

Tech Mahindra

BSE SENSEX

33,250

S&P CNX

10,266

CMP: INR496

TP: INR570(+15%)

Buy

Tech Mahindra

Stock Info

Bloomberg	TECHM IN
Equity Shares (m)	977
52-Week Range (INR)	515/358
1, 6, 12 Rel. Per (%)	6/22/-18
M.Cap. (INR b)	484.4
M.Cap. (USD b)	7.5
Avg Val, INRm	1207
Free float (%)	63.9

Financials Snapshot (INR b)

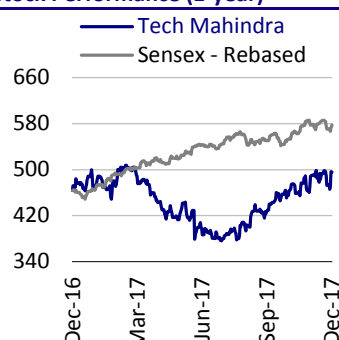
Y/E Mar	2017	2018E	2019E
Net Sales	291.4	309.1	346.9
EBITDA	41.8	43.6	50.6
PAT	27.5	31.8	33.5
EPS (INR)	30.9	35.8	37.7
Gr. (%)	-11.9	15.9	5.3
BV/Sh (INR)	187.9	196.9	223.3
RoE (%)	18.4	18.9	18.2
RoCE (%)	15.2	15.6	15.2
P/E (x)	16.1	13.9	13.2
P/BV (x)	2.6	2.5	2.2

Shareholding pattern (%)

As On	Sep-17	Jun-17	Sep-16
Promoter	36.1	36.2	36.3
DII	13.1	14.6	10.9
FII	37.5	35.2	39.3
Others	13.4	14.0	13.5

FII Includes depository receipts

Stock Performance (1-year)



Betting on mega trends

Analyst Day Takeaways

We attended the TECHM Analyst Day in Pune, where the company highlighted its 3-4-3 strategy, the various investments and partnerships it has made to propel it and demonstrated multiple solutions in areas that it is betting on. Appended below are our key takeaways from the event:

- **3-4-3 for all industries:** TECHM has identified 3 mega trends – [1] explosion of connected devices, [2] power of new technologies and [3] exponentiality of content consumption to ride on which it is placing 4 bets – [1] integrated digital customer experience, [2] connectedness through IoT, [3] software transformation and [4] network-of-the-future; with the 3 objectives – [1] run better, [2] change faster and [3] grow greater. The above strategy applies to all of the key verticals that it is present in.
- **Aligning with industry transformation in Communications:** TECHM has seen a notable slowdown in its Communications portfolio led by the changing face of the industry. Revenue pressures faced by telcos, their changing identities through varied acquisitions and the share change between incumbents and digital carries have all contributed to this. While TECHM is a partner to all major CSPs worldwide and has seen strong growth in the number of its high value accounts (35 in FY18 versus 21 in FY15), it has made several investments in line with its 3-4-3 strategy. Acquisitions of BIO and Pininfarina and partnerships in the areas of IoT, microservices, AI and networks have been accelerating business transformation for CSPs.
- **IT outsourcer to Digital partner:** In the Enterprise space, TECHM has been actively transforming the business to become a Digital partner to its customers. With >100 home grown and partner collaborated solutions, >30 platforms, 8 digital solution labs and 115,000 trained associates, it demonstrated various cases wherein it helped existing customers through solutions around digital transformation and productivity improvement. Its 5P framework (performance, pipeline, partnering, percentage wallet share and productivity of sales) and sub-verticalization strategies helped boost growth in Enterprise from 5% CAGR over FY10-13 to 14% over FY13-17.
- **Bets in Digital:** It broke down its bets in Digital for various verticals, which are aligned to overall strategy and at the same time relevant to trends playing out in the respective industries – Manufacturing (IoT based smart solutions, connected aftermarket, factory of the future and analytics); BFSI (core banking and wealth transformation, and disruptive services leveraging AI, blockchain and IoT); Healthcare (telemedicine, remote patient monitoring and critical care management).
- **M&A continues to be core:** To enhance its portfolio, augment presence in Digital and lead transformation, TECHM has been active on its M&A agenda. Recent acquisitions like HCI have helped strengthen the Healthcare portfolio

