

Tech Mahindra

BSE SENSEX
35,898

S&P CNX
10,790

CMP: INR820

TP: INR940(+15%)

Buy



Bloomberg	TECHM IN
Equity Shares (m)	894
M.Cap.(INRb)/(USDb)	805.2 / 11.3
52-Week Range (INR)	840 / 569
1, 6, 12 Rel. Per (%)	17/20/32
12M Avg Val (INR M)	2399
Free float (%)	64.1

Financials & Valuations (INR b)

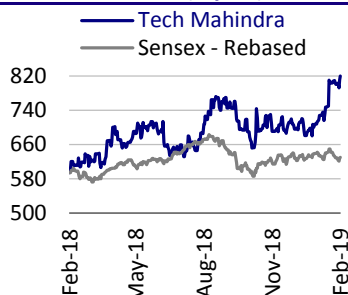
Y/E Mar	2019E	2020E	2021E
Net Sales	352.5	389.4	422.5
EBITDA	64.9	71.4	77.4
PAT	44.3	48.6	54.0
EPS (INR)	49.9	56.0	62.2
Gr. (%)	16.1	12.2	11.1
BV/Sh (INR)	226.7	238.9	271.1
RoE (%)	22.8	23.8	24.4
RoCE (%)	18.9	20.0	20.7
P/E (x)	16.9	15.1	13.6
P/BV (x)	3.7	3.5	3.1

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	35.9	36.0	36.0
DII	12.9	12.6	13.5
FII	38.6	39.2	37.7
Others	12.5	12.2	12.9

FII Includes depository receipts

Stock Performance (1-year)



Buyback announced at INR950/share

Limited upside triggers in the near term; growth uptick is imperative

TECHM announced buy back of shares worth INR19.56b at a ceiling price of INR950/share through a tender offer (~2.7% of market cap). Total amount of shares considered will not exceed 20.56m (2.3% of total paid-up equity capital). The amount is less than 10% of networth (9.4%), and thus, would not require shareholder approval.

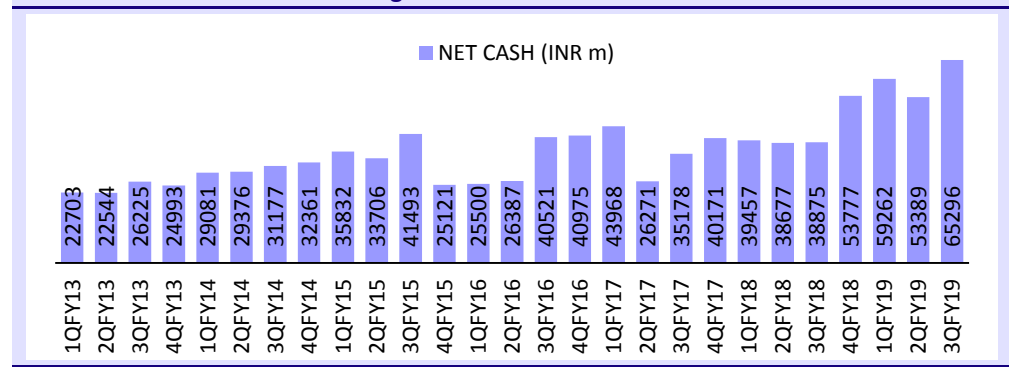
Takeaways from management's media interaction

- **Buyback should now be part of capital allocation policy:** The amount of INR19.56b (<10% of net worth) was decided after taking stock of the future needs of capital for the business.
- It is a more efficient way to return capital to shareholders. TECHM will consider this on an annual basis, in line with other peers in the industry. It is also tax efficient for the company.
- **Dividend payout impact:** This buyback is not in lieu of dividend. That said, TECHM does not have a fixed percentage on dividend as a stated policy. However, the company would not like to retain too much excess cash. TECHM will go for a 'Dividend + Buyback' strategy in the future based on the need of the business.
- The decision on promoter's participation is not out yet.

Cash position has not exceeded INR40b in the past

In the past, every time TECHM's net cash (including investments) has exceeded or come close to INR40b, there has been some allocation toward inorganic growth. That did not happen this time around, and the net cash position increased to INR65b in the last four quarters. The quantum of buyback brings total net cash down to that range at INR45b. Normal dividend announcement in 4Q should pull it down further. If TECHM pays same dividend as last year (INR14/share), it will bring net cash down to INR30-35b.

