

Tech Mahindra Ltd.

Industry	IT
Bloomberg	TECHM IN
BSE CODE	532755

Traction continues in telecom deal wins, margin to be muted in FY20

RATING	ACCUMULATE
CMP	750
Price Target	841
Potential Upside	12%

Rating Change	↔
Estimate Change	↔
Target Change	↔

Stock Info

52wk Range H/L	780/564
Mkt Capital (Rs Cr)	73602
Free float (%)	64%
Avg. Vol 1M (,000)	2158
No. of Shares (Cr)	98
Promoters Pledged (Cr)	0

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3QFY19 Result Update

- TECHM posted strong performance in its 3QFY19 result where revenue grew 3.5%QoQ to USD1261 million (above our estimates of USD1248 million) and EBITDA margin continued its growth momentum for the second consecutive quarter and expanded 50bps to 19.3% (in line with estimates of 19.2%).
- EBITDA during the quarter grew 6.4%QoQ mainly led by improvement in operational expenses on the SG&A side and supported by utilization improvement (40bps). However some headwinds like investment made on deal ramp up, change in business mix offset some portion of the margins.
- PAT stood at Rs1207 crore, a growth of 14.3% led by tax reversal benefit of 7.5%QoQ and strong revenue beat.
- Telecom sector posted a moderate growth of 2.5% in USD term after been muted for almost two year. The management expects momentum to continue as robust deal wins (240mn dollar win in 2QFY19) to led the growth in future.
- In Enterprise segment, strong revenue growth was contributed by Manufacturing and retail verticals. Manufacturing continued its healthy growth and grew 5.6%QoQ in USD term spread across sub-segments. Even BFSI bounced back in 3QFY19 by growing 2.7%QoQ in USD term as the deal started ramping up. HCI which sharply decline 50 %QoQ (contributes 40mn of revenue) in 2QFY19 revived strongly and grew 4.4%QoQ.

View and Valuation

Going ahead we expect TECHM to post better performance in FY20 led by strong revival in communication, continued deal wins (440mn dollar win during the quarter) and improvement in enterprise segment. The communication segment (contributes approx 41% of the) which was facing challenges for the past two years due to slow growth in LCC acquisition, tepid performance of Comviva, Price cuts in its large account (AT&T) however with deal wins in 2QFY19 and also in 3QFY19 especially in area like Telco, OTT and media players will result in strong growth ahead .5G plan still needs more time and it is expected to rollout in late FY20. Thus we expect the telecom to post single digit growth going ahead. The enterprise segment is expected to post 10%YoY growth led by deal wins (200mn came from enterprise side) and strong traction in verticals like Manufacturing, RETAIL and BFSI segment.

Margin for the company are expected to be muted or bit lower level in FY20 as some pressure are expected as management continues to add workforce, location challenge due to visa issues and wage hike during the year. Even the attrition is in its highest level, thus becoming challenge for the company going head. However some levers will still continue to benefit in Future.

We expect TECHM to post 13.8% CAGR over FY18 to FY20E. We largely maintain our target price of Rs841 and recommend Accumulate.

Key Risks to our rating and target

- Slower than expected growth in telecom .

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
Net Sales	26494	29141	30773	35124	39854
EBITDA	4271	4184	4710	6442	7093
EBIT	3512	3206	3625	5267	5717
PAT	3027	2851	3786	4353	4779
EPS (Rs)	31	29	39	44	49
EPS growth (%)	14%	-6%	32%	15%	10%
ROE (%)	23%	18%	21%	21%	20%
ROCE (%)	22%	17%	16%	21%	20%
BV	151	169	192	223	257
P/B (X)	3.2	2.7	3.3	3.4	2.9
P/E (x)	15.2	15.7	16.5	16.9	15.4

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3QFY19 Results

Strong PAT growth

Financials	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY %	QoQ%	FY17	FY18	YoY %
Net Sales /	7,776	8,055	8,276	8,630	8,944	15.0%	3.6%	29,141	30,773	5.6%
Other Income	225	451	111	175	81	-64%	-54%	778	1,417	82.2%
Employee	4,213	4,145	4,379	4,303	4,518	7.2%	5.0%	15,454	16,624	7.6%
Other Expenses	2,298	2,497	2,540	2,708	2,703	17.6%	-0.2%	9,503	9,439	-0.7%
EBITDA	1,265	1,412	1,357	1,619	1,723	36.2%	6.4%	4,184	4,710	12.6%
Dep and	274	299	281	294	284	3.4%	-3.7%	978	1,085	10.9%
EBIT	990	1,113	1,076	1,324	1,439	45.3%	8.7%	3,206	3,625	13.0%
Interest	34	53	31	39	36	5.0%	-7.7%	129	162	
PBT	1,181	1,512	1,157	1,461	1,484	25.6%	1.6%	3,855	4,879	26.5%
Tax	257	281	246	391	264	2.6%	-32.6%	1,002	1,093	9.0%
Ex Items	-	-	-	-	-			-	-	
PAT	924	1,231	899	1,056	1,207	30.6%	14.3%	2,851	3,786	32.8%

