

Tech Mahindra

Performance Highlights

(` cr)	3QFY19	2QFY19	% chg (qoq)	3QFY18	% chg (yoy)
Net revenue	8,944	8,630	3.6	7,776	15.0
EBITDA	1,723	1,619	6.4	1,265	36.2
EBITDA margin (%)	19.3	18.8	50bps	16.3	300bps
Adj. PAT	1,203	1,064	13.0	942	27.7

Source: Company, Angel Research;

Tech Mahindra posted good numbers for 3QFY2019 on all fronts. Revenues rose 3.5% qoq to end the period at US\$1,261mn. On CC (constant currency) terms of the 4.3% qoq. In Rupee terms, revenues came in at `8,944cr v/s. `8,630cr in 2QFY2019, up 3.6% qoq. On the operating front, the EBITDA margin came in at 19.3% v/s. 18.8% in 2QFY2019, a qoq expansion of 50bps. Consequently, PAT came in at `1,203cr v/s. `1,064cr in 2QFY2019, a growth of 13.0% qoq. **The stock has witnessed a good run-up and hence offer little upsides in near term; hence, we maintain our neutral rating.**

Result highlights: Revenues rose 3.5% qoq to end the period at US\$1,261mn. On CC (constant currency) terms of the 4.3% qoq. In Rupee terms, revenues came in at `8,944cr v/s. `8,630cr in 2QFY2019, up 3.6% qoq. The sales growth during the quarter was broad based in terms of services, while in geographies it was USA and ROW, which drove the growth while Europe saw a moderate qoq growth. On the operating front, the EBITDA margin came in at 19.3% v/s. 18.8% in 2QFY2019, a qoq expansion of 50bps. Consequently, PAT came in at `1,203cr v/s. `1,064cr in 2QFY2019, a growth of 13.0% qoq.

Outlook and valuation: We expect a CAGR of 6.8% and 10.2% in USD and INR revenue respectively over FY2018-21E. The PAT is expected to grow at a CAGR of 10.1% over FY2018-21E. **We recommend our neutral rating.**

Key financials (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2018	FY2019	FY2020E	FY2021E
Net sales	30,773	35,500	37,985	41,214
% chg	5.6	15.4	7.0	8.5
Net profit	3,800	4,498	4,693	5,072
% chg	35.1	18.4	4.3	8.1
EBITDA margin (%)	15.3	18.6	19.3	19.3
EPS (`)	43.0	50.9	53.1	57.4
P/E (x)	17.4	14.7	14.1	13.1
P/BV (x)	3.5	3.1	2.8	2.5
RoE (%)	20.2	21.2	19.8	19.2
RoCE (%)	15.4	20.7	21.1	20.9
EV/Sales (x)	2.3	2.0	1.9	1.7
EV/EBITDA (x)	15.3	10.8	9.7	9.0

Source: Company, Angel Research; Note: CMP as of February 5, 2019

NEUTRAL

CMP `750

Target Price -

Investment Period 12 Months

Stock Info

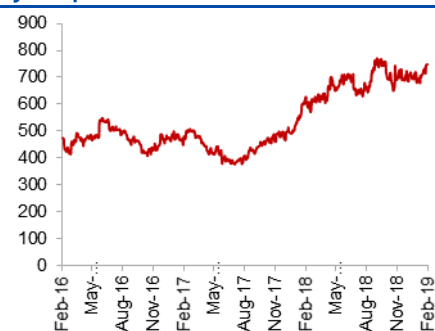
Sector	IT
Market Cap (` cr)	73,597
Net Debt (` cr)	(6,370)
Beta	0.7
52 Week High / Low	780/564
Avg. Daily Volume	70,803
Face Value (`)	5
BSE Sensex	36,617
Nifty	10,934
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	35.9
MF / Banks / Indian FIs	14.8
FII / NRIs / OCBs	39.5
Indian Public / Others	9.8

Abs.(%)	3m	1yr	3yr
Sensex	4.8	5.4	48.7
Tech Mahindra	7.9	19.2	57.9

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2019 performance (Consolidated, Indian GAAP)

