

Tech Mahindra

Performance Highlights

(₹ cr)	2QFY16	1QFY16	% chg (qoq)	2QFY15	% chg (yoy)
Net revenue	6,616	6,294	5.1	5,488	20.5
EBITDA	1,101	936	17.7	1,108	(0.7)
EBITDA margin (%)	16.6	14.9	178bp	20.2	(355)bp
Adj. PAT	786	676	16.2	720	9.2

Source: Company, Angel Research;

Tech Mahindra posted better than expected results for 2QFY2016. The company posted a 2.2% qoq growth in revenue to US\$1,011mn V/s an expected US\$1,004mn and V/s US\$989mn in 1QFY2016. On the EBITDA front, the EBITDA margin came in at 16.6% V/s 15.9% expected and V/s 14.9% in 1QFY2016. The company posted an EBIT margin of 13.7% V/s 13.1% expected and V/s 12.1% in 1QFY2016. Thus, the Net Profit came in at ₹786cr V/s ₹725cr expected and V/s ₹676cr in 1QFY2016, a qoq growth of 16.2%. **We currently have a Buy rating on the stock with a price target of ₹646.**

Result highlights: Tech Mahindra posted a 2.2% qoq growth in revenue to US\$1,011mn V/s an expected US\$1,004mn and V/s US\$989mn in 1QFY2016. In rupee terms, the company posted a 5.1% qoq revenue growth to ₹6,616cr V/s ₹6,577cr expected and V/s ₹6,294cr in 1QFY2016. The growth was primarily driven by USA, which contributed ~48.9% of sales in 2QFY2016 V/s ~47.7% in 1QFY2016. The EBITDA margin came in at 16.6% V/s 15.9% expected and V/s 14.9% in 1QFY2016. The margin expansion was driven by improved capacity utilization, which moved up from 74% in 1QFY2016 to 77% in 2QFY2016. Excluding trainees, utilization inched up to 79% V/s 75% in 1QFY2016. The attrition rate during the quarter was 20% V/s 19% in 1QFY2016. Thus, the Net Profit came in at ₹786cr V/s ₹725cr expected and V/s ₹676cr in 1QFY2016, a qoq growth of 16.2%. During the quarter, the company added 18 clients, with 1 client added in the US\$50mn+ bracket and 2 added in the US\$10mn+ bracket.

Outlook and valuation: The Management remains confident of reverting back to the original profitability by FY2017-18. We expect a CAGR of 13.0% and 8.0% in USD and INR revenue respectively over FY2015-17E, driven by acquisitions. The PAT is expected to grow at a CAGR of 8.0% over FY2015-17. **We maintain our Buy on the stock.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E
Net sales	18,831	22,621	25,566	28,890
% chg	31.4	20.1	13.0	13.0
Net profit	2,932	2,628	2,528	3,066
% chg	38.6	(10.4)	(3.8)	21.3
EBITDA margin (%)	54.5	18.4	16.0	17.0
EPS (₹)	30.5	27.4	26.3	31.9
P/E (x)	17.5	19.5	20.3	16.7
P/BV (x)	5.6	4.2	3.6	3.1
RoE (%)	31.9	21.5	17.9	18.6
RoCE (%)	83.2	24.0	20.5	21.7
EV/Sales (x)	2.5	2.2	1.9	1.6
EV/EBITDA (x)	4.6	12.1	11.7	9.4

Source: Company, Angel Research; Note: CMP as of November 19, 2015

BUY

CMP	₹534
Target Price	₹646

Investment Period 12 Months

Stock Info

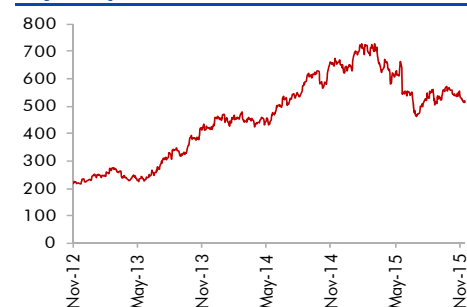
Sector	IT
Market Cap (₹ cr)	51,619
Net Debt (₹ cr)	(3,833)
Beta	0.5
52 Week High / Low	750/459
Avg. Daily Volume	229,545
Face Value (₹)	5
BSE Sensex	25,842
Nifty	7,941
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.7
MF / Banks / Indian Fls	13.9
FII / NRIs / OCBs	38.0
Indian Public / Others	11.4

