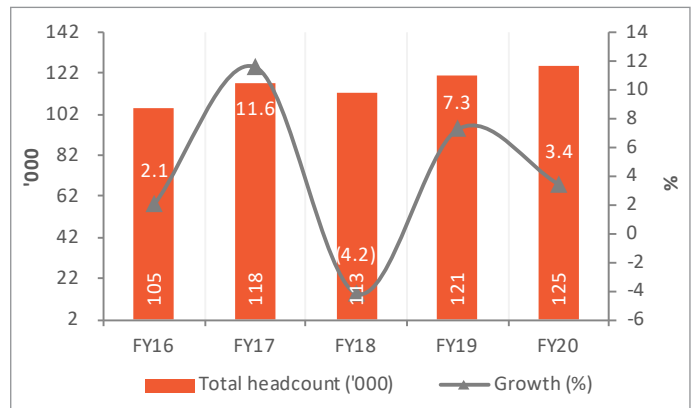
Source: Company, Sharekhan Research

**IT utilisation (including trainees)**



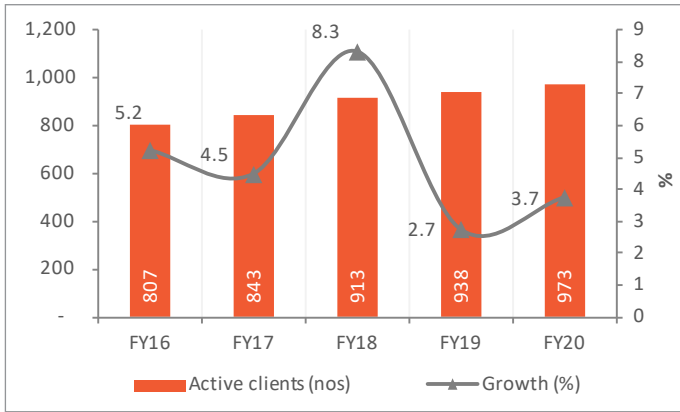
Source: Company, Sharekhan Research

**Total headcount ('000) and growth (%)**



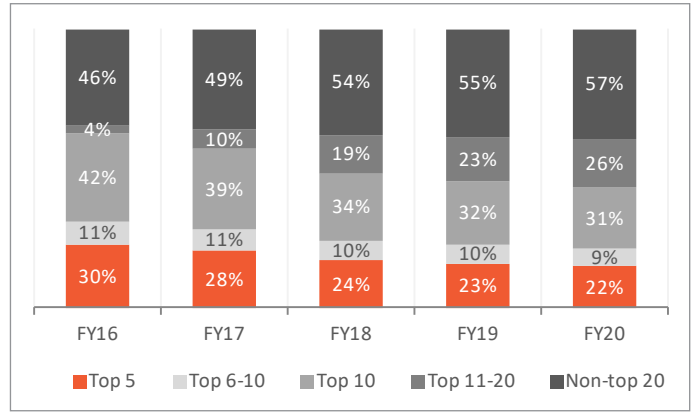
Source: Company, Sharekhan Research

**Active clients (nos)**



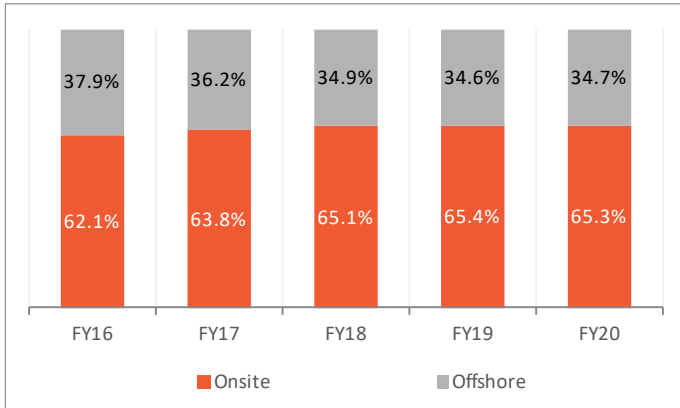
Source: Company, Sharekhan Research

**Client concentration**



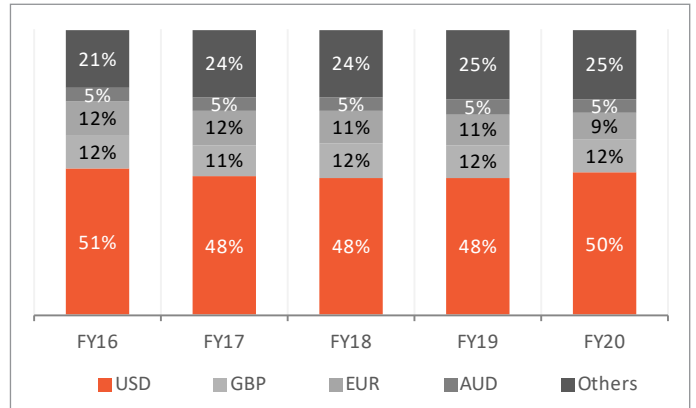
Source: Company, Sharekhan Research

**Onsite and offshore mix (%)**



Source: Company, Sharekhan Research

**Revenue exposure by currency**

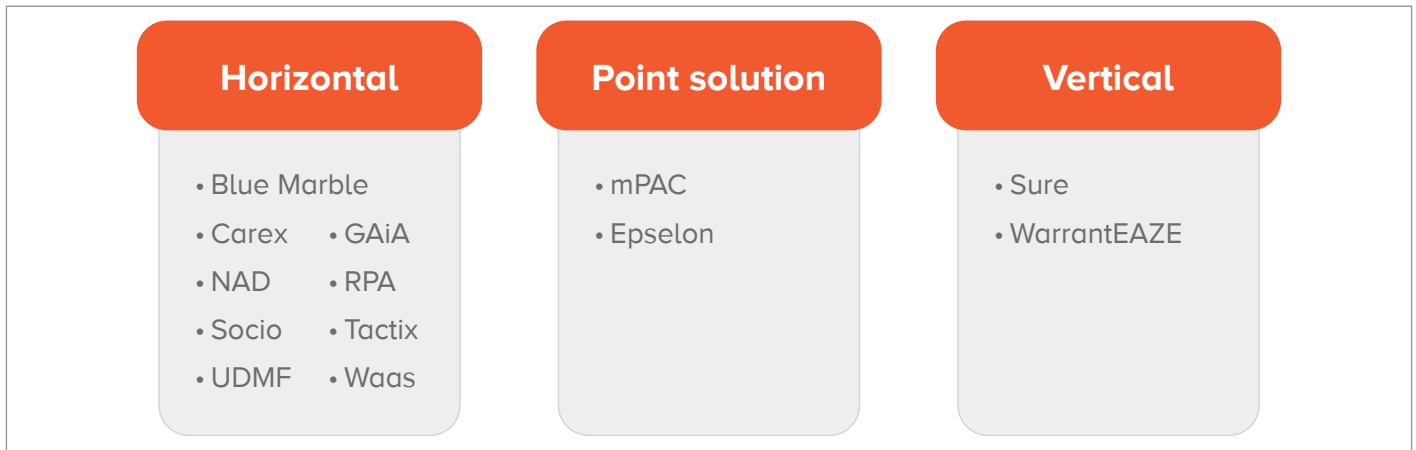


Source: Company, Sharekhan Research

### Platform partnerships of Tech Mahindra

Tech M has developed platforms either in-house or in collaboration with partners and customers. Most of the platforms have already been deployed at one or more customer locations. Tech M has been continuously expanding partnerships with platform providers as well as building organically. Tech Mahindra uses its proven strengths in business process consulting, engineering, automation and IPs in vertical platforms such as WarrantEaze (managing the warranty process for manufacturing clients), Connect Sense (Patient engagement suite), FEEDS (Farm to Fork supply chain management).

#### Platform classification



Source: Company, Sharekhan Research

The company has strengthened its competencies with in-house platforms, partnerships with top providers and start-ups to enhance its portfolio addressing Intelligent Process Automation, Conversational AI, Text Analytics and NLP, Computer Vision and Advanced Analytics solution areas.

#### Partnerships and platforms



Source: Company, Sharekhan Research

Tech M's IPs

**Entellio**

Supervised, self-learning NLP/AI/ML-based enterprise chatbot

**X-Retail**

Next generation retail transformation platform

**Storicool**

A story or content creator, which creates animation stories using natural language conversation

**Vetturino**

Indigenous smart On-Board Diagnostics (OBD) controller by an all-women team

**Darpan**

Application made for farmers by Makers Lab in their bet for Agritech within the country to enable farmers to keep a record of their expenses

