

Expect accelerated growth in FY21E...

Tech Mahindra (TechM) recently hosted an analyst meet wherein the company re-articulated its objective of 'Run business better, Bring a change and Be future ready'. To meet this objective, TechM is betting on customer experience, platforms, infrastructure & driving it by up skilling people in new technologies, adding capabilities through selective strategic acquisitions and partnerships & alliances ecosystem. Taking this into account, the company said: 1) growth would improve in communication & enterprise segments led by healthy deal pipeline, large deals and 2) margins are expected to see improved trajectory in FY21E led by operational efficiency, improvement in portfolio companies, recovery of deal transition costs.

Strong deal wins point to improved trajectory

The company segregates its revenue into two industry segments- enterprise (59% of revenue) and telecom (41% of revenue). In the past few years, enterprise (comprising manufacturing, media, retail, transport and banking) has been the major driver for revenues while growth in telecom was impacted by changes in the industry. Looking at H1FY20 and the management commentary, we believe revenue growth would accelerate in FY21E led by strong deal wins (up 3.1x QoQ to US\$1.49 billion in Q2FY20) and growth in digital revenues (11.8% QoQ, 20.7% YoY and 39% revenue contribution). Further, momentum in 5G related investments is expected to be a tailwind for growth in telecom in FY21E and beyond. The company would initially focus on developing 25 such solutions and scale each of them up to US\$25 million in revenue making it a US\$625 million opportunity. In terms of margins, we anticipate margins would see an improved trajectory in FY21E (post estimated drop in FY20E) led by operational efficiency, improvement in portfolio companies and recovery of deal transition costs.

5G rollout an opportunity across industries

Within telecom, the management said that rollout of 5G is expected to bear fruit from an opportunity perspective and expects client spending on building architecture for 5G to gain momentum. TechM is initially focusing on telecom, manufacturing and healthcare segments from 5G deployment scenario. The management sees opportunities in digital BSS, customer experience transformation, cloud transformation, network services and synergy between OEMs and ODMs. Further, cost take outs and vendor consolidation would act as an opportunity.

Valuation & Outlook

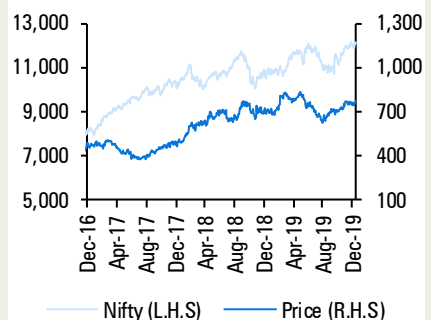
The company has won US\$1.49 billion (up 3.1x QoQ) deals across communication & enterprise segment in Q2FY20. Conversion of large deals, focus on top 200 customers for expanding service offerings, 5G opportunity across industries will be key triggers for growth acceleration. Further, considering most margin headwinds being absorbed in FY20E, we believe FY21E could witness EBIT margin expansion. Hence, we maintain our **BUY** recommendation with a target price of ₹ 900/share.

Tech Mahindra

Particulars

Particular	Amount
Market Capitalization (₹ Crore)	70,424.2
Total Debt (₹ Crore)	1,404.7
Cash and Investments (₹ Crore)	8,948.6
EV (₹ Crore)	62,880.3
52 week H/L	846 / 607
Equity capital	443.7
Face value	₹ 5

