

Tech Mahindra

BSE SENSEX 61,309
S&P CNX 18,308

Tech Mahindra

Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USD\$)	1671 / 22.5
52-Week Range (INR)	1838 / 894
1, 6, 12 Rel. Per (%)	-3/41/46
12M Avg Val (INR M)	4480

Financials & Valuations (INR b)

Y/E Mar	2021	2022E	2023E
Sales	379	444	511
EBIT Margin (%)	14.2	15.2	15.2
PAT	44	57	66
EPS (INR)	51.7	64.8	75.1
EPS Gr. (%)	6.9	25.4	15.8
BV/Sh. (INR)	284.4	315.9	353.3

Ratios

RoE (%)	19.5	21.8	22.6
RoCE (%)	19.3	21.7	22.5
Payout (%)	87.1	50.0	50.0

Valuations

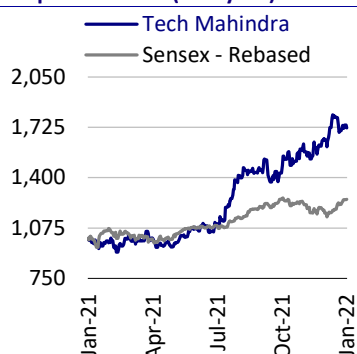
P/E (x)	33.0	26.4	22.8
P/BV (x)	6.1	5.5	4.9
EV/EBITDA (x)	21.8	18.3	15.8
Div Yield (%)	2.6	1.9	2.2

Shareholding pattern (%)

As On	Dec-21	Sep-21	Dec-20
Promoter	35.7	35.7	35.8
DII	17.4	17.1	13.7
FII	35.4	35.6	39.1
Others	11.6	11.7	11.5

FII Includes depository receipts

Stock performance (one-year)



CMP: INR1,722 **TP: INR 1,910 (+11%)** **Neutral**

CTC acquisition to bolster TECHM's Insurance capability

Deal valuation inexpensive on account of higher client concentration

- TECHM has announced the acquisition of Com Tec Co IT (CTC), an East European IT Services company with a presence in the Digital engineering and outsourced product development space, for EUR310m.
- CTC services clients in the Insurance vertical, which should strengthen TECHM's capabilities in that space. It has development centers in Eastern Europe (Latvia and Belarus) and has a workforce of 720. TECHM has also acquired a minority stake (25%) in two group SaaS companies (SWFT and Surance) for EUR20m, along with an option to acquire an additional 20% at current levels.
- CTC had a revenue of EUR36.6/EUR57.6/EUR71.3 in CY18/CY19/CY20, implying ~40% CAGR, although the growth has progressively moderated. It posted a revenue of EUR58.8m for the nine months ended Sep'21, implying a run-rate of ~EUR80m in CY21 (1.5% of TECHM's FY22 revenue). As per the management, CTC has industry-leading EBIT margin and will be accretive on an EPS, RoE, and FCF basis. While TECHM has not shared additional details, our rough estimates suggest a PAT accretion of less than 1% to our FY23 estimate.
- Given its presence in the high growth Digital and product development work, along with high operating margin, the CTC acquisition is attractive for TECHM at the trailing EV/sales of 3.8x and mid-teen EV/EBITDA multiple (our estimate). Moreover, CTC is operating at high single-digit attrition rate in today's environment, which is also a positive.
- The key strategy for this acquisition is to scale and cross-sell. TECHM will invest in expanding CTC's marketing capabilities and integrate capabilities, which will unlock scale for the latter.
- This is a good move by the company and will further add to the Digital and ER&D capabilities of TECHM in the Financial Services space.
- We maintain our **Neutral** rating with a TP of INR1,910/share, implying 22x FY24E EPS. We have not incorporated the numbers in our estimates yet.

