11th November, 2019
Q2FY20 RESULT UPDATE

Retail Equity Research

Tech Mahindra Limited

IT

BSE CODE: 532755 | NSE CODE: TECHM
Bloomberg CODE: TECHM:IN | SENSEX: 40,345

BUY

12M Investment period | Rating as per Large Cap

CMP Rs. 770 | TARGET Rs. 863 | RETURN 12%
(Closing: 11-11-19)

KEY CHANGES: ***TARGET*** ↓ ***RATING*** ↔ ***EARNINGS*** ↓

Highest ever deal wins in Q2

Tech Mahindra (TechM), a part of Mahindra Group, offers technology services and solutions across Telecom IT & Network Services, Consulting, Application & Infrastructure Outsourcing, Engineering Services, BPO & Platform Solutions, among others.

- **TechM registered a healthy growth in Q2FY20 revenue (+4.8% QoQ; +3.2% QoQ in USD terms; +4.1% in CC terms) supported by growing digital revenue**
- **Company reported a record high deal wins (USD 1.49bn, ~3.1x QoQ) boosted by largest telecom win with AT&T (~USD 1bn of TCV).**
- **EBITDA margin expanded 130bps QoQ to 16.5%, due to operational improvements and lack of visa cost in Q2FY20. PAT rose to Rs. 1,124cr (+17.2% QoQ), beating consensus estimates by 20.5%.**
- **We expect revenue to grow at 9.1% CAGR over FY19-21E backed by strong deal wins & healthy pipeline. We reiterate our Buy rating on the stock and value it at Rs. 863 based on 15x FY21E adjusted EPS.**

Healthy topline supported by growing digital business

Revenue increased 4.8% QoQ to Rs. 9,070cr in Q2FY20. In USD terms, revenue grew 3.2% QoQ to USD 1,287m (+4.1% QoQ in CC terms), primarily supported by robust growth in digital revenue (+11.8% QoQ; 39.0% of total revenue). Communications vertical continued to contribute the most to revenue (41.1% of total revenue; +2.6% QoQ) followed by manufacturing (18.0% of revenue; -2.7% QoQ) and BFSI (13% of revenue; +6.5% QoQ). Across geographies, company's revenue remained concentrated in the Americas (48.5% of total revenue; +6.8% QoQ), followed by Europe (26.7% of revenue; +1.4% QoQ). TechMz` added 5 new active clients (on net basis) during the quarter with total active clients reaching 946 and achieved 94.8% of repeat business. Company reported a record high deal wins worth USD 1.49bn in Q2FY20 (~3.1x QoQ) boosted by largest telecom win with AT&T (~USD 1bn of total contract value). Additionally, the pipeline remains strong in communications and enterprise verticals. Separately, management expects decent traction in the 5G pipeline.

Margin improvements during the quarter

EBITDA increased to Rs. 1,501cr in Q2FY20 from Rs. 1,314cr in Q1FY20, as EBITDA margin improved 130bps QoQ to 16.5% mainly due to improvement in operational efficiencies and synergies from the portfolio companies. We expect the company to report a decline in margin for FY20E due to costs involved in transition of large deals, however expect margins to gradually improve with initiatives around new age delivery, automation and productivity.

Key concall highlights

- Employee attrition remained elevated at 21%.
- During the quarter, company acquired 65% stake in Mad*Pow Media Solutions (for upfront payment of USD 17m) and 100% stake in Born Group (for USD 95m), with both being US design consultancy firms.

Valuation

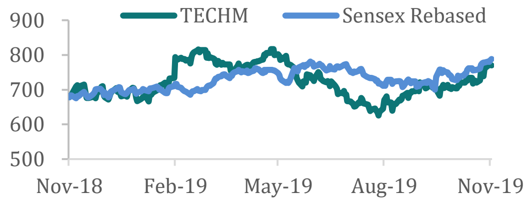
We expect recent large deal wins, strong deal pipeline and enhanced capabilities with recent acquisitions to boost company's revenue at 9.1% CAGR over FY19-21. Hence, we reiterate our Buy rating on the stock with a target price of Rs. 863, using a target multiple of 15x on FY21E adjusted EPS.

