

Tech Mahindra

Estimate change



TP change



Rating change



CMP: INR848

TP: INR940 (+11%)

Neutral

Good execution; Retain Neutral on fair valuation

Little room for margin expansion without material growth improvement

Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USDb)	820 / 11
52-Week Range (INR)	888 / 470
1, 6, 12 Rel. Per (%)	-1/34/12
12M Avg Val (INR M)	2930

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	369	381	425
EBIT Margin (%)	11.6	11.6	11.5
PAT	40	38	40
EPS (INR)	46.3	44.0	46.3
EPS Gr. (%)	(5.9)	(4.6)	5.2
BV/Sh. (INR)	235.6	284.3	312.9

Ratios

RoE (%)	18.5	15.4	14.7
RoCE (%)	13.1	12.0	12.3
Payout (%)	32.7	45.7	32.6

Valuations

P/E (x)	18.3	19.2	18.3
P/BV (x)	3.6	3.0	2.7
EV/EBITDA (x)	12.6	10.7	9.3
Div Yield (%)	1.8	2.4	1.8

Shareholding pattern (%)

As On	Sep-20	Jun-20	Sep-19
Promoter	35.8	35.8	35.9
DII	14.4	13.2	14.4
FII	38.0	39.6	37.8
Others	11.8	11.3	12.0

FII Includes depository receipts

- TechM's revenue growth of 2.9% QoQ CC was ahead of our expectations (1.5% QoQ). Growth was driven by the Enterprise business (4.3% QoQ) while Communications remained largely flat (0.8% QoQ) given the overhang in Network services. BPO (31.3% QoQ), which accounts for ~10% of the business drove more than half of the growth.
- Margin expansion of 410bp sequentially was a surprise. This was led by improvement in both supply/demand and operational efficiencies coming into play.
- New deal wins of USD421m were up sequentially. But, they were impacted by delay in few large deals and remained below average TCV in FY20 (USD900m+).
- As the business is running at elevated operational levers (utilization, employee expenses, etc.), we expect limited room for expansion in EBITDA margin (v/s FY21 guidance of 15%). We upgrade/ downgrade our FY21/FY22E EPS estimates by 3%/11% as we revisit the company's growth and margin trajectory. Our TP implies 20x FY22E EPS. Remain **Neutral**.

Beat on revenue and margins

- In 2QFY21, TechM reported revenue (USD)/EBIT/PAT growth of -2%/15%/-5% YoY (v/s est. -4%/-10%/-22% YoY). For 1HFY21, the company reported revenue (USD)/ EBIT/ PAT growth of -2%/4%/-2% YoY.
- Revenue grew 2.9% QoQ (CC), which was higher than our est. (1.5% QoQ CC). While Communication segment was largely flat at 0.8% QoQ (CC), better performance in Enterprise segment (4.3% QoQ, CC) helped in driving growth.
- BPO (10% of revenues) drove more than half the growth and 40% of margin improvement.
- Within Enterprise, Technology, Media and Enterprise (13.3% QoQ), BFSI (9.6% QoQ) and Retail, Transport and Logistics (7.8% QoQ) grew above company average growth while other verticals reported largely flat/modest growth.
- Across geographies, RoW grew at 11.7% QoQ while the Americas (2.7% QoQ) and Europe (2.1% QoQ) fared well.
- On a sequential basis, the company reported margin expansion of 410bp and stood at 14.2% (v/s est. 11.3%).
- Utilizations for the company improved by 300bp to 85% (v/s 82% in 1QFY21) and attrition reduced to 14% (v/s 17% in 1QFY21).
- Net new TCV for the quarter stood at USD421m, which was sequentially up but below FY20 trend.
- Receivable days reduced by 10 days and stood at 97 days (lowest in the last 15 quarters). Cash conversion rate (FCF/NI) stood at 164%.
- The Board has announced special dividend of INR15/share.
- The company announced two acquisitions for USD40m, which will result in incremental revenue contribution of USD35m.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Key highlights from management commentary