Valuation and view

- TECHM's higher exposure to the Communications vertical remains a potential opportunity as a broader 5G rollout can lead to a new spending cycle in this space. The company is seeing traction in 5G investments.
- We expect a gradual improvement in EBIT margin, given the levers around productivity and cost optimization. Elevated operating metrics and supply side pressure remains a risk to our margin estimates
- We expect TECHM to deliver mid-teens growth in FY22. We value the stock at 22x FY23E EPS. We remain **Neutral** on the stock.

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Highlights from the management interaction

- TECHM will completely acquire CTC for EUR310m, of which EUR210m will be paid upfront and the balance will be paid in the form of earnouts and synergy payouts over the next four years.
- TECHM also acquired a minority stake (25%) in two Insurance technology platforms (SWFT and Surance), which share common ownership with CTC. It has the option to increase its stake by another 20% at its discretion. Both of these are relatively new businesses (1.5-3 years old).
- The deal will be financed by cash and there are no plans to raise debt.
- The management iterated that the business has deep digital skill sets and capabilities, marquee projects, and delivery centers in Latvia and Belarus. The management intends to take leverage of these disruptive business models to double down on scaling the Insurance business.
- The business has industry-leading EBIT margin and the deal are EBIT, EPS, RoE and cash flow accretive. There is no seasonality in the business and the attrition rate is in single-digits.
- Synergies include opportunities to scale and cross-sell. There may be some investments in sales and talent in the near term as the business had many constraints on marketing spends (it is in a private ownership structure) and therefore the company left some money on the table. With the acquisition and TECHM's sales and marketing capabilities, it expects to scale and cross-sell not only CTC's products, but also its own products to new clients so that they leave no money on the table.
- The Insurance market is very attractive as the technology spends here are generally 2-3% higher than the industry.
- SWFT is B2B SaaS platform focused on sales and distribution, digital broking, and helps Insurance companies to launch new products. It has clients based out of Europe. Revenue is based on a percentage of brokerage.
- Surance is a B2B SaaS platform developed in Israel and is focused on personal cyber Insurance. It helps Insurance companies with the collection of relevant data and managing underwriting associated risk based on that data. The management believes there is a huge market for data driven Insurance underwriting.
- The amortization will be one-third of cost over an eight-year period.
- The company has a good set of digital capabilities and 30-40% of the employees are tenured employees with deep knowledge expertise.
- The company earns ~60% of its revenue from its anchor client.

Financials and valuations

Income Statement

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Sales	291	308	347	369	379	444	511	579
Change (%)	10.0	5.6	12.9	6.1	2.7	17.2	15.1	13.4
COGS	206	215	234	260	259	302	348	392
SGA expenses	44	45	50	52	52	60	68	78
Total Expenses	250	261	284	311	310	362	416	470
EBITDA	42	47	63	57	68	82	94	109
As a percentage of Net Sales	14.4	15.3	18.2	15.5	18.1	18.5	18.5	18.8
Depreciation	10	11	11	14	15	14	17	19
Other Income	6	12	3	10	6	10	11	13
PBT	39	49	55	53	60	78	89	103
Tax	10	11	13	12	15	20	23	27
Rate (%)	25.4	22.4	22.6	22.0	25.3	26.3	26.0	26.0
PAT	29	38	43	41	45	57	66	76
Minority interest	0	0	0	-1	-1	0	-1	0
Share from associates	0	0	0	0	0	0	0	0
PAT before EO	28	38	43	43	46	57	66	77
Change (%)	-7.4	33.9	13.1	-1.1	7.2	25.7	15.8	15.5
Extraordinary Items (EO)	0	0	0	-2	-1	0	0	0
Reported PAT	28	38	43	40	44	57	66	77
Change (%)	-7.4	33.9	13.1	-6.2	9.8	29.4	15.8	15.5