Strong recovery in enterprise beat the revenue estimates

Revenue for the quarter stood at USD1261 million, a growth of 4.3% QoQ in constant currency term .Revenue in USD term grew 3.5%QoQ as cross currency impacted adversely by 80bps. In rupee term, revenue for the quarter stood at Rs8944 crore, a growth of 3.6%QoQ and 15%YoY mainly led steady growth in Enterprise and Communications business.

Continued margin improvement

- EBITDA during the quarter stood at Rs1723 crore, a growth of 6.4%QoQ. Gross margin contracted by 90bps to 33.1% (compared to 34% in last quarter)while SG&A improved 150 bps to 13.8%, thus leading to EBITDA margin expansion of 50bps to 19.3%(in line with our estimate of Rs19.2%).
- Margin expanded during the quarter led by improvement in operational expenses on the SG&A side and supported by utilization improvement(40bps).However some headwinds like investment made on deal ramp up , change in business mix offset some portion of the margins.
- Other income stood at Rs81 crore (below estimated) mainly impacted by forex loss of negative 77.9 crore as compared to Rs50.1crore gain in previous quarter.
- PAT for the quarter stood at Rs1207crore, beating the estimates of Rs1145crore mainly led by onetime tax reversal benefit of 7.5%QoQ.

Muted margin performance for FY20

As the company has stated that they were expecting margins improvement for six to eight quarters, where it's now the seventh quarter of consecutive growth in margins , thus for now on the management expects upside to come (with levers like change in business mix and increase in digital share) however some adverse pressure(negative impact like workforce file, wage hike and location of onsite and offshore) are also present which will impact the margin going ahead. Thus the management is seeing margin pace to lower or much more muted going ahead.

Growth driven by Manufacturing, BFSI and Others

Verticals (USD Mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	CC QOQ
Communication	515	516	517	518	485	506	518	2.5%	-0.6%
Manufacturing	220	224	231	240	246	245	258	5.6%	-0.6%
Technology,media &	68	70	79	91	88	89	88	-0.8%	-0.6%
BFSI	164	166	161	162	166	164	169	2.7%	-0.6%
Retail,transport & logistics	77	85	86	77	75	79	84	6.7%	-0.6%
Others	94	117	137	157	164	136	142	4.4%	-0.6%

Communication vertical continued its steady growth and grew 2.5%QoQ while Enterprise revived back and grew 4%QoQ.Growth was seen across segment barring Tech, Media & Entertainment. Retail led the growth by growing 6.7%QoQ, Manufacturing grew 5.6%QoQ,BFSI revived and grew 2.7%QoQ.Even HCl which washed away the entire enterprise revenue by declining 50%of the revenue last quarter showed a strong growth of 4.4%QoQ, while Tech, Media & Entertainment declined 0.8%QoQ.

Americas and Europe flat in 1QFY19

Geography(USD Mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	YoY %
Americas	533	533	567	581	590	573	598	4.3%	5.3%
Europe	339	353	360	371	367	361	364	0.9%	1.1%
ROW	266	291	282	287	268	285	299	4.7%	6.0%

Weakness continued in Top client bucket

Geography(USD Mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	YoY %
Top 5 clients	295	292	281	289	268	284	285	0.3%	1.5%
Top 6-10 clients	118	121	121	118	130	115	113	-1.0%	-6.2%
Top 11-20 clients	139	131	143	162	168	157	156	-0.6%	9.5%

Client metrics saw a softness in 3QFY19 where top 5 revenue contribution largely remained flat (grew 0.3%QoQ), whereas the top 6-10 declined by 1% QoQ and the top 11-20 declined by 0.6% QoQ. On a YoY basis, the top 5 grew by 1.5%, the top 6-10 declined by 6.2%, and the top 11-20 leading the growth on YoY basis by growing by 9.5%.