(` cr)	3QFY19	2QFY19	% chg (qoq)	3QFY18	% chg (yoy)	9MFY19	9MFY18	% chg (yoy)
Net revenue	8,944	8,630	3.6	7,776	15.0	25,850	22,718	13.8
Cost of revenue	5,985	5,692	5.1	5,381	11.2	13,201	12,479	5.8
Gross profit	2,959	2,938	0.7	2,395	23.5	12,649	10,240	23.5
SG&A expense	1,237	1,319	(6.2)	1,131	9.4	7,989	6,935	15.2
EBITDA	1,723	1,619	6.4	1,265	36.2	4,660	3,305	41.0
Dep. and amortization	284	294	(3.7)	274	3.4	859	786	9.2
EBIT	1,439	1,324	8.7	991	45.3	3,801	2,519	50.9
Interest	36	39	(7.7)	34	5.0	105	110	(4.2)
Other income	81	175	(54.0)	225	(64.2)	367	958	(61.7)
PBT	1,484	1,461	1.6	1,181	25.6	4,063	3,367	20.7
Income taxes	264	391	(32.6)	257	2.6	901	812	11.0
PAT	1,220	1,069	14.1	924	32.0	3,162	2,555	23.7
Minority interest	17	5	-	(19)	-	(3)	(22)	-
PAT after minority interest	1,203	1,064	13.0	943	27.5	3,165	2,578	22.8
Profit from associates	-	-	-	-	-	-	-	-
Exceptional item	-	-	-	-	-	-	-	-
Reported PAT	1,203	1,064	13.0	943	27.5	3,165	2,578	22.8
Adj. PAT	1,203	1,064	13.0	943	27.5	3,165	2,578	22.8
Diluted EPS	13.5	11.9	12.7	10.6	26.8	35.7	29.3	21.6
Gross margin (%)	33.1	34.0	(95)bps	30.8	228bps	48.9	45.1	386bps
EBITDA margin (%)	19.3	18.8	50bps	16.3	300bps	18.0	14.5	348bps
EBIT margin (%)	16.1	15.3	75bps	12.7	335bps	14.7	11.1	362bps
PAT margin (%)	13.4	12.3	112bps	12.1	132bps	12.2	11.3	90bps

Source: Company, Angel Research

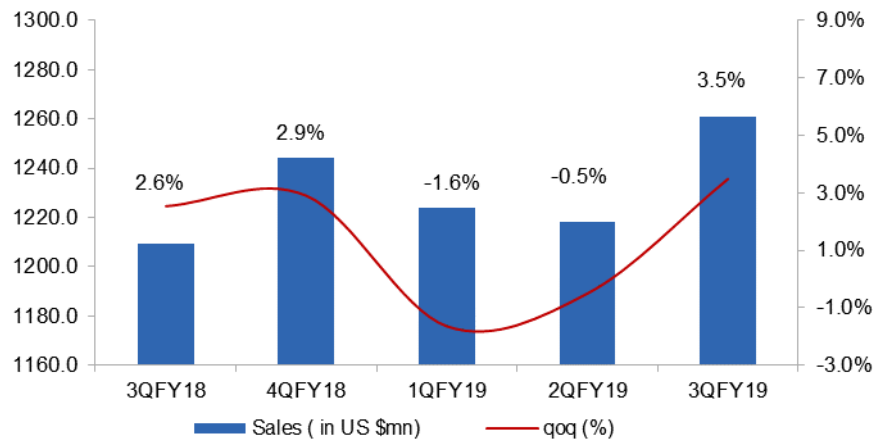
Revenue growth led by USA & ROW

For 3QFY2019, Tech Mahindra posted good set of numbers. Revenues rose 3.5% qoq to end the period at US\$1,261mn. On CC (constant currency) terms of the 4.3% qoq. In Rupee terms, revenues came in at `8,944cr v/s. `8,630cr in 2QFY2019, up 3.6% qoq.

In terms of geography, USA constituted 47.4% of sales, a qoq growth of 4.4%, while ROW was the key growth driver constituting 23.7% of sales, posting a qoq growth of 4.8%. Europe, on the other hand posted a qoq growth of 1.0%.