Abs.(%)	3m	1yr	3yr
Sensex	(7.5)	(7.8)	40.9
Tech Mahindra	(4.6)	(18.6)	141.7

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2016 performance (Consolidated, Indian GAAP)

(₹ cr)	2QFY16	1QFY16	% chg (qoq)	1QFY15	% chg (yoy)	1HFY16	1HFY15	% chg (yoy)
Net revenue	6,616	6,294	5.1	5,488	20.5	12,909	10,609	21.7
Cost of revenue	4,496	4,451	1.0	3,605	24.7	8,946	7,034	27.2
Gross profit	2,120	1,843	15.0	1,883	12.6	3,963	3,575	10.8
SG&A expense	1,019	908	12.2	775	31.5	1,927	1,528	26.0
EBITDA	1,101	936	17.7	1,108	(0.7)	2,037	2,047	(0.5)
Dep. and amortization	197	173	13.9	142	38.6	371	292	27.1
EBIT	904	762	18.6	966	(6.4)	1,666	1,755	(5.1)
Interest	17	12		15		30	29	
Other income	166	137		58		302	147	
PBT	1,052	886	18.7	1,008	4.3	1,939	1,873	3.5
Income taxes	260	210	24.1	281	(7.2)	470	511	(8.1)
PAT	792	677	17.0	728	8.8	1,468	1,361	7.9
Minority interest	7	2		8		8	11	
PAT after minority interest	786	675	16.4	720	9.2	1,460	1,350	8.1
Profit from associates	0	1		-		1	-	
Exceptional item	-	-		-		-	-	
Reported PAT	786	676	16.2	720	9.2	1,462	1,350	8.2
Adj. PAT	786	676	16.2	720	9.2	1,462	1,350	8.2
Diluted EPS	8.2	7.0	16.2	7.5	9.2	15.2	14.1	8.2
Gross margin (%)	32.0	29.3	276bp	34.3	(227)bp	30.7	33.7	(300)bp
EBITDA margin (%)	16.6	14.9	178bp	20.2	(355)bp	15.8	19.3	(352)bp
EBIT margin (%)	13.7	12.1	155bp	17.6	(394)bp	12.9	16.5	(364)bp
PAT margin (%)	11.9	10.7	113bp	13.1	(124)bp	11.3	12.7	(141)bp

Source: Company, Angel Research

Exhibit 2: 2QFY2016 – Actual vs Angel estimates

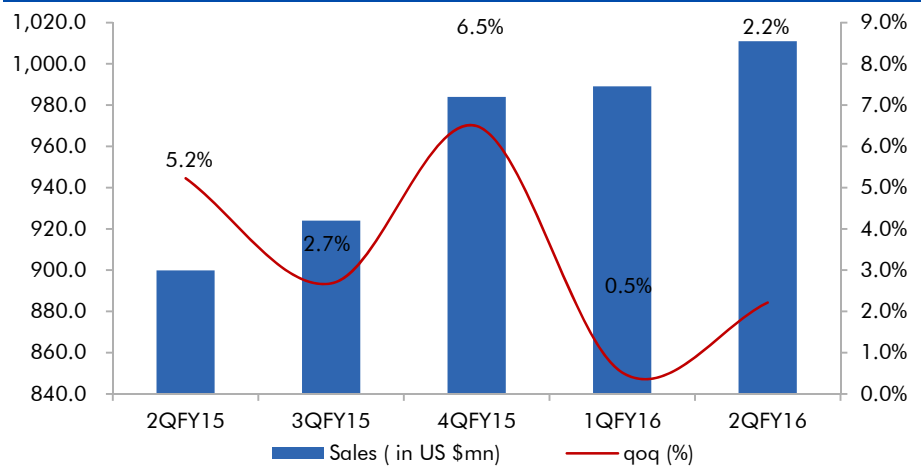
(₹ cr)	Actual	Estimate	Var. (%)
Net revenue	6,616	6,577	0.6
EBIT margin (%)	16.6	15.9	74bps
PAT	786	725	8.4

Source: Company, Angel Research

Revenue growth led by acquisitions

Tech Mahindra posted better than expected results in 2QFY2016. It posted a 2.2% qoq growth in revenue to US\$1,011mn V/s an expected US\$1,004mn and V/s US\$989mn in 1QFY2016. In rupee terms, the company posted a 5.1% qoq revenue growth to ₹6,616cr V/s ₹6,577cr expected and V/s ₹6,294cr in 1QFY2016

The growth was primarily driven by USA, which contributed ~48.9% of sales in 2QFY2016 V/s 47.7% of sales in 1QFY2016. Amongst verticals, the Telecom/Communication and the Technology, Media and Entertainment industries drove growth, contributing 52.9% of sales (V/s 52.7% of sales in 1QFY2016) and 8.2% of sales (7.3% of sales in 1QFY2016), respectively.

