Tech Mahindra

Performance Highlights

(` cr)	2QFY18	1QFY18	% chg (qoq)	2QFY17	% chg (yoy)
Net revenue	**7,606**	**7,336**	***3.7***	**7,167**	***6.1***
EBITDA	1,106	935	*18.3*	1,069	*3.4*
EBITDA margin (%)	*14.5*	*12.7*	*176bp*	*14.9*	*(42)bps*
Adj. PAT	**839**	**792**	***6.0***	**643**	***30.4***

Source: Company, Angel Research;

Tech Mahindra posted in-line results for 2QFY2018 on all fronts except net profit. In Rupee terms, revenues came in at `7,606cr v/s. `7,582cr expected, up 3.7% qoq. On the operating front, the utilization levels during the quarter came in at 81% v/s. 77% in 1QFY2018, which along with volume also aided the margins to come in higher. On the operating front, the EBITDA margin, came in at 14.5% (14.0% expected) v/s. 12.7% in 1QFY2018, a qoq expansion of 50bps. Consequently, PAT came in at `839cr v/s. `886cr expected, a growth of 6.0% qoq. **We maintain our Accumulate rating, with a Target Price of `526.**

Result highlights: The sales came in at US$1,179mn (US$1,172mn expected) v/s. US$1,138mn in 1QFY2018, a qoq growth of 3.0%. In Rupee terms, sales came in at `7,606cr (`7,582cr expected) v/s. `7,336cr in 1QFY2018, up 3.7% qoq. The sales growth during the quarter was driven by USA, which constituted 45.3% of sales in 2QFY2018 v/s. 46.8% in 1QFY2018, while ROW dipped to 24.7% of sales in 2QFY2018 v/s. 23.4% of sales in 1QFY2018. On operating front, the EBIT margins came in at 11.0% (10.7% expected) v/s. 9.4% in 1QFY2018, a qoq expansion of 167bps, mainly on the back of base effect. Consequently, the PAT came in at `839cr (`853cr expected) v/s. `792cr in 1QFY2018, a qoq growth of 6.0%.

Outlook and valuation: We expect a CAGR of 8.0% and 6.4% in USD and INR revenue respectively over FY2017-19E. The PAT is expected to grow at a CAGR of 7.8% over FY2017-19E. **We maintain our Accumulate rating on the stock with a Target Price of `526.**

Key financials (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
Net sales	**26,494**	**29,141**	**30,545**	**32,988**
% chg	17.1	10.0	4.8	8.0
Net profit	**3,118**	**2,813**	**3,062**	**3,272**
% chg	18.7	(9.8)	8.9	6.9
EBITDA margin (%)	16.3	14.4	15.0	15.0
EPS (`)	**35.8**	**32.3**	**35.2**	**37.6**
P/E (x)	13.8	15.3	14.1	13.2
P/BV (x)	3.0	2.6	2.4	2.1
RoE (%)	21.4	17.1	16.8	16.2
RoCE (%)	20.1	15.6	15.9	15.7
EV/Sales (x)	1.7	1.6	1.5	1.4
EV/EBITDA (x)	10.5	11.1	10.1	9.2

Source: Company, Angel Research; Note: CMP as of November 15, 2017

ACCUMLATE

CMP	`495
Target Price	`526
Investment Period	12 Months

Stock Info	
Sector	IT
Market Cap (` cr)	48,355
Net Debt (` cr)	(6,370)
Beta	0.7
52 Week High / Low	515/358
Avg. Daily Volume	237,207
Face Value (`)	5
BSE Sensex	32,760
Nifty	10,118
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)	
Promoters	36.1
MF / Banks / Indian FIs	14.9
FII / NRIs / OCBs	38.4
Indian Public / Others	10.5

Abs.(%)	3m	1yr	3yr
Sensex	3.1	20.6	16.3
Tech Mahindra	18.4	(24.2)	(23.7)

3-year price chart

Source: Company, Angel Research

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Exhibit 1: 2QFY2018 performance (Consolidated, Indian GAAP)