In terms of the industries, the manufacturing came in at 20.5% of sales, posting a qoq growth of 5.6% and was the main driver of growth. BFSI, which lead the segment, contributing around 13.4% of sales, posting a qoq growth of 2.7%. The key domain Retail, Transport & Logistics, posted a qoq growth of 6.7%. In addition, the Technology, Media & Entertainment, posted a qoq de-growth of 0.8%. Communication, which is 41.1% of sales, posted a qoq growth of 2.5%.

In terms of services, growth continued to be led by BPO, which grew by 13.4% qoq, while IT services grew by 2.8% qoq during the quarter. This is also reflected in terms of the headcount, which has seen a steady rise in last three quarters V/s flat or no additions in the IT services.

Exhibit 2: Trend in revenue growth


Source: Company, Angel Research

Exhibit 3: Growth in industry segments

Particulars	% to revenue	% growth (qoq)
Telecom	41.1	2.5
Manufacturing	20.5	5.6
TME	7.0	-0.8
BFSI	13.4	2.7
RTL	6.7	6.7
Others	11.3	4.4

Source: Company, Angel Research

In terms of geographies, ROW posted growth of 4.8% qoq, while Europe and US posted a growth of 1.0% and 4.4% qoq respectively.

Exhibit 4: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)
Americas	47.4	4.4
Europe	28.9	1.0
RoW	23.7	4.8

Source: Company, Angel Research

Hiring and client metrics

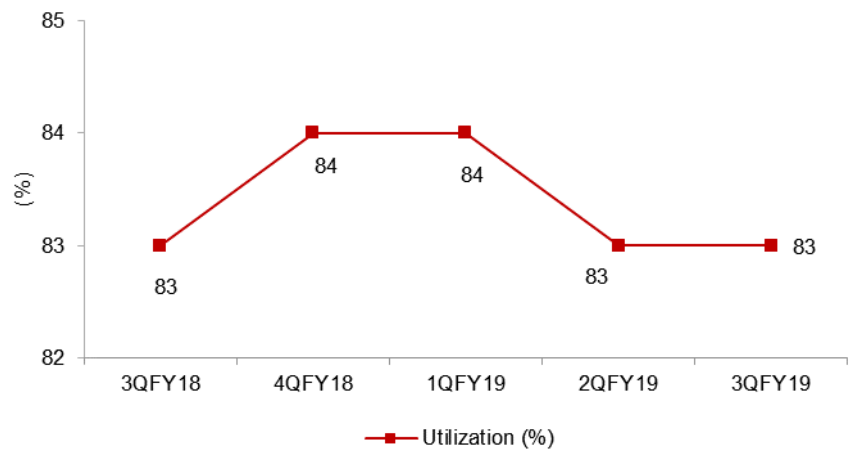
During the quarter, the company reported a net addition of 3,451 employees, taking its overall headcount to 1,21,842. The BPO headcount currently stands at 43,439. Attrition (on LTM basis) was at 21%.

Exhibit 5: Employee metrics

Particulars	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Software professionals	73,460	72,437	72,462	72,534	71,785
BPO professionals	35,496	34,190	34,700	39,407	43,439
Sales & support	6,180	6,180	6,390	6,450	6,618
Total employees	1,12,886	1,12,807	1,13,552	1,18,391	1,21,842
Attritions (%)	17	18	19	20	21

Source: Company, Angel Research

Exhibit 6: Trend in utilization rate



Source: Company, Angel Research

On the client additions front, the company added 5 clients. One client each was added in the more than US\$20mn and US\$50mn each. In addition, in terms of the growth drivers, the main driver has been client additions during the quarter, with repeat business contributing 94.6% v/s. 97.4% in 2QFY2019.