Concall highlights

- **Continued growth seen in digital and TECHM next platform:** The Company posted strong growth in digital business and grew 10% sequentially during the quarter. It now contributes 33% of overall revenue. The strategy (related to collaborating with several partners), investment made by the company and also putting together TECHM next platform is showing growth in digital revenue. TECHM NEXT platform is combination of established companies and companies like AltioStar where the management has either invested or collaborated to create a whole ecosystem). Even the management is seeing digital deal sizes increasing and becoming large.
- **Margin performance in 3QFY19:** Continued margin expansion was seen for the seven consecutive quarters. The margin expanded 50bps predominantly came from improvement in operational expenses on the SG&A side and supported by utilization improvement (40bps). However some headwinds like investment made on deal ramp up, change in business mix offset some portion of the margins. However the management expects the negative to pass through as the transition will complete. Going ahead, management expects SG&A to be in range of 14% to 14.5% which will have marginal uptake resulting in impacting the margins.
- **Tax reversal came in during the quarter:** The company saw a reversal benefit during the quarter which resulted in benefit of 7.5% on effective tax rate.
- **Deal wins:** 3QFY19 signed a net new TCv of 440mn dollar of deal wins. Out of 440mn dollar deal, 240 mn dollar deals came from telecom and rest 200mn dollar deal wins was from Enterprise segment.
- **Robust growth in Row:** Strong uptick was seen in revenue growth from RoW which came in with multiple reasons like strong growth in comviva and ramp up of deal in APAC in communication side.
- **Attrition still a concern:** The attrition during the quarter came in highest level range of 21% (17% to 21% historically) which continues to be challenge for the company. However the attrition from higher performer remains very positive. Going ahead, the management is taking essential step to manage the rate. But still on planning part, they generally consider attrition in higher range.
- **Outlook for telecom:** The Company expects the momentum in telecom to continue on the back of deal wins. Thus expecting growth momentum continues in 4QFY19 also. Deal wins (240mn in telecom) are majorly widespread mainly coming across 1.) The digital network and software transformation footprint, 2) in many ways they are all in preparation for upcoming transformation which is 5G. 5G is still been in tried and trial with the tier 1 operators mostly in US and few other parts. However management expects still more time is needed for seeing the uptake in 5G.
- **Top client bucket:** The Company expects top client growth pattern to vary in quarters. Deal wins has come outside the top client. The growth in deal wins were coming across existing as well as new customers.
- **Headcount metric:** the company is creating a digital human work workforce so while during the quarter the company added on 4000 employees QoQ and close to 8000 people for last two quarters in business, The management also continued to expand their footprint in BOTS (4500BOTS). As the demand environment continues to be boost, TECHM and its BPS business will continue to play in facilitating that and will get net benefit going ahead.

Exhibit: Telecom Segment

Steady growth in communication after been muted for last two years.

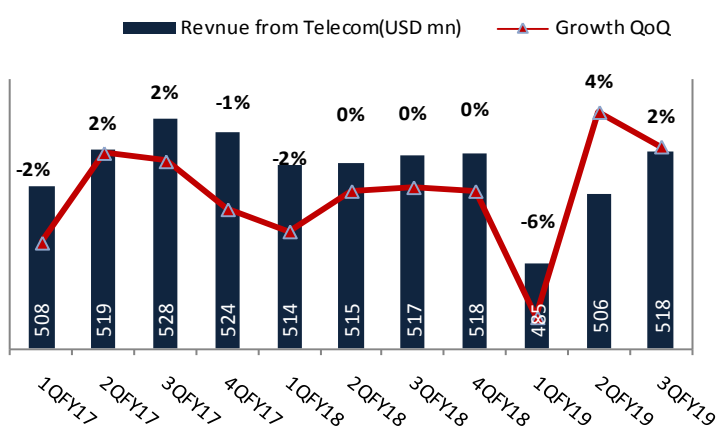


Exhibit: Enterprise Segment

Revival in enterprise revenue was led by strong growth in MFG and Retail. HCI also supported the enterprise growth.