(` cr)	2QFY18	1QFY18	*% chg (qoq)*	2QFY17	*% chg (yoy)*	1HFY18	1HFY17	*% chg (yoy)*
Net revenue	**7,606**	**7,336**	**3.7**	**7,167**	**6.1**	**14,942**	**14,088**	**6.1**
Cost of revenue	5,142	5,282	(2.6)	4,972	3.4	10,424	9,852	5.8
Gross profit	2,464	2,054	20.0	2,195	12.3	4,519	4,236	6.7
SG&A expense	1,358	1,120	21.3	1,126	20.6	2,478	2,137	16.0
EBITDA	**1,106**	**935**	**18.3**	**1,069**	**3.4**	**2,041**	**2,099**	**(2.8)**
Dep. and amortization	265	247	7.5	245	8.3	512	447	14.6
EBIT	841	688	22.2	824	2.0	1,528	1,652	(7.5)
Interest	39	37	4.4	35	10.4	76	62	22.0
Other income	322	411	(21.5)	139	131.8	733	385	90.4
PBT	**1,124**	**1,062**	**5.9**	**928**	**21.1**	**2,186**	**1,975**	**10.7**
Income taxes	285	270	5.5	286	(0.4)	555	533	4.0
PAT	**839**	**792**	**6.0**	**643**	**30.5**	**1,631**	**1,442**	**13.1**
Minority interest	0	0	-	-		-	(2)	
PAT after minority interest	**839**	**792**	**6.0**	**643**	**30.4**	**1,631**	**1,440**	**13.3**
Profit from associates	-	-		-		-	-	
Exceptional item	-	-		-		-	-	
Reported PAT	**839**	**792**	**6.0**	**643**	**30.4**	**1,631**	**1,440**	**13.3**
Adj. PAT	**839**	**792**	**6.0**	**643**	**30.4**	**1,631**	**1,440**	**13.3**
Diluted EPS	**8.7**	**8.2**	**6.0**	**6.7**	**30.4**	**17.0**	**15.0**	**13.3**
Gross margin (%)	32.4	28.0	439bp	30.6	177bps	30.2	30.1	17bp
EBITDA margin (%)	14.5	12.7	176bp	14.9	(42)bps	13.7	14.9	(124)bp
EBIT margin (%)	11.0	9.4	167bp	11.5	(45)bps	10.2	11.7	(150)bp
PAT margin (%)	11.0	10.9	15bp	9.0	206bps	10.9	10.2	69bp

Source: Company, Angel Research

Exhibit 2: 2QFY2018 – Actual Vs Angel estimates

(` cr)	Actual	Estimate	*% Var*
Net revenue	**7,606**	**7,560**	***0.6***
EBITDA margin (%)	*14.5*	*14.5*	-
PAT	**839**	**853**	***(1.6)***

Source: Company, Angel Research

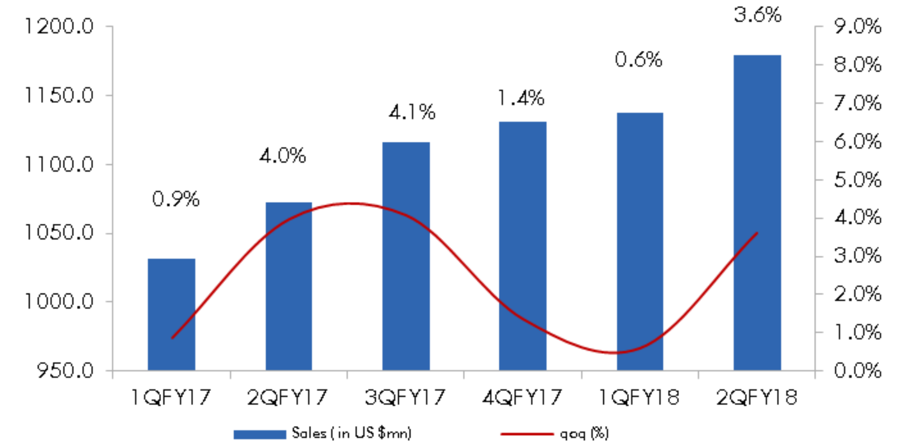
Revenue growth led by USA

For 2QFY2018, Tech Mahindra posted good set of numbers. The sales came in at US$1,179mn (US$1,172mn expected) v/s. US$1,138mn in 1QFY2018, a qoq growth of 3.6%. In Rupee terms, the sales came in at `7,606cr (`7,560cr expected) v/s. `7,167cr in 1QFY2018, a qoq growth of 3.7%. On Constant Currency (CC) terms, the company posted a 2.3% qoq growth during the quarter.

In terms of geography, USA constituted 45.3% of sales, a qoq growth of 0.3%, while ROW was the key growth driver constituting 24.7% of sales, posting a qoq growth of 9.4%. Europe, on the other hand posted a qoq growth of 4.3%.

In terms of the industries, the manufacturing came in at 19% of sales, posting a qoq growth of 2.0%. BFSI was the main driver, which lead the segment, contributing around 14.1% of sales, posting a qoq growth of 1.5%. The key domain Retail, Transport & Logistics, posted a qoq growth of 9.7%. Also, the Technology, Media & Entertainment, posted a qoq growth of 1.9%.

Exhibit 3: Trend in revenue growth



Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Telecom	43.7	*0.2*	*(0.7)*
Manufacturing	19.0	*2.0*	*8.8*
TME	5.9	*1.9*	*(9.9)*
BFSI	14.1	*1.5*	*34.8*
RTL	7.2	*9.7*	*16.4*
Others	9.9	*23.6*	*60.1*

Source: Company, Angel Research

In terms of geographies, ROW posted growth of 9.4% qoq, while Europe and US posted a growth of 4.3% and 0.3% qoq respectively.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)	% growth (yoy)
Americas	45.3	*0.3*	*3.1*
Europe	30.0	*4.3*	*11.1*
RoW	24.7	*9.4*	*23.4*