Exhibit 7: Client metrics

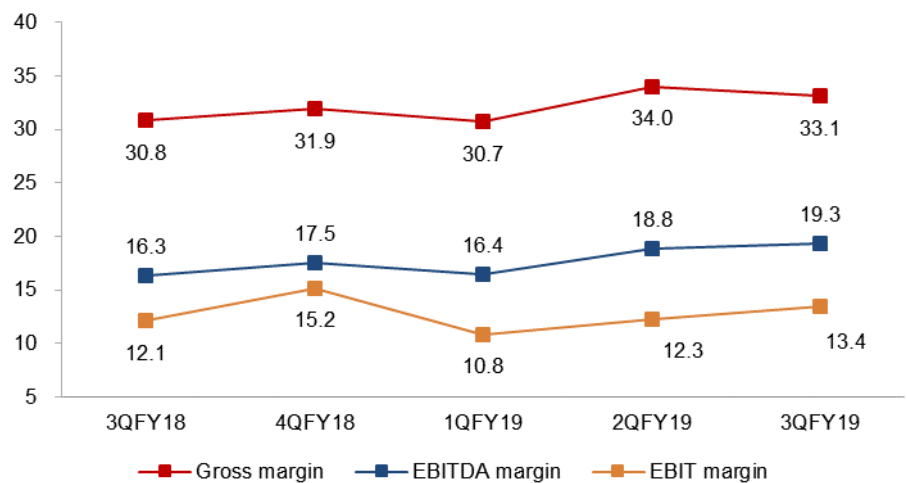
Particulars	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Total active clients	903	913	926	930	935
US\$1mn–5mn	235	236	242	250	259
US\$5mn–10mn	71	71	68	71	69
US\$10mn–20mn	43	41	39	41	42
US\$20mn–50mn	24	24	31	28	28
US\$50mn+	16	16	16	17	18

Source: Company, Angel Research

Operating margin expands

On the operating front, the utilization levels during the quarter came in at 82% v/s. 81% in 2QFY2019, which along with volumes also aided the margins to come in higher. On the operating front, the EBITDA margin came in at 19.3% v/s. 18.8% in 2QFY2019, a qoq expansion of 50bps.

Exhibit 8: Margin trend (%)



Source: Company, Angel Research

Investment arguments

Growth prospects decent: Over the last one year, the IT services of the company has just about been decent one, as reflected by the 9MFY2019 performance; where the segment has posted a 12.8% yoy, while BPO which has seen robust additions has witnessed a yoy growth of 26.3%. In addition, its main industry Communication did not witness much growth during the year, while the growth was much driven by the manufacturing & TEM space. Thus unlike large players which benefit from the uptick in the growth in the Industry; Tech Mahindra; on a best case scenario just matches the Industry growth and depends on the Telecommunication spends. Thus in near term the company is depended on the 5G spends which are expected to come out by 2020 and mostly likely reflect by FY2021. Thus, on a medium term, the company might just match the Industry growth; however, concerns over long-term drivers to sustain the growth organically persists.

Operating performance on an uptick: On the margin front, improvement, on the back of synergies and productivity gains has started reflecting from 2QFY2018. Company has continued its margin recovery since then. For 3QFY2019, the company posted margins of 19.3% on EBDITA affront from 14.4% in FY2017. While there are still levers in terms, of the improved business mix, uptick in deal size and productivity, however given the near term, pressures on employee cost where tech Mahindra is at risk given the high onsite mix, we expect up moves from heron to be gradual.

Outlook and valuation

We expect a CAGR of 6.8% and 10.2% in USD and INR revenue respectively over FY2018-21E. The PAT is expected to grow at a CAGR of 10.1% over FY2018-21E. while the stock has moved up in anticipation of a good uptick in the communication segment supported by the upcoming 5G opportunity; we view this opportunity cautiously and believe that given that the core IT services business of the company is not growing as well as large peers; could risk the stock performance going forward. Even after factoring a decent uptick in the sales growth during FY2020-21E, we find that upsides at 14x FY2020E would be limited, **We recommend our neutral rating.**

Exhibit 9: Key assumptions

	FY2020E	FY2021E
Revenue growth (US\$)	7.0	8.5
USD-INR rate (realized)	71.0	71.0
Revenue growth (₹)	7.0	8.5
EBITDA margin (%)	19.3	19.3
Tax rate (%)	25.0	25.0
EPS growth (%)	4.3	8.1

Source: Company, Angel Research

Company Background

Tech Mahindra was founded in 1986 as a joint venture between Mahindra Group and British Telecom (BT) to service the latter. Later on, the company started servicing other external clients as well (solely in the telecom industry). In June 2009, Tech Mahindra acquired a 42.7% stake in erstwhile Satyam Computers (now Mahindra Satyam) and now the latter is entirely merged with the company. The company acquired the companies - LCC and Softgen. These two acquisitions have been consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry. LCC is estimated to have annual revenues of more than US\$400mn (CY2014), with workforce of over 5,700 network professionals across five continents and more than 50 countries.