- Supply side constraints present in 1QFY21 have cleared and management is seeing increased demand momentum.
- The conversion of funnel is back to previous levels with larger number of medium-sized deals.
- During the quarter, growth came from multiple verticals. Management alluded that Manufacturing has now bottomed out and is expected to return on growth trajectory in the coming quarters.
- In case of Communications, deal signings have doubled from 1QFY21 and the funnel across transformational areas is looking decent.
- Revenues in 3QFY21 may be impacted due to increased furloughs but the same has not come up yet in client discussions.
- Margin improvement of 410bp was partly driven by: (1) supply and demand side recovery (~160bp), (2) cost management incl. offshoring, utilization and reduction in sub-con expenses (~160bp), and (3) normalization of seasonality in 1QFY21 in the mobility business (70bp).
- Management is hopeful of sustaining margins (if not improving them further).
- 5G will be more a FY22 phenomenon as despite the high data consumption revenues have been muted for service providers. This has negatively impacted investments in the 5G cycle. However, B2C should see expansion in projects.
- In the past, Enterprise business had witnessed industry-leading growth and the company is aiming to achieve the same. Breakthrough deals in FY20 should help accelerate this growth.

Valuation and view – further rerating requires revenue pickup

- TechM's high exposure to Communications vertical remains a potential opportunity as the broader 5G rollout can lead to a new spending cycle in the space. But, the segment continues to deliver tepid growth (flat growth in 2QFY21), which has resulted in overall growth being stuck in single digits.
- Also, while the company has delivered robust improvement in EBITDA margin, it has maintained the 15% guidance band (although with upside bias). In our view, there is limited room for EBITDA margin expansion (v/s FY21 guidance) as the company needs to invest back into the business (utilization, employee wage hikes, etc.) after keeping a tight leash on them during 1HFY21.
- We expect TechM to deliver single-digit growth in FY22 (unlike double-digit growth from its peers), which would lead to a lower P/E multiple. Hence, we value the stock at 20x FY22E EPS, at 25% discount to our target P/E for TCS. Remain Neutral.

Quarterly Performance

(INR b)

Y/E March	FY20				FY21E				FY20	FY21E	Est. 2QE	Var. (% / bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
Revenue (USD m)	1,247	1,287	1,353	1,295	1,207	1,265	1,285	1,318	5,182	5,076	1,236	2.4
QoQ (%)	-1.6	3.2	5.1	-4.3	-6.8	4.8	1.6	2.6	4.3	-2.1	2.4	244bp
Revenue (INR b)	87	91	97	95	91	94	97	100	369	381	92	1.6
YoY (%)	4.6	5.1	7.9	6.7	5.2	3.3	0.5	4.9	6.1	3.4	1.7	167bp
GPM (%)	25.0	25.8	26.3	25.3	24.3	27.5	25.9	25.0	25.6	25.7	24.9	259bp
SGA (%)	13.6	13.0	14.1	15.3	14.2	13.3	14.2	14.5	14.0	14.1	13.6	-32bp
EBITDA	13	15	16	13	13	17	15	15	57	60	14	19.2
EBITDA Margin (%)	15.2	16.5	16.2	14.2	14.3	18.2	15.8	14.6	15.5	15.7	15.5	267bp
EBIT	10	12	12	9	9	13	11	10	43	44	10	27.9
EBIT Margin (%)	11.5	12.8	12.2	10.0	10.1	14.2	11.7	10.5	11.6	11.6	11.3	291bp
Other income	3	2	3	2	4	1	1	1	10	6	2	-51.2
ETR (%)	25.7	16.9	24.6	20.2	25.5	24.6	24.0	24.0	22.0	24.5	25.5	-96bp
PAT	10	11	11	8	10	11	9	9	40	38	9	21.1
QoQ (%)	-15.3	17.2	2.0	-29.8	20.9	9.5	-11.9	-6.8			-9.6	1906bp
YoY (%)	6.8	5.6	-4.7	-29.0	1.4	-5.3	-18.1	8.7	-6.2	-4.6	-21.8	1649bp
EPS (INR)	11.0	12.8	13.0	9.1	11.1	12.1	10.7	9.9	45.9	43.8	10.0	20.9