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and that of Pininfarina has given leading capabilities in design and engineering. To successfully draw out benefits from acquisitions, it has been keeping close scrutiny on financial performance post acquisition, deploying resources dedicated to drawing out synergies and integrating functions for seamless amalgamation. The company is likely to continue its thrust on M&A in order to fulfill its stated objectives.

Valuation view

- Restructuring of LCC and sluggish offtake in the large deals signings in Communications have dragged TECHM's revenue growth performance, and more so the margins.
- While Telecom recovery may be gradual, there are some structural strengths in TECHM's business to drive much improved growth over the medium-to-long term:
 - 1. Success in large deal wins and above-industry growth in the Enterprise segment is an encouraging indicator of improving competitive prowess.
 - 2. Network management services have potentially expanded the addressable market for TECHM, with directly addressable spend standing at ~USD40b. That may not start playing out until TECHM brings the LCC house in order (revenue has been pruned down to ~USD300-310m annualized in run rate USD430m during acquisition 1 year ago).
 - 3. TECHM also has a sizeable scale in Engineering services, and the opportunity in the same can be leveraged, especially after the acquisition of Mahindra Engineering Services (MES)
- Profitability has taken a hit for TECHM over the last three years, with a cumulative decline in EBITDA margin of 780bp over FY14-17. This has shown improvement intermittently as the company squeezed some of its operational levers and underwent cost optimization. However, sustained improvement in margins has been elusive, with persistent issues in LCC (and occasional ones in the core business too).
- We expect TECHM to grow its USD revenue at a CAGR of 9.7% over FY18-20 and EPS at a CAGR of 9.8% during this period. While profitability improvement has been on-track for the last two quarters, the remainder tailwinds on, and consequent improvement of profitability are likely to feed positively into the valuation multiple. Our price target of INR560 discounts forward earnings by 14x, implying an upside of 15%. Maintain Buy.

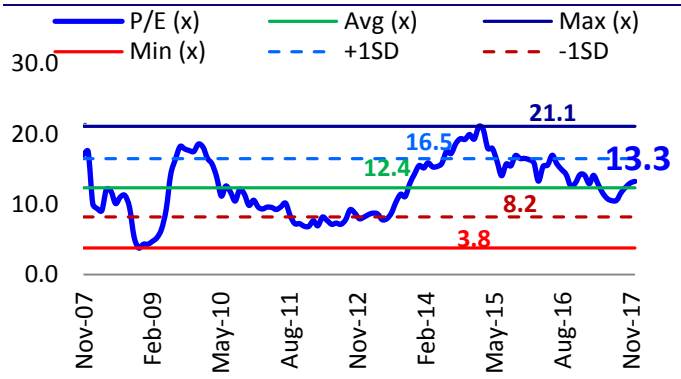
Key triggers

- Large deal announcements in enterprise segment
- Recovery in Telecom growth
- Sustained margin improvement on account of measures taken

Key risk factors

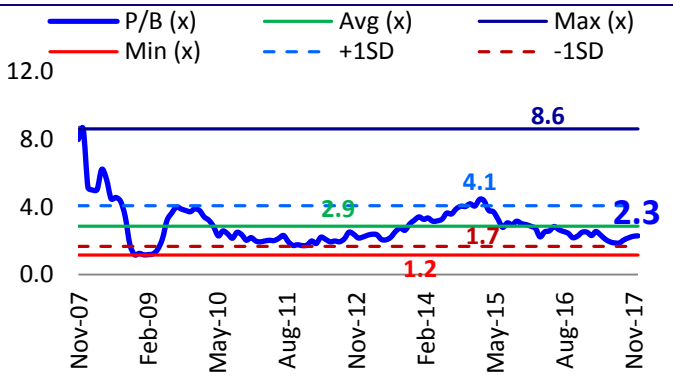
- Adverse visa related regulations as TECHM's proportion of local resources at onsite is lower than peers
- Currency fluctuations given higher sensitivity to earnings v/s peers
- More adversity in integration of acquisitions