Company Data	
Market Cap (cr)	Rs. 67,724
Enterprise Value (cr)	Rs. 64,815
Outstanding Shares (cr)	87.9
Free Float	64.0%
Dividend Yield	1.8%
52 week high	Rs. 846
52 week low	Rs. 608
6m average volume	70,437
Beta	1.1
Face value	Rs. 5

Shareholding %	Q4FY19	Q1FY20	Q2FY20
Promoters	35.9	35.9	35.9
FII's	38.1	38.4	37.3
MFs/Insti	12.5	12.6	14.8
Public	9.1	9.1	8.8
Others	4.4	4.1	3.2
Total	100.0	100.0	100.0
Promoters pledge	0.0	0.0	0.0

Price Performance	3 Month	6 Month	1 Year
Absolute Return	14.1%	-3.4%	12.7%
Absolute Sensex	10.8%	6.2%	15.4%
Relative Return*	3.3%	-9.6%	-2.6%

***over or under performance to benchmark index**



Consolidated (cr)	FY19A	FY20E	FY21E
Sales	34,742	37,400	41,366
Growth (%)	12.9	7.6	10.6
EBITDA	6,337	6,044	6,905
EBITDA Margin (%)	18.2	16.2	16.7
Adj. PAT	4,298	4,349	5,065
Growth (%)	13.1	1.2	16.5
Adj. EPS	47.7	49.4	57.5
Growth (%)	11.8	3.4	16.5
P/E	16.3	15.6	13.4
P/B	3.4	2.9	2.5
EV/EBITDA	11.0	10.7	9.0
ROE (%)	21.2	18.7	18.8
D/E	0.1	0.0	0.0

Quarterly Financials (Consolidated)

Profit & Loss Account

	Q2FY20	Q2FY19	YoY Growth %	Q1FY20	QoQ Growth %	H1FY20	H1FY19	YoY Growth %
Revenue	9,070	8,630	*5.1*	8,653	*4.8*	17,723	16,906	*4.8*
EBITDA	**1,501**	**1,619**	*(7.3)*	**1,314**	*14.2*	**2,815**	**2,976**	*(5.4)*
EBITDA margins	16.5	18.8	(230bps)	15.2	130bps	15.9	17.6	(170bps)
Depreciation	342	294	*16.0*	321	*6.3*	663	575	*15.2*
EBIT	**1,159**	**1,324**	*(12.5)*	**993**	*16.8*	**2,152**	**2,400**	*(10.3)*
Interest	38	39	*(1.2)*	45	*(15.6)*	84	69	*20.8*
Other Income	216	175	*23.5*	341	*(36.6)*	558	287	*94.6*
Exceptional Items	-	-	-	-	-.	-	-	-
PBT	**1,337**	**1,461**	*(8.4)*	**1,289**	*3.8*	**2,626**	**2,618**	*0.3*
Tax	227	391	*(42.1)*	332	*(31.7)*	558	637	*(12.4)*
Share of profit from Associate	(0)	13	-	8	-	8	25	*(70.2)*
Minority Interest	(13)	(8)	*51.4*	(10)	*24.5*	(23)	(7)	*237.3*
Reported PAT	**1,124**	**1,064**	*5.6*	**959**	*17.2*	**2,083**	**1,962**	*6.2*
Adjustments	-	-	-	-	-	-	-	-
Adjusted PAT	**1,124**	**1,064**	*5.6*	**959**	*17.2*	**2,083**	**1,962**	*6.2*
No. of shares	87.9	90.1	*(2.4)*	88.1	*(0.2)*	87.9	90.1	*(2.4)*
EPS (Rs.)	**12.8**	**11.8**	*8.1*	**10.9**	*17.4*	**23.7**	**21.8**	*8.7*

Change in Estimates

	Old estimates		New estimates		Change %	
Year / Rs. cr	**FY20E**	**FY21E**	**FY20E**	**FY21E**	**FY20E**	**FY21E**
Revenue	38,667	-	37,400	41,366	*(3.3)*	-
EBITDA	7,215	-	6,044	6,905	*(16.2)*	-
Margins (%)	18.7	-	16.2	16.7	*(250bps)*	-
Adj. PAT	4,837	-	4,349	5,065	*(10.1)*	-
EPS	54.7	-	49.4	57.5	*(9.7)*	-