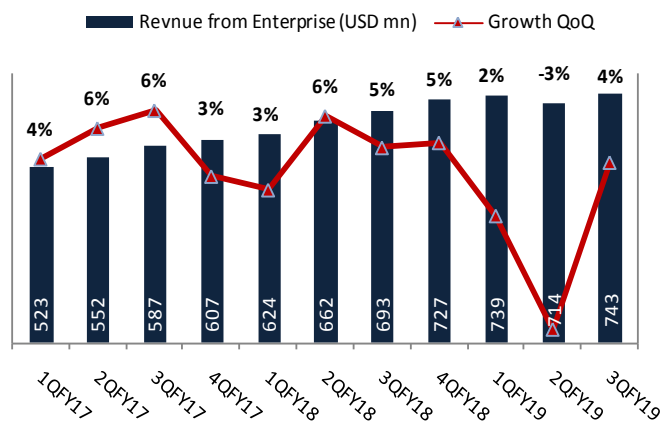


Exhibit: Margin Trend

Operational efficiency and INR depreciation led the margin expansion,

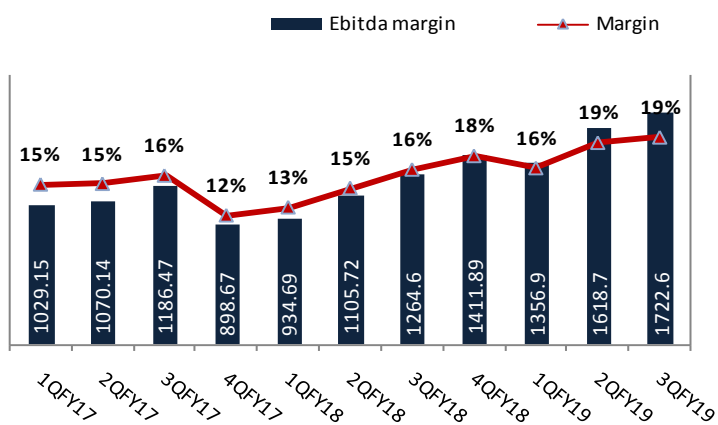


Exhibit: Utilization trend

Utilization remained flat in 3QFY19 after achieving its all time high range.

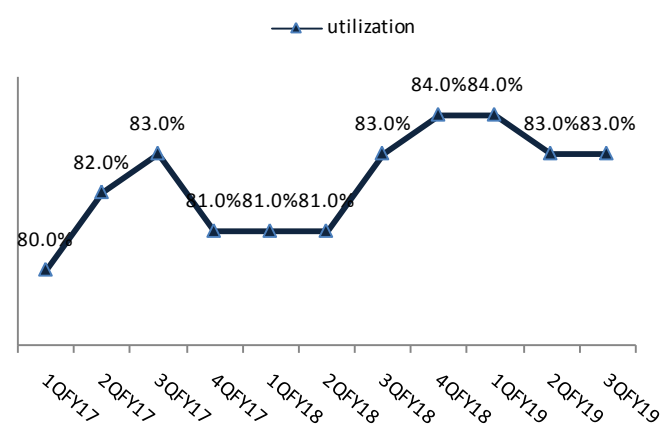
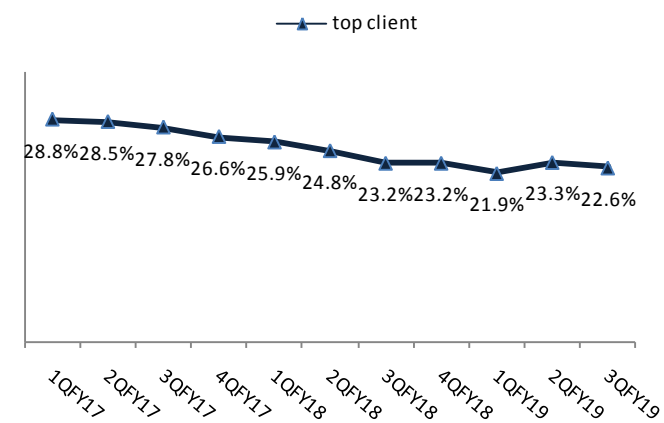


Exhibit: Top Client contribution

Weakness continued in Top client bucket.