Exhibit 1: TECHM 1-year forward PE chart



Source: Company, MOSL

Exhibit 2: TECHM 1-year forward PB chart



Source: Company, MOSL

Financials and Valuations

Income Statement						(INR Million)		
Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Net Sales	143,320	188,313	224,779	264,941	291,408	309,139	346,883	382,440
Change (%)	161.1	31.4	19.4	17.9	10.0	6.1	12.2	10.3
EBITDA	30,631	41,836	41,536	43,426	41,843	43,639	50,595	56,737
EBITDA Margin (%)	21.4	22.2	18.5	16.4	14.4	14.1	14.6	14.8
Depreciation	3,896	5,221	6,079	7,620	9,781	10,021	10,343	10,841
EBIT	26,735	36,615	35,457	35,806	32,062	33,619	40,252	45,895
Interest	922	673	689	961	1,286	1,394	1,183	987
Other Income	2,121	1,129	1,006	5,322	6,836	9,932	4,745	5,238
Extraordinary items	-2,940	-1,117	0	0	0	0	0	0
PBT	24,994	35,954	35,774	40,167	37,612	42,157	43,814	50,146
Tax	6,479	9,790	9,472	8,600	9,785	10,316	10,296	11,784
Tax Rate (%)	25.9	27.2	26.5	21.4	26.0	24.5	23.5	23.5
Min. Int. & Assoc. Share	301	336	310	412	357	1	-9	2
Reported PAT	18,214	25,828	25,992	31,155	27,470	31,840	33,527	38,360
Adjusted PAT	19,554	26,945	25,992	31,155	27,470	31,840	33,527	38,360
Change (%)	79.1	37.8	-3.5	19.9	-11.8	15.9	5.3	14.4

Balance Sheet						(INR Million)		
Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Share Capital	2,316	2,335	4,804	4,839	4,388	4,400	4,400	4,400
Reserves	66,214	89,469	117,682	138,824	159,984	168,576	191,752	217,691
Net Worth	68,530	91,804	122,486	143,663	164,372	172,976	196,152	222,091
Debt	14,702	8,420	11,287	15,564	23,761	23,787	23,695	23,603
Deferred Tax	-3,477	-3,830	-3,901	-5,575	-2,674	-5,047	-5,047	-5,047
Total Capital Employed	93,408	110,151	143,780	167,990	202,404	210,545	233,630	259,477
Gross Fixed Assets	22,318	28,606	40,329	43,446	63,590	70,410	74,068	77,226
Less: Acc Depreciation	0	0	0	0	0	0	0	0
Net Fixed Assets	22,318	28,606	40,329	43,446	63,590	70,410	74,068	77,226
Capital WIP	2,595	0	5,677	6,294	3,729	3,760	3,760	3,760
Investments	14,174	14,718	21,028	24,934	24,966	28,696	32,196	35,696
Current Assets	95,541	112,241	127,545	154,821	165,706	166,478	196,555	228,565
Inventory	0	0	0	0	0	0	0	0
Debtors	33,688	43,486	52,059	57,705	53,377	65,682	73,233	79,750
Cash & Bank	34,629	33,202	24,049	40,138	32,186	22,640	41,482	63,796
Loans & Adv, Others	27,224	35,554	51,438	56,978	80,143	78,157	81,840	85,019
Curr Liabs & Provns	41,220	45,415	50,800	61,505	55,587	58,798	72,949	85,770
Curr. Liabilities	8,577	14,722	20,587	22,755	23,117	27,510	31,151	34,006
Provisions	32,643	30,693	30,213	38,750	32,470	31,289	41,797	51,764
Net Current Assets	54,321	66,827	76,745	93,316	110,119	107,680	123,606	142,795
Total Assets	93,408	110,151	143,779	167,990	202,404	210,545	233,630	259,477