Exhibit 1: Cash levels at all-time high



Source: Company, MOS

Marginal EPS impact

Post buyback, adjustment to net cash position by INR19,560m implies a total treasury income reduction of INR1.1/1.5b for FY20/21. Total share count post buyback will be 867m. Factoring in this, our EPS estimate for FY20/21 has marginally increased by 30bp/10bp.

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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.motilalosal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Valuation and view

A foreword on the long-term industry view: Growth for Indian IT should gradually pick-up from current 6-7% as Digital services proliferate, which today are still small to move the needle on the overall performance. India will remain the hotbed for talent supply en masse, making a case for increasing shift of Digital business from onsite. That said, with Automation the top priority of every board, without exceptions, delineation of revenue growth with headcount growth appears obvious – and the only lever to stem the decline in profitability witnessed in recent years.

TECHM in that industry backdrop

- **Prowess in Telecom:** TECHM has strong capabilities in Communications (nearly half of current revenue) and works with most of the major global service providers. It has historically benefitted out of upswings in capital expenditure triggered by adoption of new technology. With 5G implementation being spoken of by most providers, the vertical should see higher spends in the years to come – benefitting TECHM directly.
- **Sustained outperformance in Enterprise:** TECHM has been able to see sustained outperformance in Enterprise, because of [1] success in large deal wins, [2] less baggage of traditional services, [3] small scale in most verticals and [4] sizeable Engineering revenue. Sustained above-industry growth will bode well for overall growth.

Basis the above (mid-single digit growth in Telecom and 10-12% in Enterprise), we expect TECHM to grow revenues in line with the industry as of today. However, any uptick in spend in Telecom would be reflected in better performance for the company.

Valuation and 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.
 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 contraction in the EBITDA margin of 780bp over FY14-17. This has shown an improvement intermittently as the company squeezed some of its operational levers and underwent cost optimization. However, further improvement in margins would be a function of a serious pick-up in revenue from the Communications vertical and from better performance in portfolio companies.

- We expect revenues/EPS CAGR of 7/13% over FY18-21. At 15.1/13.6x FY20/21E, TECHM’s valuations remain below those of leading peers such as TCS and INFO.
- The company’s valuations have nearly doubled in the past 18 months on the back of strong margin execution, and post the uptick from the announcement of buyback, we believe that upside triggers are limited in the near term. We believe that further upside will be a function of acceleration in Communications vertical and overall growth. Near-term upside will be limited given that there is still time for impetus from 5G to play out, and earnings growth should settle down after the margins’ run. Our price target of INR940 (15% upside) discounts forward earnings by 15x, v/s 5-year average of 14.5x, baking in a higher payout. Maintain **Buy**.

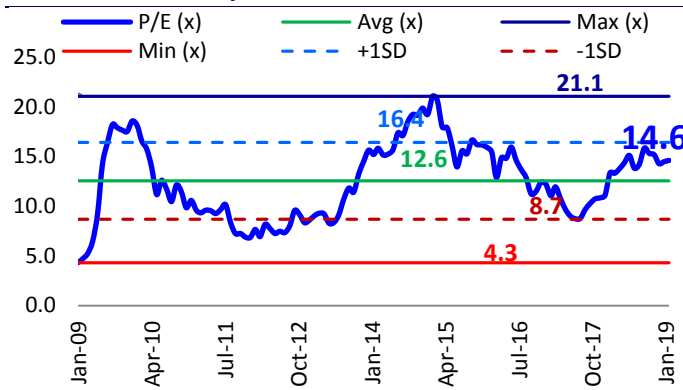
Key Triggers

- Large deal announcements in Enterprise segment
- Continued momentum in Telecom
- Sustained margin improvement on account of measures taken