Exhibit 3: Trend in revenue growth


Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Telecom	53	2.6	14.3
Manufacturing	17	(0.2)	4.2
TME	8	14.8	15.2
BFSI	10	(1.9)	7.9
RTL	6	(5.6)	12.3
Others	7	3.8	23.6

Source: Company, Angel Research

In terms of geographies, ROW posted a qoq decline of 2.2%. Europe posted a 1.9% qoq growth, while the US posted a 4.8% qoq growth.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Americas	49	4.8	12.1
Europe	29	1.9	6.2
RoW	22	(2.2)	23.0

Source: Company, Angel Research

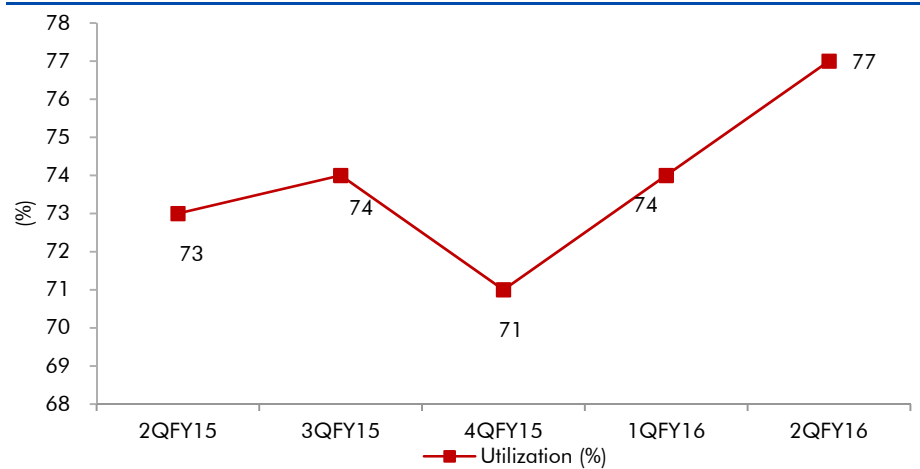
Hiring and client metrics

During the quarter, the company reported a net addition of 1,576 employees, taking its overall headcount to 1,05,235. The BPO headcount currently stands at 26,513 and was the only division to witness additions. Attrition (on LTM basis) was at 20%.

Exhibit 6: Employee metrics

Particulars	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16
Software professionals	66,175	67,592	72,952	71,997	71,657
BPO professionals	22,433	23,566	22,693	24,394	26,513
Sales & support	6,701	6,851	7,636	7,232	7,065
Total employees	95,309	98,009	1,03,281	1,03,673	1,05,235
Attritions (%)	18	19	19	19	20

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate


Source: Company, Angel Research

The company added 18 new clients during the quarter, taking the active client base to 788 V/s 770 in 1QFY2016, with 1 client added in US\$50mn+ bracket and 2 in the US\$10mn+ bracket.

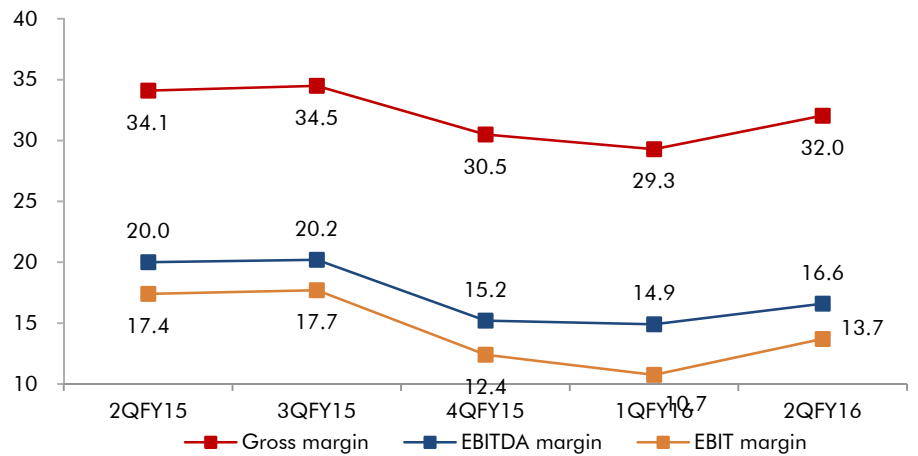
Exhibit 8: Client metrics

Particulars	2QFY15	3QFY15	4QFY14	1QFY16	2QFY16
Total active clients	649	674	767	770	788
US\$1mn–5mn	159	166	195	195	196
US\$5mn–10mn	36	37	40	41	40
US\$10mn–20mn	20	19	21	24	26
US\$20mn–50mn	18	19	22	23	22
US\$50mn+	12	13	13	13	14