Key Performance Indicators

Y/E March	FY20				FY21				FY20	FY21
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenue (QoQ CC %)	-1.0	4.1	4.3	-3.3	-6.3	2.9			5.6	
Costs (% of revenue)										
COGS	71.2	70.4	69.7	70.5	71.5	68.6	70.0	70.9	70.5	70.2
SGA	13.6	13.0	14.1	15.3	14.2	13.3	14.2	14.5	14.0	14.1
Depreciation	3.7	3.8	4.0	4.2	4.2	4.0	4.1	4.1	3.9	4.1
Margins (%)										
Gross Margin	25.0	25.8	26.3	25.3	24.3	27.5	25.9	25.0	25.6	25.7
EBITDA margin	15.2	16.5	16.2	14.2	14.3	18.2	15.8	14.6	15.5	15.7
EBIT Margin	11.5	12.8	12.2	10.0	10.1	14.2	11.7	10.5	11.6	11.6
Net Margin	11.1	12.4	11.9	8.5	10.7	11.4	9.7	8.8	10.9	10.1
Operating Metrics										
Headcount (k)	126	132	131	125	123	124			125	
Util excl. trainees (%)	82.0	83.0	85.0	84.0	82.0	85.0			83.5	
Attrition (%)	21.0	21.0	20.0	19.0	17.0	14.0			19.0	
Offshore rev. (%)	34.7	34.6	34.7	34.8	36.0	37.0			34.7	
Deal TCV (USD m)	475	1490	1230	505	290	360			3,700	
Key Verticals (QoQ %)										
Communication	-3.2	1.0	8.9	-8.4	-8.6	3.0			5.3	
Enterprise	-0.8	5.0	2.6	-1.5	-5.5	6.1			3.5	
Key Geographies (QoQ%)										
North America	0.9	5.2	4.9	-5.7	-3.8	3.1			6.0	
Europe	-5.0	-0.2	6.3	-6.1	-9.2	2.4			-4.0	



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Strong beat on margins

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- The Board has announced special dividend of INR15/share.
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Exhibit 1: TME, BFSI and Retail reported strong performance

Verticals	Contribution to rev (%)	Growth (QoQ %)
Telecom	39.3	3.0
Manufacturing	16.1	0.5
Tech Media Entertainment	9.8	14.2
BFSI	16.4	9.5
Retail Transport Logistics	7.5	7.7
Others	10.9	2.0

Exhibit 2: Key geographies fared well while RoW reported strong growth

Geographies	Contribution to rev (%)	Growth (QoQ %)
Americas	48.4	3.1
Europe	25.2	2.4
Rest of World	26.4	11.2

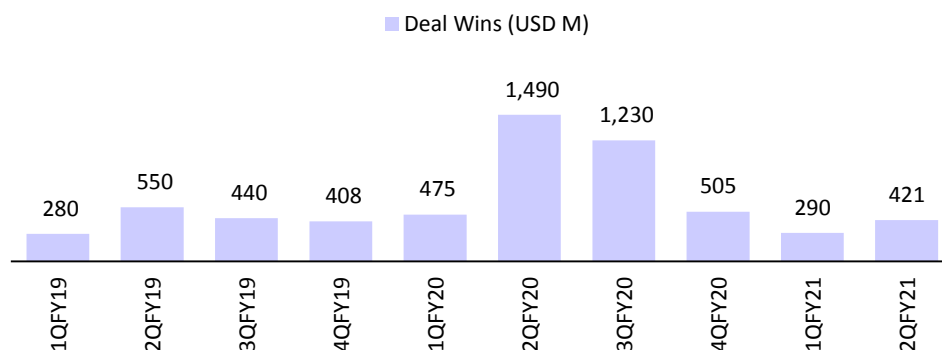
Exhibit 3: Company witnessed sequential decline in Top 6-10 bucket