Key Risks

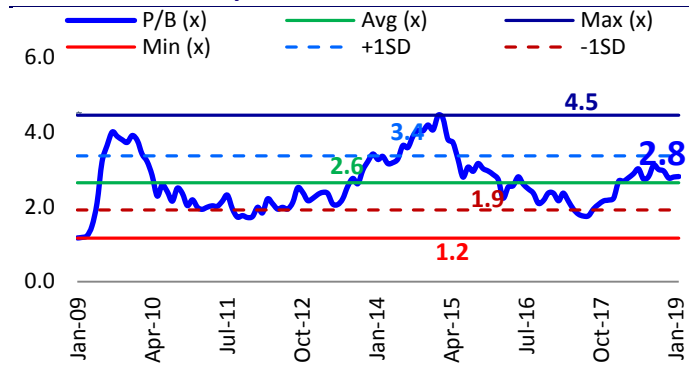
- Adverse visa related regulations as TECHM’s proportion of local resources at onsite is lower than peers
- Currency fluctuations given higher sensitivity to earnings v/s peers
- More adversity in integration of acquisitions

Exhibit 2: TECHM 1-year forward P/E



Source: Company, MOSL

Exhibit 3: TECHM 1-year forward P/B



Source: Company, MOSL

Exhibit 4: Operating metrics

Operating metrics	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Revenue by geography (%)										
Americas	48.3	46.7	45.1	46.8	45.3	46.9	47.4	48.2	47.0	47.4
Europe	29.7	29.4	29.6	29.8	30.0	29.8	29.6	30.0	29.6	28.9
Rest of World	22	23.9	25.3	23.4	24.7	23.3	23.0	21.9	23.4	23.7
Vertical Split (%)										
Telecom	48.4	47.3	46.3	45.2	43.7	42.8	41.6	39.6	41.5	41.1
Manufacturing	19.2	18.4	19.2	19.3	19	19.1	19.3	20.1	20.1	20.5
Tech Media Entertainment	7.2	6.4	6.2	6.0	5.9	6.5	7.3	7.2	7.3	7
BFSI	11.5	13.1	14.1	14.4	14.1	13.3	13.0	13.6	13.5	13.4
Retail Transport Logistics	6.8	7.6	6.5	6.8	7.2	7.1	6.2	6.1	6.5	6.7
Others	6.8	7.1	7.7	8.3	9.9	11.3	12.6	13.4	11.2	11.3
Onsite-offshore mix (%)										
Onsite	63.5	63.9	64.3	63.7	64.1	65.8	67.0	66.6	64.5	65.5
Offshore	36.5	36.1	35.7	36.3	35.9	34.2	33.0	33.4	35.5	34.5
Client metrics										
No. of active clients	825	837	843	864	885	903	913	926	930	935
% of repeat business	95.6	93.4	93.5	97.2	95	92.9	88.4	98.5	97.4	94.6
No. of Million \$ clients										
USD1m+	341	356	354	377	390	389	392	396	407	416
USD5m+	120	128	134	139	147	154	156	154	157	157
USD10m+	66	65	71	74	81	83	85	86	86	88
USD20m+	40	38	36	41	40	40	44	47	45	46
USD50m+	14	14	14	14	14	16	16	16	17	18
Client concentration (%)										
Top client										
Top 5 Clients	28.5	27.8	26.6	25.9	24.8	23.2	23.2	21.9	23.3	22.6
Top 6-10	11.4	10.6	11	10.4	10.3	10	9.5	10.6	9.4	9
Top 11-20	11.8	12.1	11.4	12.2	11.1	11.8	13	13.7	12.9	12.4
Headcount (end of period)										
Software professionals	78,404	80,858	82,403	78,996	75,587	73,460	72,437	72,462	72,534	71,785
BPO	27,669	29,372	28,414	30,332	35,287	35,496	34,190	34,700	39,407	43,439
Sales and Support	5,670	6,865	6,876	6,662	6,351	6,285	6,180	6,390	6,450	6,618
Total	111,743	117,095	117,693	115,990	117,225	115,241	112,807	1,13,552	118,391	1,21,842
IT Attrition (LTM) (%)	19	18	17	17	16	17	18	19	20	21
IT Utilization (%)	78	77	77	77	81	83	84	81	81	82
IT Utilization (excluding trainees) (%)	82	83	81	81	81	83	84	84	83	83
Receivable Days (DSO)-Including Unbilled	107	102	95	104	106	105	102	108	112	107
Borrowings (USD m)	206.3	211	210.7	320.7	210.7	341.5	367.7	363.2	353.3	316
Cash and Cash Equivalent (USD m)	600.7	728.9	830.2	931.8	913.2	950.1	1192.9	1228.7	1089.8	1251.8
Capital Expenditure (USD m)	50.4	28.1	42.8	22.5	70.6	25.6	32.4	27.7	21.3	31.6