Source: Company, Angel Research

Operating margin expands

The EBIDTA margin came in at 16.6% V/s 15.9% expected and V/s 14.9% in 1QFY2016. The company posted a 13.7% EBIT margin V/s 13.1% expected and V/s 12.1% in 1QFY2016. The margin expansion was driven by improved capacity utilization, which moved up from 74% in 1QFY2016 to 77% in 2QFY2016. Excluding trainees, utilization inched up to 79% V/s 75% in 1QFY2016. The attrition rate during the quarter was 20% V/s 19% in 1QFY2016.

Exhibit 9: Margin trend (%)


Source: Company, Angel Research

Investment arguments

Growth prospects robust: The Management indicated that the company remains confident of growth in the non-BT business with it continuing to see a robust deal pipeline across geographies. Also, the company, in the recent past, has been looking at inorganic mode to enhance its presence in the non-telecom segment. Tech Mahindra has been able to scale up well across verticals through its focused approach on large deals. We expect a CAGR of 12.0% and 13.0% in USD and INR revenue, respectively, over FY2015-17E.

Deal pipeline healthy: Tech Mahindra remains confident of improving revenue growth, citing healthy deal pipeline along with pick up in discretionary spending, primarily in the US. The Management sounded confident of demand from BFSI, Healthcare, Manufacturing and Retail. Tech Mahindra is following a two-pronged strategy to expand its enterprise business; ie providing end-to-end offerings in leadership areas like Manufacturing, and following a niche offerings-led entry strategy in areas like BFSI where it is a challenger. Better cross-sell of services can help grow marquee accounts post-merger. We expect the enterprise segment growth to be led by broader revival in the markets and deepening of existing relationships. During 2QFY2016 the company won deals worth TCW of US\$300mn and of the total wins, 60% were from the enterprise vertical and 40% were from the communication vertical.

Inorganic growth initiatives to augment well for company: The company has been active in the M&A space, with it having acquired Satyam a few years back, to acquiring LCC and Softgen recently. Softgen's and LCC's acquisition has 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 (estimated for CY2014), with workforce of over 5,700 network professionals across five continents and more than 50 countries. With this acquisition, Tech Mahindra will also be addressing a rapidly growing market opportunity as telecommunications companies and enterprises accelerate the network upgrade cycle.

Outlook and valuation

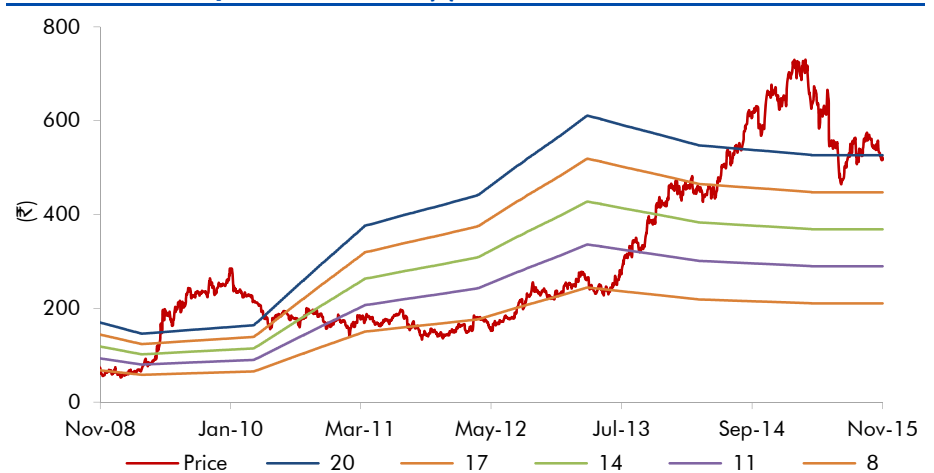
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 12.0% and 13.0% respectively. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2016E EBDIT margins to drop to 16.0% in FY2016 from 22.2% in FY2014. The company, given its success in turnaround of its earlier acquisition - Satyam, believes it would be able to do the same with the recent acquisitions and would be able to get close to achieving the 20.0% EBIT levels in future. The company is one of the fastest growing IT companies. Given the conducive valuations on EV/sales front, where it trades at a significant discount to its peers, we believe the stock should witness uptrend once the profitability returns to its mean average. **We recommend a Buy rating on the stock.**