	Contribution to rev (%)	Growth (QoQ %)
Top 5	22	4.8
Top 6-10	8	-6.8
Top 11-20	13	13.6

Exhibit 4: BPO drove growth during the quarter

	Contribution to rev (%)	Growth (QoQ %)
BPO proportion	10.2	31.1
Services (Rest)	89.8	2.5

Source: Company, MOFSL

Exhibit 5: Deal wins were up sequentially but below FY20 trend

Source: MOFSL, Company

Valuation and view – further rerating needs revenue pickup

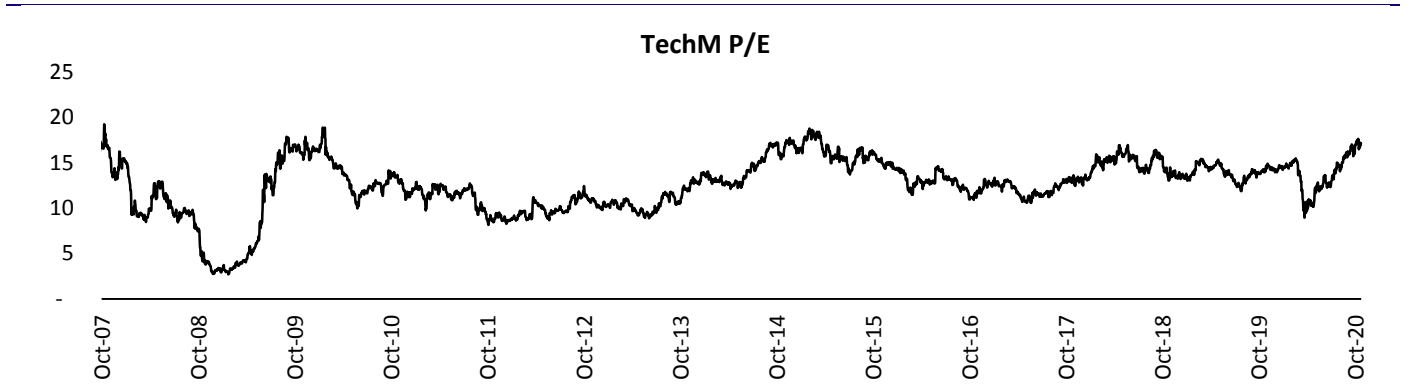
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- We expect TechM to deliver single-digit growth in FY22 (unlike double-digit growth from its peers), which would lead to a lower P/E multiple. Hence, we value the stock at 20x FY22E EPS, at 25% discount to our target P/E for TCS. Remain Neutral.

Exhibit 6: Revisions to our estimates

	Revised		Earlier		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
INR/USD	75.1	76.5	75.3	76.5	-0.2%	0.0%
USD Revenue - m	5,076	5,557	5,010	5,506	1.3%	0.9%
Growth (%)	(2.1)	9.5	(3.3)	9.9	130bps	-40bps
EBIT margin(%)	11.6	11.5	11.1	12.8	50bps	-130bps
PAT (INR B)	38	40	37	46	3.2%	-11.2%
EPS	43.8	46.1	42.5	51.9	3.1%	-11.2%