Balance Sheet

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	4	4	4	4	4	4	4	4
Reserves	160	184	198	214	244	273	306	344
Net Worth	164	188	203	218	249	277	310	348
Minority Interest	5	5	5	4	4	4	4	4
Loans	12	17	14	24	17	17	17	17
Other LT liabilities	12	12	9	28	28	32	36	40
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	205	235	243	287	309	342	379	422
Applications								
Assets	68	79	73	89	91	84	76	66
Investments	7	15	12	2	6	6	6	6
Other non-current assets	22	30	33	50	47	55	64	72
Curr. Assets	163	181	216	232	253	298	349	406
Debtors	53	65	70	76	65	76	88	101
Cash and Bank Balance	20	20	20	30	27	30	33	41
Investments	63	75	98	57	98	118	143	168
Other Current Assets	27	22	28	68	63	74	85	96
Current Liab. and Prov.	56	70	91	87	88	101	115	128
Net Current Assets	108	111	124	145	165	197	234	278
Application of Funds	205	235	243	287	309	342	379	422

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Basic (INR)								
EPS	32.4	43.0	48.5	48.7	52.1	65.3	75.6	87.3
Diluted EPS	31.9	42.7	47.7	48.3	51.7	64.8	75.1	86.7
Cash EPS	42.9	54.8	60.3	62.3	66.7	81.1	94.1	108.3
Book Value	187.9	213.4	228.7	249.9	284.4	315.9	353.3	396.9
DPS	9.0	14.0	14.0	15.0	45.0	32.4	37.5	43.3
Payout (%)	28.2	32.8	29.3	31.0	87.1	50.0	50.0	50.0
Valuation (x)								
P/E	53.1	40.0	35.5	35.4	33.0	26.4	22.8	19.7
Cash P/E	40.1	31.4	28.6	27.6	25.8	21.2	18.3	15.9
EV/EBITDA	35.8	32.2	24.0	26.2	21.8	18.3	15.8	13.7
EV/Sales	5.1	4.9	4.4	4.1	3.9	3.4	2.9	2.6
Price/Book Value	9.2	8.1	7.5	6.9	6.1	5.5	4.9	4.3
Dividend Yield (%)	0.5	0.8	0.8	0.9	2.6	1.9	2.2	2.5
Profitability Ratios (%)								
RoE	18.4	21.5	22.0	20.2	19.5	21.8	22.6	23.3
RoCE	17.7	17.2	22.8	17.3	19.3	21.7	22.5	23.3
Turnover Ratios								
Debtors (Days)	67	77	73	75	62	63	63	64
Fixed Asset Turnover (x)	4.3	3.9	4.7	4.1	4.1	5.3	6.7	8.8
Leverage Ratio								
Debt/Equity Ratio(x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0

Cash Flow Statement

(INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
CF from Operations	35	43	55	49	65	72	83	95
Change in Working Capital	6	-8	-11	-5	16	-13	-14	-15
Net Operating CF	41	36	44	44	81	59	69	81
Net Purchase of FA	-8	-8	-8	-8	-6	-8	-8	-9
Free Cash Flow	33	28	37	35	75	51	61	71
Net Purchase of Invest.	-21	-26	-13	19	-49	-20	-25	-25
Net Cash from Invest.	-29	-34	-21	10	-55	-28	-33	-34
Inc./ (Dec.) in Equity	0	0	0	0	1	0	0	0
Proceeds from LTB/STB	-4	6	-6	-20	-13	0	0	0
Dividend Payments	-12	-9	-17	-25	-18	-28	-33	-38
Cash Flow from Fin.	-16	-3	-23	-45	-30	-28	-33	-38
Other adjustments	0	0	0	1	0	0	0	0
Net Cash Flow	-4	0	1	10	-3	3	3	8
Opening Cash Balance	24	20	20	20	30	27	30	33
Add: Net Cash	-4	0	1	10	-3	3	3	8
Closing Cash Balance	20	20	20	30	27	30	33	41

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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* MOSL has been amalgamated with Motilal Oswal Financial Services Limited (MOFSL) w.e.f August 21, 2018 pursuant to order dated July 30, 2018 issued by Hon'ble National Company Law Tribunal, Mumbai Bench.