Source: Company, Sharekhan Research

### Operating metrics

	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21
Revenue (\$ mn)	4,771	1,224	1,218	1,261	1,268	1,247	1,287	1,353	1,295	1,208
Revenues In INR (Rs. Cr)	8,055	8,276	8,630	8,944	8,892	8,653	9,070	9,655	9,490	9,106
<b>Geographic mix (%)</b>										
Americas	47.4	48.2	47.0	47.4	46.4	47.6	48.5	48.4	47.7	49.3
Europe	29.6	30.0	29.6	28.9	28.6	27.6	26.7	27.0	26.5	25.8
RoW	23.0	21.9	23.4	23.7	24.9	24.8	24.9	24.6	25.8	24.9
<b>Revenue by verticals (%)</b>										
Telecom	41.6	39.6	41.5	41.1	42.7	42.0	41.1	42.6	40.8	40.0
Manufacturing	19.3	20.1	20.1	20.5	20.2	19.4	18.0	17.3	17.7	16.8
TME	7.3	7.2	7.3	7.0	7.5	7.6	8.1	7.6	7.4	9.0
BFSI	13.0	13.6	13.5	13.4	13.1	12.8	13.0	13.2	15.3	15.7
Retail, transport, logistics	6.2	6.1	6.5	6.7	6.4	6.2	7.0	7.2	7.3	7.3
Others	12.6	13.4	11.2	11.3	10.2	11.9	12.8	12.2	11.5	11.2
<b>Revenue by location (IT services)</b>										
Onsite	67	66.6	64.5	65.5	65.2	65.3	65.4	65.3	65.2	64.1
Offshore	33	33.4	35.5	34.5	34.8	34.7	34.6	34.7	34.8	35.9
<b>Manpower details</b>										
Software	72,437	72,462	72,534	71,785	71,477	74,093	72,597	73,079	71,515	71,020
BPO	34,190	34,700	39,407	43,439	43,081	45,000	52,193	51,096	46,816	45,554
Sales and support	6,180	6,390	6,450	6,618	6,524	6,680	6,732	6,664	6,905	6,842
Total	112,807	113,552	118,391	121,842	121,082	125,773	131,522	130,839	125,236	123,416
IT attrition (LTM)	18	19	20	21	21	21	21	20	19	17
<b>Utilization rate (%)</b>										
IT utilization	84	81	81	82	82	80	82	84	83	81.7
<b>Client metrics</b>										
No of active clients	904	926	930	935	938	941	946	964	973	981
Repeat business (%)	92.9	98.5	97.4	94.6	88.7	97.7	94.8	91.3	86.1	97.3
<b>Client buckets</b>										
>US\$1 mn	389	389	407	416	425	429	437	446	446	451
>US\$5 mn	154	154	157	157	156	160	155	164	160	161
>US\$10 mn	83	83	86	88	83	81	80	83	85	81
>US\$20 mn	40	47	45	46	50	49	49	50	49	48
>US\$50 mn	16	16	17	18	20	21	22	22	22	21
<b>Client contribution (%)</b>										
Top 5 clients	23.2	21.9	23.3	22.6	22.8	21.4	21.6	22.3	21.4	21.8
Top 10 clients	32.7	32.5	32.7	31.6	32	30.7	31.5	31	31	31.1
Top 20 clients	45.7	46.2	45.6	44	45.1	43.6	43.6	42.1	43.6	43.5
DSO (including unbilled)	102	108	112	107	102	110	114	112	112	107
<b>Order book (\$ mn)</b>										
Telecom (\$ mn)	-	200	300	240	170	100	1,079	150	174	105
Enterprise (\$ mn)	-	70	200	200	238	375	414	1,081	339	185
Total (\$ mn)	280	270	500	440	408	475	1,493	1,231	513	290