Price Performance



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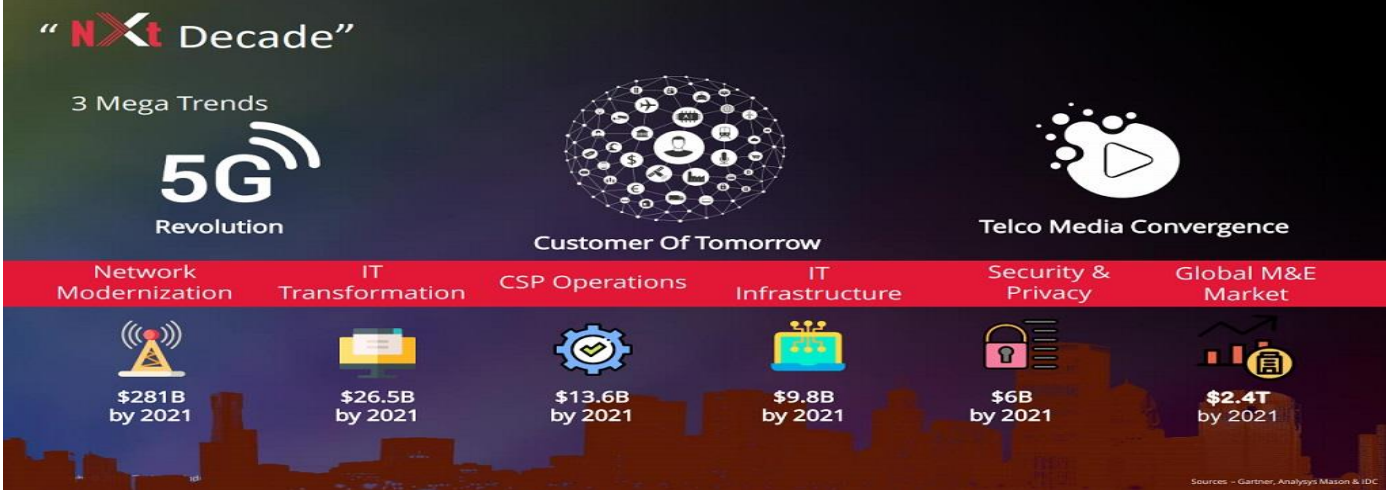
Key Financial Summary

Key Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net sales	29,140	30,773	34,742	36,716	39,941	7.2%
EBITDA	4,184	4,710	6,337	6,242	7,189	6.5%
EBITDA Margin (%)	14.4	15.3	18.2	17.0	18.0	
Net Profit	2,812	3,800	4,298	4,289	4,941	7.2%
EPS (₹)	31.7	42.8	47.7	47.6	54.9	
P/E	24.7	18.3	16.4	16.4	14.3	
RoNW (%)	17.1	20.2	21.2	18.5	18.7	
RoCE (%)	19.4	21.5	23.6	21.2	21.9	

Other highlights

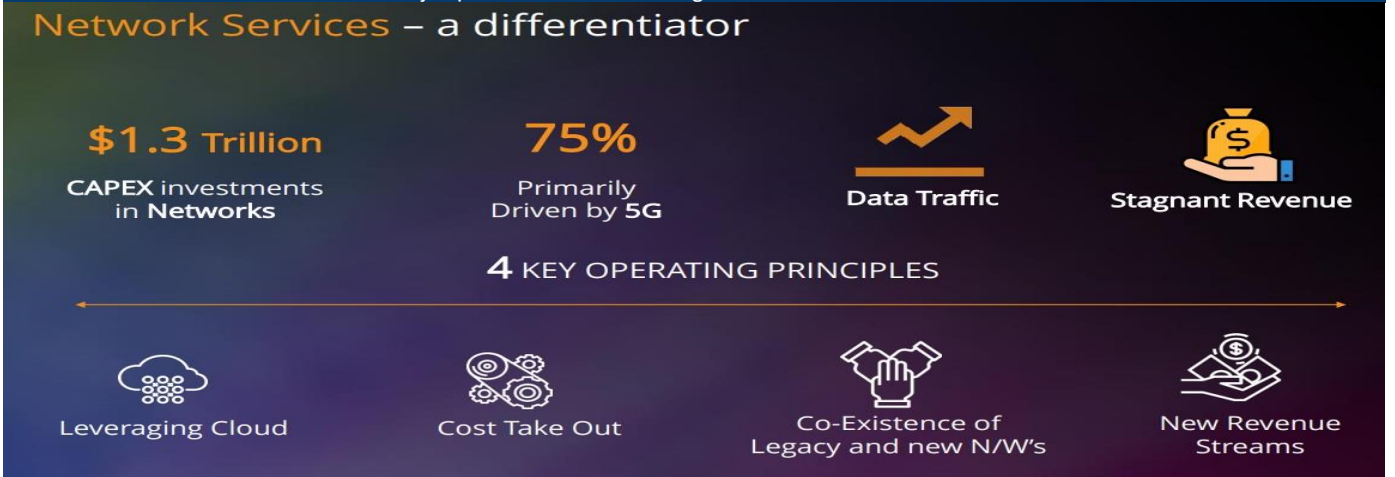
- **Increased focus on top 200 clients-** The management indicated at a restructuring of the company to increase focus on its top 200 clients. Currently, ~90% of clients are connected to TechM by way of single service offering while only 10% have more than one service offering. The company will rework the offerings to increase the base from top 200 clients
- **Focus on bundled solutions-** The company said that it has strengths in areas of 5G, artificial intelligence, cyber security and design. TechM believes that bundling of technology solutions is seeing a change and the company is working on the same aspects. TechM would initially focus on developing 25 such solutions and scale each of them up to US\$25 million in revenue making it a US\$625 million opportunity
- **Engineering services doing well-** TechM indicated that engineering in combination with IoT is gaining traction. Engineering services have grown at a CAGR of 20% over the past five years, has 350+ clients and works with 50 of top 100 R&D spenders. The management expects engineering services to clock \$700 million in revenue in FY20E with focus on manufacturing, hi-tech and communication segments
- **Strong deal pipeline-** The company won record new deal wins worth \$1.49 billion, up 3.1x QoQ. Of this, telecom segment comprised ~\$1 billion while the remaining falls within enterprise
- **Growth drivers in BPS business-** In BPS, growth momentum is expected to continue led by sales execution strategy, leadership in customer experience, localisation, M&A, BPaaS offerings
- **Scope of margin expansion-** The company's organic business margins were at ~20%. TechM has made certain acquisitions mostly having a margin profile of ~8-10%. This has marginally impacted the overall margins of the company. Improvement in the portfolio companies would act as a potential tailwind for the margin expansion, going forward. Further, optimisation of SG&A cost (15% in FY19) is also a lever
- **Payout policy likely to continue-** The company expects to maintain its payout policy of ~40% of PAT by way of dividends/buyback