Operational Details

Geography %	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
America	46.7%	45.1%	46.8%	45.3%	46.9%	46.6%	48.2%	47.0%	47.4%
Europe	29.4%	29.6%	29.8%	30.0%	29.8%	29.8%	30.0%	29.6%	28.9%
Rest of world	23.9%	25.3%	23.4%	24.7%	23.3%	23.0%	21.9%	23.4%	23.7%

Vertical %	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Communication(telecom)	47.3%	46.3%	45.2%	43.7%	42.8%	41.6%	39.6%	41.5%	41.1%
Manufacturing	18.4%	19.2%	19.3%	19.0%	19.1%	19.3%	20.1%	20.1%	20.5%
TMT	6.4%	6.2%	6.0%	5.9%	6.5%	7.3%	7.2%	7.3%	7.0%
BFSI	13.1%	14.1%	14.4%	14.1%	13.3%	13.0%	13.6%	13.5%	13.4%
Retail, transport & logistics	7.6%	6.5%	6.8%	7.2%	7.1%	6.2%	6.1%	6.5%	6.7%
Others	7.1%	7.7%	8.3%	9.9%	11.3%	12.6%	13.4%	11.2%	11.3%

Onsite/Offshore%	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Onsite	63.9%	64.3%	63.7%	64.1%	65.8%	67.0%	66.6%	64.5%	65.5%
Offshore	36.1%	35.7%	36.3%	35.9%	34.2%	33.0%	33.4%	35.5%	34.5%

Total Headcount	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Software professionals	80898	82403	78999	75587	73460	72437	72462	72534	71785
BPO professionals	29372	28414	30322	35287	35496	34190	34700	39407	43439
Sales & support	6895	6876	6662	6351	6285	6180	6390	6450	6618
IT Attrition % (LTM)	18%	17%	17%	16%	17%	18%	19%	20%	21%
IT Utilization %	77%	77%	77%	81%	83%	84%	81%	81%	82%
IT Utilization % (ExTrainee)	83%	81%	81%	81%	83%	84%	84%	83%	83%

Active Clients	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
No. of Active Clients	837	843	864	885	903	913	926	930	935
% of Repeat Business	93.4%	93.5%	97.2%	95.0%	92.9%	88.4%	98.5%	97.4%	94.6%

No. of Million \$ Clients	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
≥ \$1 million clients	356	354	377	390	389	392	396	407	416
≥ \$5 million clients	128	134	139	147	154	156	154	157	157
≥ \$10 million clients	65	71	74	81	83	85	86	86	88
≥ \$20 million clients	38	36	41	40	40	44	47	45	46
≥ \$50 million clients	14	14	14	14	16	16	16	16	18

Clients	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Top 5	27.8%	26.6%	25.9%	24.8%	23.2%	23.2%	21.9%	23.3%	22.6%
Top 10	38.4%	37.6%	36.3%	35.1%	33.2%	32.7%	32.5%	32.7%	31.6%
Top 20	50.5%	49.0%	48.5%	46.2%	45.0%	45.7%	46.2%	45.6%	44.0%

Capex	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Capital Expenditure	190	284	145	455	167	209	187	151	225

Hedge book	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
GBP IN MN	227	201	247	260	241	229	213	190	171
STRIKE RATE(INR)	100.2	99.8	97.0	95.4	94.2	94.4	95.1	97.0	98.5
USD IN MN	1123	1030	878	646	577	598	894	1069	1084
STRIKE RATE(INR)	72.5	72.9	72.6	72.2	72.2	71.0	70.7	71.9	72.8
EURO IN MN	110	138	165	256	236	244	228	220	202
STRIKE RATE(INR)	82	82	82	84	82	85	86	87	89

Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	128	234	480	436	439	442	442	442
Reserves	5297	8947	11768	14155	15998	18401	21381	24787
Networth	5425	9181	12249	14591	16437	18843	21823	25229
Debt	1080	52	675	1002	1220	1726	1726	1726
Other Non Cur Liab	432	790	454	678	1157	1167	1167	1167
Total Capital Employed	7047	11398	14768	17695	20508	23475	26493	29899
Net Fixed Assets (incl CWIP)	938	2297	2872	3106	4104	4899	5980	6330
Non Cur Investments	3924	1219	1299	118	231	1246	1246	1246
Other Non Cur Asst	0	21	31	537	646	602	602	602
Non Curr Assets	1969	4157	6266	6884	8863	10482	11563	11914
Debtors	1704	4349	5206	5771	5338	6498	7417	8415
Cash & Bank	536	3315	2405	4018	3219	3044	2742	4649
Other Curr Assets	666	2616	3813	2446	3361	2112	2387	2701
Current investments	175	253	804	1125	2165	3445	5043	5496
current financial asset	0	0	0	1587	2157	2942	2942	2942
current tax asset	11	10	25	40	61	66	75	85
Short-term loans and advances	3091	10542	12253	14986	16300	18107	20606	24289
Curr Assets	640	1472	2059	2276	2312	2037	2325	2638
Creditors	317	1267	1799	355	387	403	460	522
Provisions	981	1802	1223	1238	1612	1707	1949	2211
Other Curr Liab	0	0	0	270	423	1877	1877	1877
Other financial liability	0	0	0	692	825	938	938	938
Curr Liabilities	1938	4542	5080	4830	5559	6962	7548	8186
Net Curr Assets	1154	6000	7173	10156	10768	11145	13082	16138
Total Assets	8984	15940	19848	22525	26067	30437	34041	38085