Source: MOFSL, Company

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



Source: MOFSL, Bloomberg

Exhibit 8: Operating metrics

	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21
Revenue by Geography (%)										
Americas	48.2	47.0	47.4	46.4	47.6	48.5	48.4	47.7	49.2	48.4
Europe	30.0	29.6	28.9	28.6	27.6	26.7	27.0	26.5	25.8	25.2
Rest of World	21.9	23.4	23.7	24.9	24.8	24.9	24.6	25.8	24.9	26.4
Vertical Split (%)										
Telecom	39.6	41.5	41.1	42.7	42.0	41.1	42.6	40.8	40.0	39.3
Manufacturing	20.1	20.1	20.5	20.2	19.4	18.0	17.3	17.7	16.8	16.1
Tech Media Entertainment	7.2	7.3	7.0	7.5	7.6	8.1	7.6	7.4	9.0	9.8
BFSI	13.6	13.5	13.4	13.1	12.8	13.0	13.2	15.3	15.7	16.4
Retail Transport Logistics	6.1	6.5	6.7	6.4	6.2	7.0	7.2	7.3	7.3	7.5
Others	13.4	11.2	11.3	10.2	11.9	12.8	12.2	11.5	11.2	10.9
Onsite-Offshore Mix (%)										
Onsite	66.6	64.5	65.5	65.2	65.3	65.4	65.3	65.2	64.0	63.0
Offshore	33.4	35.5	34.5	34.8	34.7	34.6	34.7	34.8	36.0	37.0
Client Metrics										
No. of active clients	926	930	935	938	941	946	964	973	981	988
% of repeat business	98.5	97.4	94.6	88.7	97.7	94.8	91.2	86.1	97.0	95.0
No. of Million \$ clients										
USD1m+	396	407	416	425	429	437	446	446	451	460
USD5m+	154	157	157	156	160	155	164	160	161	165
USD10m+	86	86	88	83	81	80	83	85	81	82
USD20m+	47	45	46	50	49	49	50	49	48	50
USD50m+	16	17	18	20	21	22	22	22	21	21
Client concentration (%)										
Top 5 Clients	21.9	23.3	22.6	22.8	21.4	21.6	22.3	21.4	22.0	22.0
Top 6-10	10.6	9.4	9.0	9.2	9.3	9.9	8.7	9.6	9.0	8.0
Top 11-20	13.7	12.9	12.4	13.1	12.9	12.1	11.1	12.6	12.0	13.0
Headcount										
Software professionals	72,462	72,534	71,785	71,477	74,093	72,597	73,039	71,515	71,020	69,512
BPO	34,700	39,407	43,439	43,081	45,000	52,193	50,886	46,816	45,554	48,462
Sales and support	6,390	6,450	6,618	6,524	6,680	6,732	6,874	6,905	6,842	6,284
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	1,24,258
IT Attrition (LTM %)	19	20	21	21	21	21	20	19	17	14
IT Utilization (%)	81	81	82	82	80	82	84	83	82	85
IT Utilization (excl. trainees)	84	83	83	82	82	83	85	84	82	85
DSO - incl. unbilled	108	112	107	102	110	114	112	112	107	97
Borrowings (USD m)	363.2	353.3	316.0	288.5	296.1	311.4	288.9	326.7	280.0	230.0
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	1,564.0
Capital Expenditure (USD m)	27.7	21.3	31.6	29.2	29.4	31.1	31.8	26.9	26.0	34.0

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	425
Change (%)	19.4	17.9	10.0	5.6	12.9	6.1	3.4	11.5
COGS	151	183	206	215	234	260	268	298
SGA expenses	33	39	44	45	50	52	54	62
Total Expenses	184	222	250	261	284	311	321	359
EBITDA	41	43	42	47	63	57	60	66
% of Net Sales	18.3	16.1	14.4	15.3	18.2	15.5	15.7	15.5
Depreciation	6	8	10	11	11	14	16	17
Other Income	1	4	6	12	4	10	6	4
PBT	36	39	39	49	56	53	51	53
Tax	9	8	10	11	13	12	12	13
Rate (%)	26.5	20.9	25.4	22.4	22.4	22.0	24.5	24.0
PAT	26	31	29	38	44	41	38	40
Minority interest	0	0	0	0	0	-1	0	0
PAT before EO	26	31	28	38	43	43	38	40
Change (%)	-10.6	18.0	-7.4	33.9	13.1	-1.1	-9.5	5.2
Extraordinary Items (EO)	0	0	0	0	0	-2	0	0
Reported PAT	26	31	28	38	43	40	38	40
Change (%)	-13.2	16.7	-7.4	33.9	13.1	-6.2	-4.6	5.2