Exhibit 1: Trends and opportunities in telecom vertical



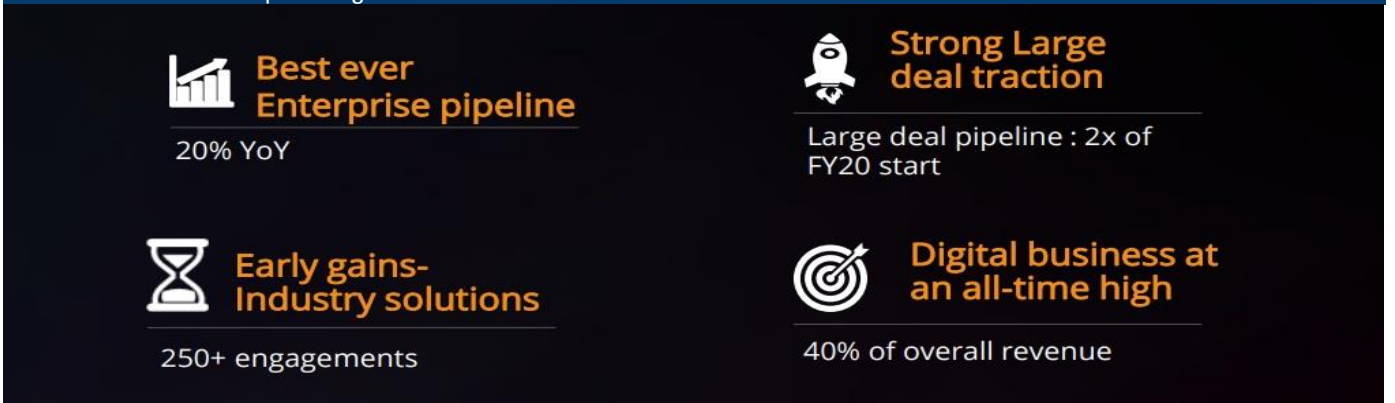
Source: Company, ICICI Direct Research

Exhibit 2: Network services forms major portion in telecom segment



Source: Company, ICICI Direct Research

Exhibit 3: View of enterprise segment in FY19



Source: Company, ICICI Direct Research

Exhibit 4: BPO market

BPO market continues to expand...

Amt in bn\$

1. Overall Addressable Market



2. CCO Market



3. BPaaS Market



..and our expanding customer base is testimony to our growth.



YOY revenue growth

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Source: Nelson Hall Growth in US\$ terms

Source: Company, ICICI Direct Research

Exhibit 5: Growth drivers in BPS business

Growth momentum expected to continue.