Exhibit 10: Key assumptions

	FY2016E	FY2017E
Revenue growth (US\$)	11.0	13.0
USD-INR rate (realized)	62.5	62.5
Revenue growth (₹)	13.0	13.0
EBITDA margin (%)	16.0	17.0
Tax rate (%)	26.4	26.4
EPS growth (%)	(3.8)	21.3

Source: Company, Angel Research

Exhibit 11: One-year forward PE (x)



Source: Company, Angel Research. Note: P/E includes profits of Mahindra Satyam from FY2012

Exhibit 12: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2017E EBITDA (%)	FY2017E P/E (x)	FY2015-17E EPS CAGR (%)	FY2017E EV/Sales (x)	FY2017E RoE (%)
HCL Tech	Buy	874	1,132	29.6	23.5	13.9	10.6	2.0	19.8
Infosys	Buy	1,047	1,306	24.7	28.0	16.4	8.9	2.8	19.7
TCS	Buy	2,363	3,165	33.9	28.7	16.4	13.9	3.3	42.2
Tech Mahindra	Buy	534	646	20.9	17.0	16.7	8.0	1.5	18.6
Wipro	Buy	557	719	29.0	23.8	13.2	9.7	1.8	18.0

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 has recently 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 (estimated for 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)	FY2013	FY2014E	FY2015	FY2016E	FY2017E
Net sales	14,332	18,831	22,621	25,566	28,890
Cost of revenues	9,001	7,034	11,914	17,385	19,356
Gross profit	5,331	11,797	10,708	8,181	9,534
% of net sales	37.2	62.6	47.3	32.0	33.0
SG&A expenses	2,268	1,528	6,555	4,091	4,622
% of net sales	15.8	8.1	29.0	16.0	16.0
EBITDA	3,063	10,269	4,153	4,091	4,911
% of net sales	21.4	54.5	18.4	16.0	17.0
Depreciation and amortization	390	522	611	690	780
% of net sales	2.7	2.8	2.7	2.7	2.7
EBIT	2,674	9,747	3,541	3,400	4,131
% of net sales	18.7	51.8	15.7	13.3	14.3
Interest expense	92	29	30	30	30
Other income, net of forex gain/(loss)	212	113	106	106	106
Profit before tax	2,793	9,830	3,618	3,477	4,208
Provision for tax	648	511	960	918	1,111
% of PBT	23.2	5.2	26.5	26.4	26.4
PAT	2,146	9,319	2,659	2,559	3,097
Exceptional item	160	120	-	-	-
Minority interest	30	11	31	31	31
Reported PAT	1,955	9,428	2,628	2,528	3,066
Adjusted PAT	2,115	2,932	2,628	2,528	3,066
Fully diluted EPS (₹)	22.0	30.5	27.4	26.3	31.9

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Equity capital	232	234	480	480	480
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	6,621	8,947	11,768	13,622	16,014
Other reserves	-	2	0	0	0
Net worth	6,854	9,182	12,249	14,103	16,494
Secured loans	322	309	621	621	621
Unsecured loans	531	54	54	54	55
Total debt	853	363	675	675	676
Other long term liability	224	376	376	376	377
Long-term provisions	393	414	414	414	415
Minority interest	134	144	160	144	145
Amount pending investigation	1,230	1,230	895	895	895
Total capital employed	9,689	11,709	14,768	16,606	19,001
Gross block	3,611	5,460	7,811	8,811	9,811
Accumulated dep.	(1,379)	(2,866)	(3,477)	(4,167)	(4,947)
Net block	2,232	2,594	4,334	4,644	4,864
Capital WIP	260	266	266	266	267
Total fixed assets	2,491	2,861	4,601	4,910	5,131
Investments	36	36	2,103	2,103	2,103
Long term loans and adv.	743	914	1,306	1,502	1,727
Interest in TML benefit trust	1,207	-	-	-	-
Deferred tax asset, net	348	383	390	390	390
Other non-current assets	120	16	-	-	-
Inventories	11	10	24	11	11
Sundry debtors	3,369	4,349	5,206	5,987	6,885
Cash and cash equiv.	3,463	4,756	2,405	4,547	6,473
Loans and advances	1,293	2,616	3,813	2,998	2,999
Current investments	175	-	-	-	-
Unbilled revenue	556	-	-	-	-
Sundry creditors	(858)	(1,549)	(1,654)	(1,903)	(2,188)
Other liabilities	(2,037)	(1,415)	(1,627)	(1,871)	(2,152)
Provision	(1,227)	(1,267)	(1,799)	(2,068)	(2,379)
Working capital	4,744	7,500	6,368	7,700	9,650
Total capital deployed	9,689	11,709	14,768	16,606	19,001