PROFIT & LOSS

Y.E March (Rs. cr)	FY17A	FY18A	FY19A	FY20E	FY21E
Revenue	**29,141**	**30,773**	**34,742**	**37,400**	**41,366**
% change	10.0	5.6	12.9	7.6	10.6
EBITDA	**4,184**	**4,710**	**6,337**	**6,044**	**6,905**
% change	1.6	12.2	28.8	(2.7)	11.7
Depreciation	978	1,085	1,129	1,218	1,205
EBIT	**3,206**	**3,625**	**5,208**	**4,825**	**5,700**
Interest	129	162	133	130	353
Other Income	775	1,417	469	913	1,186
PBT	**3,853**	**4,879**	**5,543**	**5,609**	**6,532**
% change	(7.3)	26.6	13.6	1.2	16.5
Tax	1,002	1,093	1,254	1,269	1,478
Tax Rate (%)	26.0	22.4	22.6	22.6	22.6
Reported PAT	**2,824**	**3,800**	**4,298**	**4,349**	**5,065**
Adj*	-	-	-	-	-
Adj PAT	**2,824**	**3,800**	**4,298**	**4,349**	**5,065**
% change	(9.4)	34.6	13.1	1.2	16.5
No. of shares (cr)	88.9	89.1	90.1	88.1	88.1
Adj EPS (Rs.)	**31.8**	**42.7**	**47.7**	**49.4**	**57.5**
% change	0.3	34.3	11.8	3.4	16.5
DPS (Rs.)	9.0	14.0	14.0	14.0	14.0
CEPS (Rs.)	42.8	54.8	60.3	63.2	71.2

BALANCE SHEET

Y.E March (Rs. cr)	FY17A	FY18A	FY19A	FY20E	FY21E
Cash	3,219	3,044	2,359	4,596	6,954
Accounts Receivable	5,338	6,498	6,959	7,453	8,203
Inventories	61	66	75	80	91
Other Cur. Assets	7,709	8,499	12,173	12,396	12,727
Investments	332	1,436	923	933	938
Gross Fixed Assets	6,063	8,335	8,941	10,063	11,304
Net Fixed Assets	3,072	2,981	2,623	2,526	2,559
CWIP	373	240	276	277	280
Intangible Assets	3,287	4,451	4,268	4,318	4,418
Def. Tax (Net)	1,581	2,354	2,749	2,781	3,239
Other Assets	1,095	868	1,043	1,078	1,103
Total Assets	**26,067**	**30,437**	**33,447**	**36,438**	**40,512**
Current Liabilities	6,789	8,192	10,366	10,708	11,342
Provisions	620	555	580	580	580
Debt Funds	1,219	1,726	1,405	1,105	855
Other Liabilities	537	612	335	323	338
Equity Capital	439	442	444	444	444
Reserves & Surplus	15,998	18,401	19,841	22,810	26,495
Shareholder's Fund	16,437	18,843	20,284	23,254	26,939
Minority Interest	464	509	478	469	458
Total Liabilities	**26,067**	**30,437**	**33,447**	**36,438**	**40,512**
BVPS (Rs.)	**185**	**212**	**225**	**264**	**306**