Source: Company, MOSL

Exhibit 5: Operating metrics

Operating metrics	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Rupee USD Rate										
Period closing rate	66.61	67.92	64.85	64.57	65.28	63.87	65.17	68.47	72.49	69.77
Period average Rate	66.86	67.7	66.47	64.44	64.45	64.35	64.64	67.51	70.68	71.11
Proportion of Revenues From Major Currencies										
USD	48.9	48.6	45.9	48.6	46.9	47.4	49.4	49.3	48.0	47.7
GBP	11	12	12.3	12.1	12	11.4	12.1	11.6	11.2	11.1
EURO	12.7	11.5	11.4	11.0	11.2	11.9	11.7	11.4	11.4	11
AUD	4.6	4.4	4.6	4.8	4.9	4.9	4.6	4.8	4.9	5.1
Others	22.7	23.5	25.8	23.4	24.9	24.5	22.2	22.9	24.5	25.1
Consolidated Hedge Position										
GBP In Mn	192.6	226.7	201	247	260	241	229	213	190	171
Strike rate (INR)	104.8	100.2	99.8	97.0	95.4	94.2	94.4	95.1	97	98.5
USD In Mn	1087.9	1123.2	1030.2	878	646	577	598	894	1069	1084
Strike rate (INR)	72.4	72.5	72.9	72.6	72.2	72.2	71	70.7	71.9	72.8
Verticals (QoQ)										
Telecom	2.2	1.7	-0.8	-1.8	0.2	0.4	0.0	-6.4	4.3	2.5
Manufacturing	10.0	-0.3	5.8	1.1	2.0	3.1	4.0	2.5	-0.5	5.6
Tech Media Entertainment	-0.2	-7.5	-1.8	-2.6	1.9	13.0	15.6	-3.0	0.9	-0.8
BFSI	5.8	18.6	9.1	2.8	1.5	-3.3	0.6	2.9	-1.2	2.7
Retail Transport Logistics	8.8	16.3	-13.3	5.3	9.7	1.1	-10.1	-3.2	6.0	6.7
Others	-3.2	8.7	9.9	8.4	23.6	17.0	14.8	4.6	-16.8	4.4
Total	3.9	4.1	1.5	0.6	3.4	2.8	2.8	-1.6	-0.4	3.4
Revenue by geography (QoQ)										
Americas	2.5	0.6	-2.1	4.4	0.3	6.2	4.0	0.0	-3.0	4.4
Europe	9.2	3.0	2.0	1.3	4.3	1.9	2.2	-0.3	-1.8	1.0
Rest of World	0.4	13.1	7.3	-6.9	9.4	-3.3	1.6	-6.3	6.3	4.8
Total	3.9	4.1	1.4	0.6	3.6	2.5	2.9	-1.5	-0.6	3.5
Client concentration (QoQ)										
Top 5	2.9	1.5	-3.0	-2.0	-0.8	-4.1	2.9	-7.1	5.9	0.4
Top 6-10	5.8	-3.2	5.2	-4.9	2.6	-0.5	-2.2	9.8	-11.7	-0.9
Top 11-20	-2.6	6.7	-4.5	7.7	-5.7	9.0	13.4	3.7	-6.3	-0.5
Net additions										
Software professionals	4,814	2,454	1,545	-3,407	-3,409	-2,127	-1,023	25	72	-749
BPO	343	1,703	-958	1,918	4,955	209	-1,306	510	4,707	4,032
Sales and Support	-630	1,195	11	-214	-311	-66	-105	210	60	168
Total	4,527	5,352	598	-1,703	1,235	-1,984	-2,434	745	4,839	3,451

Source: Company, MOSL

Financials and valuations

Key Assumptions

Y/E March	2014	2015	2016	2017	2018	2019E	2020E	2021E
INR/USD Rate	60.8	61.4	65.6	67.0	64.5	70.4	72.0	72.0
Revenues (USD m)	3,098	3,664	4,037	4,351	4,771	5,008	5,409	5,869
Total Headcount	89,441	1,03,281	1,05,432	1,17,693	1,12,807	1,28,781	1,36,124	1,48,321
Net Addition	6,332	13,840	2,151	12,261	-4,886	15,974	7,343	12,197
Per Capita Productivity (USD)	34,638	35,471	38,294	36,971	42,291	38,891	39,733	39,567
Utilization incl. Trainees (%)	73.1	69.9	74.0	73.4	80.1	80.4	83.2	83.6
IT Services (%)	90.3	91.7	92.6	93.1	92.8	92.0	91.7	91.9