1 Sales Execution

Digital Natives
Account mining & creation potential
Brand value & top-of-the-mind recall

2 Leadership in CX

Born BIO
Mad*power
Dyna-commerce

3 Localization

Americas
Europe
Asia

4 M&A

Acquisition strategy to complement capabilities

5 BPaaS

Moving the dot from transactional to strategic
End to End Delivery & Process ownership

Source: Company, ICICI Direct Research

Financial summary

Exhibit 6: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Net sales	30,773	34,742	36,716	39,941
Growth (%)	6	13	6	9
COGS (employee expenses)	21,530	23,359	25,261	27,280
Gross profit	9,243	11,383	11,455	12,661
S,G&A expenses	4,533	5,046	5,214	5,472
Total Operating Expenditure	26,063	28,405	30,474	32,751
EBITDA	4,710	6,337	6,242	7,189
Growth (%)	13	35	(2)	15
Depreciation	1,085	1,129	1,358	1,478
Interest	162	133	120	108
Other Income	1,417	534	863	967
PBT	4,879	5,609	5,627	6,571
Total Tax	1,093	1,254	1,350	1,643
Exceptional item	-	-	-	-
PAT	3,800	4,298	4,289	4,941
Growth (%)	35	13	(0)	15
EPS (₹)	42.8	47.7	47.6	54.9

Source: Company, ICICI Direct Research

Exhibit 8: Balance sheet				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Liabilities				
Equity Capital	442	444	444	444
Share application money	-	-	-	-
Reserve and Surplus	18,401	19,841	22,715	26,025
Total Shareholders funds	18,843	20,284	23,158	26,469
Minority Interest	509	478	455	432
Total Debt	1,726	1,405	1,405	1,405
Other long term liabilities	2,398	2,145	2,145	2,145
Total Liabilities	23,475	24,312	27,163	30,450
Assets				
Net Block	2,981	2,623	2,439	2,240
Capital WIP	240	276	276	276
Investments	4,691	7,342	8,332	9,322
Deferred tax assets	577	609	609	609
Goodwill on consolidation	2,773	2,816	2,816	2,816
Debtors	6,512	6,965	7,361	8,007
Loans and Advances (short)	150	-	-	-
Other non-current assets	2,632	3,176	3,176	3,177
Cash	3,044	2,359	2,770	3,705
Other current assets	4,904	5,583	6,242	7,109
Total Current Assets	18,121	21,572	24,037	27,486
Trade payables	2,037	2,489	2,631	2,862
Current liabilities	4,522	6,251	5,507	5,192
Provisions	403	395	418	454
Total Current Liabilities	6,962	9,135	8,556	8,508
Application of Funds	23,475	24,312	27,163	30,450

Source: Company, ICICI Direct Research

Exhibit 7: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit before Tax	4,879	5,543	5,627	6,571
Add: Depreciation	1,085	1,129	1,358	1,478
(Inc)/dec in Current Assets	(1,044)	(1,619)	(1,054)	(1,515)
Inc/(dec) in CL and Provisions	261	562	(579)	(47)
Taxes paid	(1,526)	(1,661)	(1,350)	(1,643)
CF from operating activities	3,554	4,432	4,883	5,919
(Inc)/dec in Investments	(2,070)	(2,457)	(1,000)	(1,000)
(Inc)/dec in Fixed Assets	(790)	(779)	(1,175)	(1,278)
Others	125	148	(762)	(967)
CF from investing activities	(3,360)	(2,116)	(2,937)	(3,245)
Issue/(Buy back) of Equity	86	36	-	-
Inc/(dec) in loan funds	749	(450)	-	-
Dividend paid & dividend tax	(944)	(1,491)	(1,415)	(1,630)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(160)	(135)	(120)	(108)
CF from financing activities	(269)	(2,251)	(1,535)	(1,738)
Net Cash flow	(76)	64	411	935
Cash by acquisition	-	-	-	-
Opening Cash	3,219	3,044	2,359	2,770
Cash carried to B/S	3,044	2,359	2,770	3,705

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	42.8	47.7	47.6	54.9
Cash EPS	55.0	60.3	62.7	71.3
BV	212.4	225.2	257.2	293.9
DPS	14.0	14.0	18.4	21.2
Cash Per Share	34.3	26.2	30.8	41.1
Operating Ratios (%)				
EBITDA Margin	15.3	18.2	17.0	18.0
PAT Margin	12.3	12.4	11.7	12.4
Return Ratios (%)				
RoE	20.2	21.2	18.5	18.7
RoCE	21.5	23.6	21.2	21.9
RoIC	21.6	34.5	29.5	31.9
Valuation Ratios (x)				
P/E	18.3	16.4	16.4	14.3
EV / EBITDA	13.9	9.9	9.8	8.3
EV / Net Sales	2.1	1.8	1.7	1.5
Market Cap / Sales	2.3	2.0	1.9	1.8
Price to Book Value	3.7	3.5	3.0	2.7
Solvency Ratios				
Debt/EBITDA	0.4	0.2	0.2	0.2
Current Ratio	1.7	1.4	1.6	1.8
Quick Ratio	1.7	1.4	1.6	1.8

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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