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Pre tax profit from operations	2,581	9,319	2,659	2,559	3,097
Depreciation	390	522	611	690	780
Exp. (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	2,971	9,841	3,270	3,249	3,877
Other income/prior period ad	182	113	106	106	106
Net cash from operations	3,153	9,954	3,376	3,356	3,984
Tax	(648)	(511)	(960)	(918)	(1,111)
Cash profits	2,505	9,442	2,417	2,438	2,873
(Inc)/dec in					
Sundry Debtors	(647)	(980)	(857)	(781)	(898)
Inventories	4	1	(15)	13	-
Loans and advances	(235)	(1,324)	(1,197)	815	(1)
Sundry creditors	167	692	105	248	285
Others	673	(623)	212	244	281
Net trade working capital	(39)	(2,233)	(1,752)	540	(333)
Cashflow from operating activities	2,466	7,209	665	2,978	2,540
(Inc)/dec in fixed assets	(1,025)	(369)	(1,740)	(310)	(221)
(Inc)/dec in investments	(1)	-	(2,067)	-	-
(Inc)/dec in other non current assets	(611)	104	16	-	-
Cashflow from investing activities	(1,636)	(265)	(3,791)	(310)	(221)
Inc/(dec) in debt	(297)	490	(311)	-	(1)
Inc/(dec) in deferred revenue	(207)	-	-	-	1
Inc/(dec) in equity/premium	1	(2)	1	-	-
Inc/(dec) in minority interest	119	(9)	(16)	16	(1)
Addition to reser. on amalgamation	70	-	-	-	1
Dividends	(149)	(231)	(674)	(674)	(674)
Others		(5,898)	1,776	131	282
Cashflow from financing activities	(463)	(5,651)	775	(527)	(392)
Cash generated/(utilised)	367	1,293	(2,351)	2,141	1,926
Cash at start of the year	3,096	3,463	4,756	2,405	4,547
Cash at end of the year	3,463	4,756	2,405	4,547	6,473

Key Ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Valuation ratio (x)					
P/E (on FDEPS)	24.3	17.5	19.5	20.3	16.7
P/CEPS	21.9	5.2	15.8	15.9	13.3
P/BVPS	7.5	5.6	4.2	3.6	3.1
Dividend yield (%)	0.9	0.9	0.9	0.9	1.1
EV/Sales	3.4	2.5	2.2	1.9	1.6
EV/EBITDA	16.0	4.6	12.1	11.7	9.4
EV/Total assets	19.7	16.6	10.9	9.8	9.0
Per share data (₹)					
EPS	22.0	30.5	27.4	26.3	31.9
Cash EPS	24.4	37.0	33.7	33.5	40.0
Dividend	5.0	5.0	5.0	5.0	6.0
Book value	71.3	95.6	127.5	146.8	171.7
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.7	0.8	0.7	0.7	0.7
Cost of debt (PBT/EBIT)	1.0	1.0	1.0	1.0	1.0
EBIT margin (EBIT/Sales)	0.2	0.2	0.2	0.1	0.1
Asset turnover ratio (Sales/Assets)	5.8	6.6	4.9	5.2	5.6
Leverage ratio (Assets/Equity)	0.4	0.3	0.4	0.3	0.3
Operating ROE (%)	28.5	33.0	21.5	17.9	18.6
Return ratios (%)					
RoCE (pre-tax)	27.6	31.3	24.0	20.5	21.7
Angel RoIC	46.2	54.8	29.3	28.8	33.7
RoE	30.9	31.9	21.5	17.9	18.6
Turnover ratios(x)					
Asset turnover (fixed assets)	5.8	6.6	4.9	5.2	5.6
Receivables days	78	78	92	91	92
Payable days	25	26	29	29	29

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Disclosure of Interest Statement	Tech Mahindra
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	Yes
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

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