Source: Company; Sharekhan estimates

## Financials

### Statement of Profit and Loss

	Rs cr				
Rs crore	FY2019	FY2020	FY2021E	FY2022E	FY2023E
<b>Revenue</b>	<b>34,742</b>	<b>36,868</b>	<b>37,023</b>	<b>40,276</b>	<b>44,189</b>
Employee cost	23,359	25,974	26,252	27,868	30,171
Other expenses	5,046	5,167	5,231	5,688	6,241
<b>Total operating expense</b>	<b>28,405</b>	<b>31,142</b>	<b>31,483</b>	<b>33,557</b>	<b>36,412</b>
<b>EBITDA</b>	<b>6,337</b>	<b>5,726</b>	<b>5,539</b>	<b>6,719</b>	<b>7,777</b>
Other income	534	1,192	992	994	1,243
Depreciation	1,129	1,446	1,546	1,576	1,611
<b>EBIT</b>	<b>5,742</b>	<b>5,473</b>	<b>4,985</b>	<b>6,137</b>	<b>7,408</b>
Interest	133	192	218	219	220
Exceptional & extra ordinary items	-	218	-	-	-
<b>PBT</b>	<b>5,609</b>	<b>5,063</b>	<b>4,767</b>	<b>5,918</b>	<b>7,188</b>
Tax Expenses	1,254	1,160	1,234	1,509	1,833
Profit/loss from associates	-66	-6	-	-	-
Minority interest	9	136	62	77	22
<b>Net profit</b>	<b>4,298</b>	<b>4,033</b>	<b>3,594</b>	<b>4,486</b>	<b>5,378</b>
Exceptional items	-	218	-	-	-
<b>Adjusted net profit</b>	<b>4,298</b>	<b>4,251</b>	<b>3,594</b>	<b>4,486</b>	<b>5,378</b>

Source: Company; Sharekhan estimates

### Balance Sheet

	Rs cr				
Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
<b>Sources of Fund</b>					
Equity capital	444	436	436	436	436
Reserves & surplus	19,841	21,377	23,458	26,057	29,172
<b>Net worth</b>	<b>20,284</b>	<b>21,813</b>	<b>23,894</b>	<b>26,493</b>	<b>29,607</b>
Non-controlling interest	478	393	331	254	232
Total debt	1,405	2,428	2,418	2,408	2,398
Other long-term liabilities	2,145	4,389	4,376	4,416	4,474
<b>Total capital employed</b>	<b>24,312</b>	<b>29,023</b>	<b>31,019</b>	<b>33,572</b>	<b>36,712</b>
<b>Application of Funds</b>					
Net Block	4,350	5,390	4,844	4,267	3,656
Investments	7,513	5,993	6,285	6,592	6,915
Other-nor current assets	6,608	8,411	8,453	8,497	8,544
<b>Current Assets, Loans &amp; Advances</b>					
Inventory	75	36	36	36	36
Receivables	6,959	7,577	7,199	7,831	8,592
Cash & bank balances	2,359	3,148	4,836	7,270	10,304
Loans & advances	-	-	370	403	442
Other current assets	5,583	6,799	6,799	6,799	6,799
<b>Total</b>	<b>14,976</b>	<b>17,560</b>	<b>19,239</b>	<b>22,338</b>	<b>26,173</b>
<b>Less: Current Liabilities &amp; Provisions</b>					
Payables	2,489	3,257	2,536	2,796	3,034
Other current liabilities & provisions	6,646	5,074	5,266	5,327	5,541
<b>Total</b>	<b>9,135</b>	<b>8,330</b>	<b>7,802</b>	<b>8,123</b>	<b>8,576</b>
Net current assets	5,841	9,230	11,437	14,215	17,597
<b>Total assets</b>	<b>24,312</b>	<b>29,023</b>	<b>31,019</b>	<b>33,572</b>	<b>36,712</b>

Source: Company; Sharekhan estimates

### Cash Flow Statement

Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Cash flow from operating activities	6,758	3,906	4,735	5,816	6,792
Cash flow from investing activities	(3,749)	(1,962)	(1,292)	(1,307)	(1,322)
Cash flow from financing activities	(3,695)	(1,155)	(1,755)	(2,076)	(2,435)
Free cash flow	3,490	3,101	3,735	4,816	5,792
Opening cash (include bank balance)	3,044	2,359	3,148	4,836	7,270
Closing cash	2,359	3,148	4,836	7,270	10,304