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	6,873	18,831	22,621	26,494	29,141	30,773	35,124	39,854
Change (%)	25%	174%	20%	17%	10%	6%	14%	13%
EBITDA	1,424	4,184	4,153	4,271	4,184	4,710	6,442	7,093
Change (%)	55%	194%	-1%	3%	-2%	13%	37%	10%
Margin (%)	21%	22%	18%	16%	14%	15%	18%	18%
Depr & Amor.	200	522	611	759	978	1,085	1,175	1,377
EBIT	1,224	3,662	3,542	3,512	3,206	3,625	5,267	5,717
Int. & other fin. Cost	103	80	30	97	129	162	141	143
Other Income	(75)	113	107	439	778	1,417	553	799
EBT	1,224	3,662	3,542	3,512	3,206	3,625	5,267	5,717
Exp Item	-	(120)	-	-	-	-	-	-
Tax	236	752	960	830	1,002	1,093	1,287	1,593
Minority Int & P/L share of Ass.	(20)	(34)	(31)	-	-	-	-	-
Reported PAT	811	3,062	2,659	3,024	2,853	3,786	4,391	4,779
Adjusted PAT	791	3,029	2,628	3,027	2,851	3,786	4,353	4,779
Change (%)	47%	283%	-13%	15%	-6%	33%	15%	10%
Margin(%)	12%	16%	12%	11%	10%	12%	12%	12%

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
ROE	16.7%	41.5%	24.5%	22.6%	18.4%	21.5%	21.4%	20.3%
ROCE	19.1%	39.7%	27.1%	21.6%	16.8%	16.5%	21.1%	20.3%
Asset Turnover	8	12	9	9	8	7	6	6
Current Ratio	2	2	2	3	3	3	3	3
Debtor Days	90	84	84	79	67	77	77	77
Book Value Per Share	212	197	127	151	169	192	223	257
Payable Days	34	29	33	31	29	24	24	24
Earnings Per Share	31	65	27	31	29	39	44	49
P/E	17	14	23	15	16	17	17	15
Price / Book Value	3	5	5	3	3	3	3	3
EV/EBITDA	10	9	14	10	11	13	11	10
EV/Sales	2	2	3	2	2	2	2	2
Div Payout%	16%	15%	22%	38%	31%	36%	32%	29%

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	1047	3695	3618	3857	3853	4879	5678	6372
(inc)/Dec in Working Capital	-31	-1615	-850	-461	544	-783	-640	-696
Non Cash Op Exp	181	610	713	1057	754	984	1175	1377
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	-341	-1094	-1073	-1315	-1080	-1526	-1287	-1593
others	0	0	0	0	0	0	0	0
CF from Op. Activities	855	1596	2409	3137	4071	3554	4926	5460
(inc)/Dec in FA & CWIP	-175	-914	-1113	-871	-760	-790	-2256	-1727
Free Cashflow	681	682	1296	2266	3311	2763	2669	3733
(Pur)/Sale of Inv	0	-62	-447	-278	-912	0	-1599	-452
CF from Inv. Activities	-783	-190	-2092	-1460	-3051	-3360	-3855	-2179
inc/(dec) in NW	7	50	58	36	35	25	0	0
inc/(dec) in Debt	219	852	802	138	-14	960	0	0
Int. Paid	-102	-97	-64	-93	-111	-160	0	0
Div Paid (inc tax)	-59	-136	-550	-555	-1239	-944	-1373	-1373
others	-102	-1738	-1101	-115	-352	-311	0	0
CF from Fin. Activities	65	-972	-790	-496	-1571	-269	-1373	-1373
Inc(Dec) in Cash	138	434	-473	1181	-550	-76	-302	1907
Add: Opening Balance	400	1018	1679	1213	2555	2042	1966	1664
Closing Balance	538	1452	1206	2394	2005	1966	1664	3571

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Disclosure of Interest Statement-

Analyst's ownership of the stocks mentioned in the Report	NIL
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