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	246	271
Net Worth	122	146	164	188	203	218	250	275
Minority Interest	2	2	5	5	5	4	4	4
Loans	7	11	14	24	20	25	17	17
Other LT liabilities	4	5	10	5	3	28	27	27
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	148	176	205	235	243	287	310	335
Applications								
Assets	40	43	68	79	73	89	89	83
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	259	301
Debtors	70	80	78	90	99	116	101	112
Cash & Bank Balance	32	52	54	78	97	88	123	150
Other Current Assets	21	18	31	13	19	27	35	39
Current Liab. & Prov	51	48	56	70	91	87	90	100
Net Current Assets	72	102	108	111	124	145	169	200
Application of Funds	148	176	205	235	243	287	310	335

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	44.0	46.3
Diluted EPS	27.0	34.5	32.0	42.7	48.8	45.9	43.8	46.1
Cash EPS	33.6	43.1	43.0	54.9	61.6	59.2	61.5	65.4
Book Value	127.1	164.3	185.0	211.8	230.1	235.6	284.3	312.9
DPS	6.0	12.0	9.0	14.0	14.0	15.0	20.0	15.0
Payout %	22.2	34.8	28.2	32.8	28.7	32.7	45.7	32.6
Valuation (x)								
P/E	30.5	23.9	26.1	19.6	17.2	18.3	19.2	18.3
Cash P/E	25.2	19.7	19.7	15.4	13.8	14.3	13.8	12.9
EV/EBITDA	19.2	16.7	17.0	14.8	10.6	12.6	10.7	9.3
EV/Sales	3.5	2.7	2.4	2.3	1.9	2.0	1.7	1.4
Price/Book Value	6.7	5.2	4.6	4.0	3.7	3.6	3.0	2.7
Dividend Yield (%)	0.7	1.4	1.1	1.7	1.7	1.8	2.4	1.8
Profitability Ratios (%)								
RoE	24.5	22.8	18.3	21.5	21.2	18.5	15.4	14.7
RoCE	19.7	17.2	13.4	14.2	18.5	13.1	12.0	12.3
ROIC	26.6	23.2	19.0	21.3	33.3	20.1	21.4	24.6
Turnover Ratios								
Debtors (Days)	113	110	98	107	104	115	97	96
Fixed Asset Turnover (x)	5.6	6.2	4.3	3.9	4.7	4.1	4.3	5.2
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

Y/E March	2015	2016	2017	2018	2019	2020	2021E	2022E
(INR b)								
CF from Operations	43	50	46	57	71	71	72	77
Change in Working Capital	-9	-5	5	17	11	-22	9	-1
Other adjustments	-11	-13	-11	-11	-13	-12	-12	-13
Net Operating CF	35	45	41	63	69	38	69	63
Net Purchase of FA	-11	-9	-8	-21	-6	-30	-15	-11
Free Cash Flow	24	36	33	42	63	7	54	52
Net Purchase of Invest.	-10	2	-23	0	0	0	0	0
Net Cash from Invest.	-21	-7	-31	-21	-6	-30	-15	-11
Inc./ (Dec) in Equity	1	0	0	0	0	0	0	0
Proceeds from LTB/STB	-3	0	-4	9	-10	24	-14	-7
Dividend Payments	-2	-6	-12	-14	-15	-15	-20	-15
Cash Flow from Fin.	-5	-6	-16	-6	-24	9	-35	-22
Net Cash Flow	9	33	-6	36	39	17	19	30
Opening Cash Balance	36	32	52	54	78	97	88	123
Add: Net Cash	9	33	-6	36	39	17	19	30
Closing Cash Balance	32	52	54	78	97	88	123	150

NOTES

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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