Profit and loss statement (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Net sales	29,141	30,773	35,500	37,985	41,214
Cost of revenues	20,566	21,530	23,785	25,070	27,201
Gross profit	8,575	9,243	11,715	12,915	14,013
% of net sales	29.4	30.0	33.0	34.0	34.0
SG&A expenses	4,390	4,533	5,112	5,584	6,058
% of net sales	15.1	14.7	14.4	14.7	14.7
EBITDA	4,184	4,710	6,603	7,331	7,954
% of net sales	14.4	15.3	18.6	19.3	19.3
Depreciation and amortization	978	1085	1243	1329	1442
% of net sales	3.4	3.5	3.5	3.5	3.5
EBIT	3,206	3,625	5,361	6,002	6,512
% of net sales	11.0	11.8	15.1	15.8	15.8
Interest expense	129	162	162	162	162
Other inc., net of forex gain/(loss)	778	1,417	481	481	481
Profit before tax	3,855	4,879	5,679	6,320	6,830
Provision for tax	1,002	1,093	1,136	1,580	1,708
% of PBT	26.0	22.4	20.0	25.0	25.0
PAT	2,853	3,786	4,543	4,740	5,123
Exceptional item	-	-	-	-	-
Minority interest	40	(14)	45	47	51
Reported PAT	2,813	3,800	4,498	4,693	5,072
Adjusted PAT	2,813	3,800	4,498	4,693	5,072
Fully diluted EPS (`)	32.1	43.0	50.9	53.1	57.4

Balance sheet (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Equity capital	439	442	442	442	442
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	15,998	18,401	20,794	23,291	25,989
Other reserves	0	-	-	-	-
Net worth	16,438	18,843	21,236	23,732	26,430
Secured loans	1,219	1,726	1,726	1,726	1,726
Unsecured loans	-	-	-	-	-
Total debt	1,219	1,726	1,726	1,726	1,726
Other long term liability	537	537	537	537	537
Long-term provisions	620	555	555	555	555
Minority interest	464	509	555	602	653
Amount pending investigation	1,230	1,300	1,300	1,300	1,300
Total capital employed	20,508	23,469	25,908	28,452	31,201
Gross block	11,677	13,924	14,924	15,924	16,924
Accumulated dep.	(5,217)	(6,302)	(7,545)	(8,874)	(10,317)
Net block	6,460	7,622	7,380	7,050	6,608
Capital WIP	373	240	240	240	240
Total fixed assets	6,833	7,862	7,620	7,290	6,848
Investments	2,396	4,691	9,636	13,054	16,733
Long term loans and adv.	2,435	2,646	3,117	3,118	3,119
Interest in TML benefit trust	-	-	-	-	-
Deferred tax asset, net	267	571	571	571	571
Other non-current assets	0	-	-	-	-
Inventories	61	66	66	66	66
Sundry debtors	5,338	6,498	7,136	7,521	8,160
Cash and cash equiv.	3,219	3,044	4,000	3,900	3,841
Loans and advances	5,518	5,054	5,054	5,051	5,048
Current investments	-	-	-	-	-
Unbilled revenue	-	-	-	-	-
Sundry creditors	(2,312)	(6,559)	(10,828)	(11,585)	(12,570)
Other liabilities	(2,860)	(403)	(463)	(533)	(613)
Provision	(387)	-	-	-	-
Working capital	8,577	7,700	4,964	4,419	3,931
Total capital deployed	20,508	23,469	25,908	28,452	31,201