Source: Company; Sharekhan estimates

### Key Ratios

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
<b>Margins (%)</b>					
Gross profit margin	32.8	29.5	29.1	30.8	31.7
EBITDA margin	18.2	15.5	15.0	16.7	17.6
EBIT margin	15.0	11.6	10.8	12.8	14.0
Net profit margin	22.6	22.9	25.9	25.5	25.5
Tax rate	12.4	10.9	9.7	11.1	12.2
<b>As a % of net sales</b>					
Employee expense	67.2	70.5	70.9	69.2	68.3
Other expense	14.5	14.0	14.1	14.1	14.1
<b>Measure of financial status</b>					
Debt/ Equity (x)	0.1	0.1	0.1	0.1	0.1
Debtor days	70	71	70	70	70
Payable days	29	33	29	30	30
Working capital days	41	38	41	40	40
Asset turnover ratio	1.4	1.3	1.2	1.2	1.2
<b>Measure of investment</b>					
Adjusted EPS (Rs)	47.7	45.9	40.8	51.0	61.1
Cash EPS (Rs)	61.2	63.0	59.1	69.7	80.4
DPS (Rs)	15.5	16.7	14.5	18.1	21.6
Dividend payout (%)	32.5	36.3	35.4	35.4	35.4
BVPS (Rs)	228.6	250.8	274.7	304.6	340.4
RoE (%)	22.0	19.2	15.7	17.8	19.2
RoCE (%)	24.0	20.5	16.6	19.0	21.1
RoIC (%)	47.7	45.9	40.8	51.0	61.1
<b>Valuation ratio</b>					
CMP (Rs.)	696	696	696	696	696
P/E (x)	14.6	15.2	17.0	13.7	11.4
Mcap (Rs. crore)	67,243	67,243	67,243	67,243	67,243
Market cap / Sales (x)	1.9	1.8	1.8	1.7	1.5
EV/Sales (x)	1.7	1.6	1.6	1.4	1.2
EV/EBITDA (x)	9.3	10.6	10.6	8.3	6.8
P/BV (x)	3.0	2.8	2.5	2.3	2.0
Dividend yield (%)	2.2	2.4	2.1	2.6	3.1
<b>Growth rate (%)</b>					
Revenue in INR	12.9	6.1	0.4	8.8	9.7
EBITDA	34.6	(9.6)	(3.3)	21.3	15.7
EBIT	43.7	(17.8)	(6.7)	28.8	19.9
Adjusted net profit	13.1	(1.1)	(15.4)	24.8	19.9
EPS	0.1	(0.0)	(0.1)	0.2	0.2

Source: Company; Sharekhan estimates

## About company

Incorporated in 1986, Tech Mahindra was formed with a joint venture between Mahindra & Mahindra and British Telecom Plc, under the name of Mahindra British Telecom. The company has been providing end-to-end services to telecom OEMs and service providers. Over the years, the company has acquired Comviva Technologies, LCC and Hutchison Global Services to fill gaps in its service offerings in the telecom space. Notably, post the acquisition of Satyam, Tech Mahindra entered the enterprise solutions space and became the fifth-largest Indian IT player. The company has now diversified its exposure to other verticals like BFSI and manufacturing. Tech Mahindra offers a bouquet of services include IT outsourcing services, consulting, next generation solutions, application outsourcing, network services, infrastructure management services, integrated engineering solutions, business process outsourcing, platform solutions and mobile value-added services.

## Investment theme

Tech Mahindra is one of leading players in providing end-to-end services and solutions to telecom OEMs and major global service providers in the communication space (contributes ~40% to its total revenue). Historically, this has helped the company whenever there is any uptick in technology spends, led by adoption of new technology. As the pace of spending from the roll-out of 5G network to accelerate across the globe, Tech Mahindra is well-positioned to capitalize on the 5G opportunity across networks and IT services given its investments in network capabilities, IPs, platforms and partnerships. Further, the company has successfully improved its capabilities in enterprise segment through organically and inorganically as well, which has enabled the company to capture large deals in this space.

## Key Risks

- ◆ Any hostile development against current visa regime would affect employee expenses as lower proportion of local resources are deployed onsite;
- ◆ Rupee appreciation or/and adverse cross-currency movements might affect earnings;
- ◆ Delay/loss of accounts in the enterprise segment;
- ◆ Delay in pick-up of 5G-related spends;
- ◆ High concentration in Communication vertical;
- ◆ M&A and Integration risk

## Additional Data

### Key management personnel

Mr. Anand Mahindra	Chairman
CP Gurnani	Chief Executive Officer
Manoj Bhat	Chief Financial Officer
Jagdish Mitra	Chief Strategy Officer
Manish Vyas	President, Communications, Media & Entertainment Business
Vivek Agarwal	Global Head for Enterprise Verticals

Source: Company website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	First State Investments ICVC	5.75
2	BlackRock Inc	4.99
3	First State Global Umbrella Fund	4.19
4	ICICI Prudential Asset Management	1.97
5	SBI Funds Management Pvt Ltd	1.93
6	Vanguard Group Inc/The	1.75
7	Republic of Singapore	1.73
8	SBI-ETF NIFTY 50	1.58
9	Government Pension fund	1.58
10	Aditya Birla Sun Life Trustee	1.50

Source: Bloomberg

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## Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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