Financials and Valuations

Ratios

Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Basic (INR)								
EPS	22.0	30.7	29.3	35.1	30.9	35.8	37.7	43.1
Cash EPS	28.2	36.9	36.1	43.7	41.9	47.1	49.3	55.3
Book Value	81.4	112.3	142.2	165.6	187.9	196.9	223.3	252.8
DPS	5.0	5.0	6.0	12.0	9.0	12.0	10.0	12.0
Payout (incl. Div. Tax.)	23.1	16.3	20.5	34.2	29.1	33.5	26.5	27.8
Valuation(x)								
P/E	22.9	16.2	16.9	14.2	16.1	13.9	13.2	11.5
Cash P/E	17.6	13.5	13.7	11.4	11.9	10.5	10.1	9.0
Price / Book Value	5.9	4.4	3.5	3.0	2.6	2.5	2.2	2.0
EV/Sales	2.6	2.0	1.8	1.5	1.4	1.4	1.2	1.0
EV/EBITDA	12.2	8.8	9.7	9.0	10.1	9.9	8.1	6.8
Dividend Yield (%)	1.0	1.0	1.2	2.4	1.8	2.4	2.0	2.4
Profitability Ratios (%)								
RoE	32.6	36.4	24.5	23.4	18.4	18.9	18.2	18.3
RoCE	28.7	26.3	20.5	20.1	15.2	15.6	15.2	15.5
RoIC	65.1	46.5	30.0	25.7	17.0	14.5	16.6	18.9
Turnover Ratios (%)								
Fixed Asset Turnover (x)	5.8	7.0	6.0	5.5	5.0	4.4	4.6	4.8
Debtors (No. of Days)	60	75	78	76	70	70	73	73
Leverage Ratios (%)								
Net Debt/Equity (x)	-0.3	-0.3	-0.1	-0.2	0.0	0.0	-0.1	-0.2

Cash Flow Statement

(INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Adjusted EBITDA	30,631	41,836	41,536	43,426	41,843	43,639	50,595	56,737
Non cash opr. exp (inc)	-16,372	-7,901	-9,496	-8,987	-9,226	-10,317	-10,288	-11,786
(Inc)/Dec in Wkg. Cap.	-7,608	-12,302	-8,874	5,456	-17,243	-5,155	2,916	3,125
Tax Paid	0	0	0	0	0	0	0	0
Other operating activities	37,353	0	0	0	0	0	0	0
CF from Op. Activity	44,004	21,634	23,167	39,895	15,374	28,168	43,223	48,075
(Inc)/Dec in FA & CWIP	-3,099	-7,854	-21,365	-17,357	-9,694	-11,995	-12,000	-12,000
Free cash flows	40,905	13,780	1,802	22,538	5,680	16,173	31,223	36,075
(Pur)/Sale of Invt	-1,940	-8,539	-9,050	10,611	5,293	-2,738	1,061	1,554
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-5,039	-16,393	-30,415	-6,746	-4,401	-14,733	-10,939	-10,446
Inc/(Dec) in Net Worth	1,032	19	2,469	35	-451	12	0	0
Inc / (Dec) in Debt	-7,036	-1,305	2,396	-3,469	-9,196	-1,167	-1,091	-895
Interest Paid	0	0	0	0	0	0	0	0
Divd Paid (incl Tax) & Others	-750	-5,381	-6,771	-13,626	-9,278	-12,421	-10,351	-12,421
CF from Fin. Activity	-6,754	-6,668	-1,905	-17,060	-18,925	-13,576	-11,442	-13,316
Inc/(Dec) in Cash	32,211	-1,427	-9,154	16,089	-7,952	-142	20,843	24,313
Add: Opening Balance	2,418	34,629	33,202	24,048	40,138	32,185	32,044	52,886
Closing Balance	34,629	33,202	24,048	40,138	32,185	32,044	52,886	77,200

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Tech Mahindra

No

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