Income Statement

(INR Million)

Y/E March	2014	2015	2016	2017	2018	2019E	2020E	2021E
Sales	1,88,313	2,24,779	2,64,941	2,91,408	3,07,730	3,52,477	3,89,417	4,22,544
Change (%)	31.4	19.4	17.9	10.0	5.6	14.5	10.5	8.5
Employee Cost	1,17,001	1,50,342	1,83,226	2,05,661	2,15,299	2,36,543	2,62,516	2,84,707
Other Expenses	29,476	32,901	38,289	43,904	45,270	51,036	55,492	60,467
Total Expenses	1,46,477	1,83,243	2,21,515	2,49,565	2,60,569	2,87,579	3,18,008	3,45,174
EBITDA	41,836	41,536	43,426	41,843	47,161	64,898	71,409	77,370
% of Net Sales	22.2	18.5	16.4	14.4	15.3	18.4	18.3	18.3
Depreciation	5,221	6,079	7,620	9,781	10,849	11,466	12,028	12,461
Interest	673	689	961	1,286	1,624	1,395	1,371	1,366
Other Income	1,129	1,006	5,322	6,836	14,091	5,357	6,708	8,351
PBT	37,071	35,774	40,167	37,612	48,779	57,394	64,717	71,894
Tax	9,790	9,472	8,600	9,785	10,925	13,104	16,179	17,973
Rate (%)	26.4	26.5	21.4	26.0	22.4	22.8	25.0	25.0
PAT	27,281	26,302	31,567	27,827	37,854	44,290	48,538	53,920
Minority Interest & EO items	336	310	412	357	-136	-45	-47	-34
PAT before EO	26,945	25,992	31,155	27,470	37,990	44,335	48,585	53,955
Change (%)	37.8	-3.5	19.9	-11.8	38.3	16.7	9.6	11.1
Effect of restructuring fees	-1,117	0	0	0	0	0	0	0
PAT after RF before EO	25,828	25,992	31,155	27,470	37,990	44,335	48,585	53,955
Change (%)	41.8	0.6	19.9	-11.8	38.3	16.7	9.6	11.1

Balance Sheet

(INR Million)

Y/E March	2014	2015	2016	2017	2018	2019E	2020E	2021E
Share Capital	2,335	4,804	4,839	4,388	4,417	4,425	4,367	4,367
Reserves	89,469	1,17,682	1,38,824	1,59,984	1,84,011	1,96,810	2,02,826	2,30,706
Net Worth	91,804	1,22,486	1,43,663	1,64,372	1,88,428	2,01,235	2,07,194	2,35,074
Minority Interest	1,453	1,604	2,034	4,641	5,091	5,165	5,165	5,165
Loans	8,420	11,287	15,564	23,761	28,931	26,691	26,599	26,507
Deferred Revenue	0	0	0	0	0	0	0	0
Amount pending invest.	12,304	12,304	12,304	12,304	12,304	12,304	12,304	12,304
Capital Employed	1,13,981	1,47,681	1,73,565	2,05,078	2,34,754	2,45,395	2,51,262	2,79,050
Assets	28,606	40,329	43,446	63,590	74,318	70,829	72,801	76,339
CWIP	0	5,677	6,294	3,729	2,399	2,721	2,721	2,721
Investments	12,194	12,987	13,244	3,319	14,364	15,779	19,279	22,779
Long term loans and adv	9,137	12,755	16,766	9	52	44	44	44
Deferred Tax Assets	3,830	3,901	5,575	2,674	5,766	5,971	5,971	5,971
Other non-current assets	157	306	294	24,079	26,403	32,985	32,985	32,985
Curr. Assets	1,05,472	1,22,526	1,49,451	1,63,265	1,81,070	2,04,290	2,18,322	2,54,869
Debtors	43,486	52,059	57,705	53,377	64,979	77,243	82,715	90,553
Cash & Bank Balance	33,202	24,049	40,138	32,186	30,443	21,468	35,232	57,387
Loans & Advances	14,544	18,728	17,084	26,122	21,123	28,545	30,567	33,463
Current Investments	2,525	8,041	11,690	21,647	34,449	40,350	30,570	30,570
Other Current Assets	11,715	19,649	22,834	29,933	30,076	36,685	39,238	42,896
Current Liab. & Prov	45,415	50,800	61,505	55,587	69,618	87,224	1,00,861	1,16,658
Net Current Assets	60,057	71,726	87,946	1,07,678	1,11,452	1,17,066	1,17,461	1,38,211
Application of Funds	1,13,981	1,47,680	1,73,565	2,05,078	2,34,754	2,45,395	2,51,262	2,79,050