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Pretax profit from operations	2,853	3,786	4,543	4,740	5,123
Depreciation	978	1,085	1,243	1,329	1,442
Exp. (deferred)/written off/others	-	-	-	-	1
Pre tax cash from operations	3,831	4,871	5,786	6,070	6,566
Other income/prior period ad	778	1,417	481	481	481
Net cash from operations	4,609	6,288	6,267	6,551	7,047
Tax	(1,002)	(1,093)	(1,136)	(1,580)	(1,708)
Cash profits	3,607	5,195	5,131	4,971	5,340
(Inc)/dec in					
Sundry Debtors	433	(1,160)	(638)	(386)	(639)
Inventories	(21)	(5)	-	-	-
Loans and advances	(1,485)	464	-	3	3
Sundry creditors	36	4,247	4,269	758	985
Others	660	(2,457)	60	70	80
Net trade working capital	(377)	1,089	3,692	445	429
Cashflow from operating activities	3,230	6,284	8,823	5,416	5,768
(Inc)/dec in fixed assets	(1,840)	(1,029)	243	329	442
(Inc)/dec in investments	(1,153)	(2,295)	(4,945)	(3,418)	(3,679)
(Inc)/dec in other non-current assets	0	0	-	-	-
Cashflow from investing activities	(2,992)	(3,324)	(4,703)	(3,088)	(3,237)
Inc/(dec) in debt	(217)	(507)	-	-	-
Inc/(dec) in deferred revenue	-	-	-	-	-
Inc/(dec) in equity/premium	-	0	-	-	-
Inc/(dec) in minority interest	(271)	(45)	(45)	(47)	(51)
Dividends	(924)	(1,447)	(2,105)	(2,196)	(2,373)
Others	376	(1,136)	(1,015)	(186)	(170)
Cashflow from financing activities	(1,037)	(3,134)	(3,164)	(2,428)	(2,592)
Cash generated/(utilised)	(800)	(174)	955	(100)	(60)
Cash at start of the year	4,018	3,219	3,044	4,000	3,900
Cash at end of the year	3219	3044	4000	3900	3841

Key Ratios

Y/E March	FY2017	FY2018	FY2019	FY2020E	FY2021E
Valuation ratio (x)					
P/E (on FDEPS)	23.4	17.4	14.7	14.1	13.1
P/CEPS	17.4	13.6	11.5	11.0	10.2
P/BVPS	4.0	3.5	3.1	2.8	2.5
Dividend yield (%)	1.2	1.9	2.7	2.8	3.1
EV/Sales	2.5	2.3	2.0	1.9	1.7
EV/EBITDA	17.1	15.3	10.8	9.7	9.0
EV/Total assets	10.5	9.2	9.4	9.8	10.4
Per share data (₹)					
EPS	32.1	43.0	50.9	53.1	57.4
Cash EPS	43.2	55.3	65.0	68.2	73.7
Dividend	9.0	14.0	20.4	21.2	23.0
Book value	187.3	213.3	240.4	268.6	299.2
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.7	0.8	0.8	0.7	0.7
Cost of debt (PBT/EBIT)	1.2	1.3	1.1	1.1	1.0
EBIT margin (EBIT/Sales)	0.1	0.1	0.2	0.2	0.2
Asset turnover ratio (Sales/Assets)	4.3	3.9	4.7	5.2	6.0
Leverage ratio (Assets/Equity)	0.4	0.4	0.4	0.3	0.3
Operating ROE (%)	17.1	20.2	21.2	19.8	19.2
Return ratios (%)					
RoCE (pre-tax)	15.6	15.4	20.7	21.1	20.9
Angel RoIC	19.0	18.0	24.7	24.7	24.0
RoE	17.1	20.2	21.2	19.8	19.2
Turnover ratios (x)					
Asset turnover (fixed assets)	4.3	3.9	4.7	5.2	6.0
Receivables days	70	79	79	75	75
Payable days	30	80	119	115	116

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2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):	<i>Buy (> 15%)</i>	<i>Accumulate (5% to 15%) Reduce (-5% to -15%)</i>	<i>Neutral (-5 to 5%) Sell (< -15)</i>
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