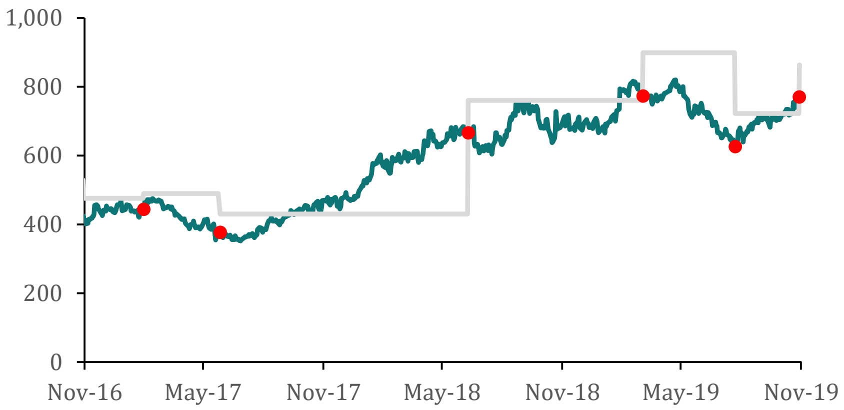
CASH FLOW

Y.E March (Rs. cr)	FY17A	FY18A	FY19A	FY20E	FY21E
Net inc. + Depn.	**3,802**	**4,885**	**5,427**	**5,567**	**6,270**
Non-cash adj.	(274)	(548)	63	(9)	(11)
Changes in W.C	544	(783)	(1,057)	(157)	(126)
C.F. Operation	**4,071**	**3,554**	**4,432**	**5,401**	**6,133**
Capital exp.	(760)	(790)	(779)	(1,122)	(1,241)
Change in inv.	(2,442)	(3,176)	(2,322)	(267)	(362)
Other invest.CF	152	607	985	(83)	(558)
C.F – Investment	**(3,051)**	**(3,360)**	**(2,116)**	**(1,472)**	**(2,161)**
Issue of equity	35	25	(175)	-	-
Issue/repay debt	(255)	749	(450)	(300)	(250)
Dividends paid	(1,239)	(944)	(1,491)	(1,379)	(1,379)
Other finance.CF	(111)	(99)	(135)	(12)	15
C.F – Finance	**(1,571)**	**(269)**	**(2,251)**	**(1,691)**	**(1,614)**
Chg. in cash	(550)	(76)	64	2,238	2,358
Closing cash	3,219	3,044	2,359	4,596	6,954

RATIOS

Y.E March	FY17A	FY18A	FY19A	FY20E	FY21E
Profitab. & Return					
EBITDA margin (%)	14.4	15.3	18.2	16.2	16.7
EBIT margin (%)	11.0	11.8	15.0	12.9	13.8
Net profit margin (%)	9.7	12.3	12.4	11.6	12.2
ROE (%)	17.2	20.2	21.2	18.7	18.8
ROCE (%)	17.7	17.2	23.5	19.4	20.2
W.C & Liquidity					
Receivables (days)	66.9	77.1	73.1	72.7	72.4
Inventory (days)	6.2	6.2	6.3	6.5	6.7
Payables (days)	233.7	191.2	208.9	209.4	210.0
Current ratio (x)	2.1	2.0	1.9	2.1	2.3
Quick ratio (x)	1.4	1.4	1.4	1.6	1.8
Turnover & Leverage					
Gross asset T.O (x)	5.1	4.3	4.0	3.9	3.9
Total asset T.O (x)	1.2	1.1	1.1	1.1	1.1
Int. coverage ratio (x)	24.9	22.3	39.1	37.2	16.2
Adj. debt/equity (x)	0.1	0.1	0.1	0.0	0.0
Valuation					
EV/Sales (x)	1.5	1.8	2.0	1.7	1.5
EV/EBITDA (x)	10.3	11.6	11.0	10.7	9.0
P/E (x)	15.9	14.6	16.3	15.6	13.4
P/BV (x)	2.7	2.9	3.4	2.9	2.5

Recommendation Summary



Dates	Rating	Target
23-Feb-16	BUY	530
8-Nov-16	HOLD	476
8-Feb-17	HOLD	490
5-Jun-17	HOLD	430
19-Jun-18	HOLD	760
13-Mar-19	BUY	899
11-Nov-19	BUY	863

Investment Rating Criteria

Large Cap Stocks;		
Buy	-	**Upside is above 10%.**
Hold	-	**Upside is between 0% - 10%.**
Reduce	-	**Downside is more than 0%.**
Neutral	-	**Not Applicable**

Mid Cap and Small Cap;		
Buy	-	**Upside is above 15%.**
Accumulate	-	**Upside is between 10% - 15%.**
Hold	-	**Upside is between 0% - 10%.**
Reduce/Sell	-	**Downside is more than 0%.**
Neutral	-	**Not Applicable**

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.
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