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	2014	2015	2016	2017	2018	2019E	2020E	2021E
Basic (INR)								
EPS	31.6	30.2	35.9	31.4	43.0	49.9	56.0	62.2
Diluted EPS	28.7	29.6	35.1	32.0	42.7	49.1	55.0	61.1
Cash EPS	38.2	36.1	43.6	41.9	54.8	61.8	68.8	75.4
Book Value	112.3	142.2	165.6	187.9	213.4	226.7	238.9	271.1
DPS	5.0	6.0	12.0	9.0	14.0	18.0	22.0	25.0
Payout %	17.4	20.3	34.2	28.2	32.8	36.6	40.0	40.9
Valuation (x)								
P/E	28.9	28.0	23.6	25.9	19.4	16.9	15.1	13.6
Cash P/E	21.7	22.9	19.0	19.8	15.1	13.4	12.1	11.0
EV/EBITDA	15.3	16.6	15.7	17.1	15.2	11.2	9.7	8.6
EV/Sales	3.4	3.1	2.6	2.4	2.3	2.1	1.8	1.6
Price/Book Value	7.4	5.8	5.0	4.4	3.9	3.7	3.5	3.1
Dividend Yield (%)	0.6	0.7	1.4	1.1	1.7	2.2	2.7	3.0
Profitability Ratios (%)								
RoE	36.4	24.5	23.4	18.4	21.5	22.8	23.8	24.4
RoCE	26.3	20.5	20.1	15.2	17.8	18.9	20.0	20.7
ROIC	46.5	30.0	25.7	17.0	15.9	21.0	22.3	25.0
Turnover Ratios								
Debtors (Days)	75	78	76	70	70	74	75	75
Fixed Asset Turnover (x)	7.0	6.0	5.5	5.0	4.3	4.7	5.2	5.5
Leverage Ratio								
Debt/Equity Ratio(x)	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1

Cash Flow Statement

(INR Million)

Y/E March	2014	2015	2016	2017	2018	2019E	2020E	2021E
CF from Operations	33,935	32,040	34,439	32,617	36,372	51,324	54,749	58,903
Change in Working Capital	-12,302	-8,874	5,456	-17,243	8,540	-4,292	3,589	1,405
Net Operating CF	21,634	23,167	39,895	15,374	44,912	47,032	58,338	60,308
Net Purchase of FA	-7,854	-21,365	-17,357	-9,694	-9,735	-8,620	-12,000	-12,500
Free Cash Flow	13,780	1,802	22,538	5,680	35,177	38,412	46,338	47,808
Net Purchase of Invest.	-8,539	-9,050	10,611	5,293	-16,794	-23,487	-8,755	2,667
Net Cash from Invest.	-16,393	-30,415	-6,746	-4,401	-26,529	-32,107	-20,755	-9,833
Inc./ (Dec) in Equity	19	2,469	35	-451	29	8	-58	0
Proceeds from LTB/STB	-1,305	2,396	-3,469	-9,196	-5,587	5,262	-1,280	-1,274
Dividend Payments	-5,381	-6,771	-13,626	-9,278	-14,568	-29,170	-22,481	-27,047
Cash Flow from Fin.	-6,668	-1,905	-17,060	-18,925	-20,126	-23,900	-23,818	-28,320
Net Cash Flow	-1,427	-9,154	16,089	-7,952	-1,743	-8,975	13,764	22,155
Opening Cash Balance	34,629	33,202	24,048	40,138	32,185	30,443	21,468	35,232
Add: Net Cash	-1,427	-9,154	16,089	-7,952	-1,743	-8,975	13,764	22,155
Closing Cash Balance	33,202	24,048	40,138	32,185	30,443	21,468	35,232	57,387

E: MOSL Estimates

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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