Source: Company, Angel Research

Hiring and client metrics

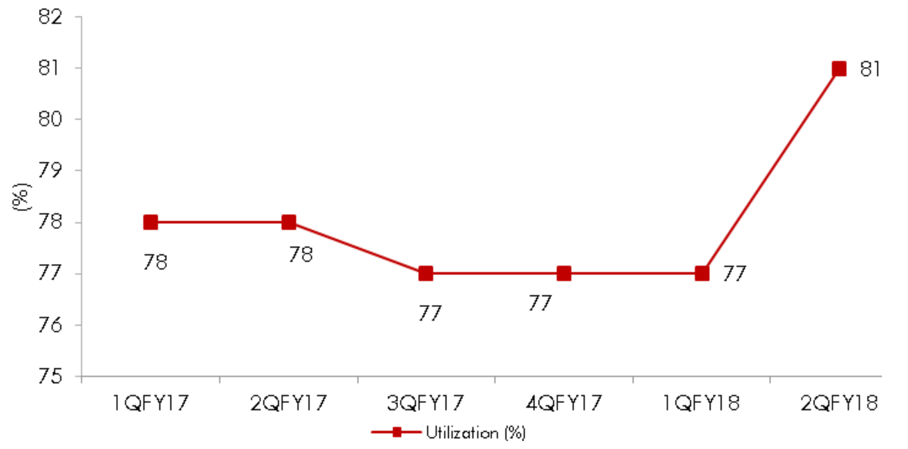
During the quarter, the company reported a net addition of 1,245 employees, taking its overall headcount to 1,17,225. The BPO headcount currently stands at 35,287 and was the only division to witness additions. Attrition (on LTM basis) was at 16%.

Exhibit 6: Employee metrics

Particulars	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Software professionals	78,404	80,858	82,403	78,996	75,587
BPO professionals	27,669	29,372	28,414	30,322	35,287
Sales & support	6,813	6,865	6,876	6,662	6,351
Total employees	1,12,886	1,17,095	1,17,693	1,15,980	1,17,225
Attritions (%)	19	18	17	17	16

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate



Source: Company, Angel Research

On the client additions front, the company added 21 clients, with major of the client additions in the range of US$1-5mn.

Also, in terms of the growth drivers, the main driver has been client additions during the quarter, with repeat business contributing 95% v/s. 97% in 1QFY2018.

Exhibit 8: Client metrics

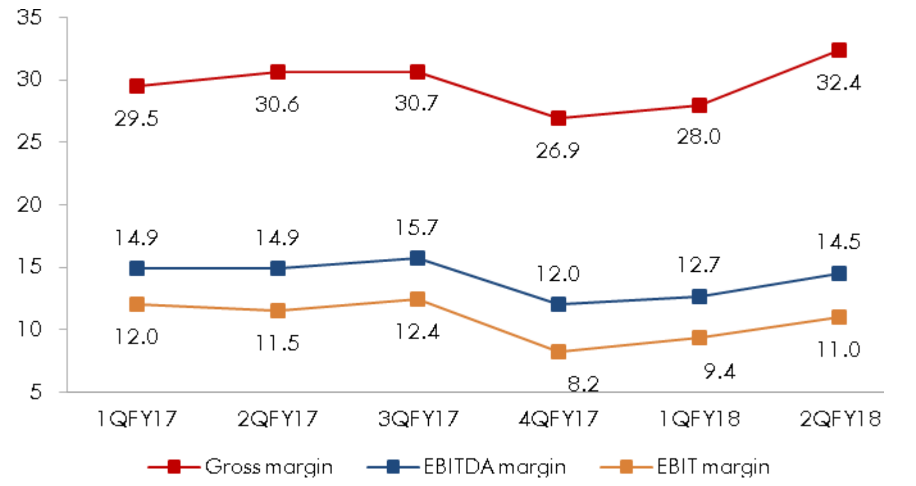
Particulars	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Total active clients	**818**	**837**	**843**	**864**	**885**
US$1mn–5mn	197	228	220	238	243
US$5mn–10mn	56	63	63	65	66
US$10mn–20mn	22	27	35	33	41
US$20mn–50mn	28	24	22	27	26
US$50mn+	14	14	14	14	14

Source: Company, Angel Research

Operating margin expands

On the operating front, the utilization levels during the quarter came in at 81% v/s. 77% in 1QFY2018, which along with volumes also aided the margins to come in higher. On the operating front, the EBITDA margin came in at 14.5% v/s. 14.0% expected, and 12.7% in 1QFY2018, a qoq expansion of 180bps.

Exhibit 9: Margin trend (%)



Source: Company, Angel Research

Investment arguments

Growth prospects decent: The Management is more optimistic about its performance in the 2HFY2018. 2HFY2018, is strong for company because of seasonality in the Communication business. On the margin front, improvement, on the back of synergies and productivity gains has started reflecting from 2QFY2018. Company expects continued margin recovery going forward. We expect a CAGR of 8.0% and 6.4% in USD and INR revenue respectively over FY2017-19E. On EBIT front, we expect the EBIT to be around 15.0% v/s. 14.4% in FY2017.

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 was consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry with an estimated annual revenue of more than US$400mn (CY2014; the effective run-rate for the business is pruned down to US$200-220mn annualized), 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 their network upgrade cycle.

Outlook and valuation

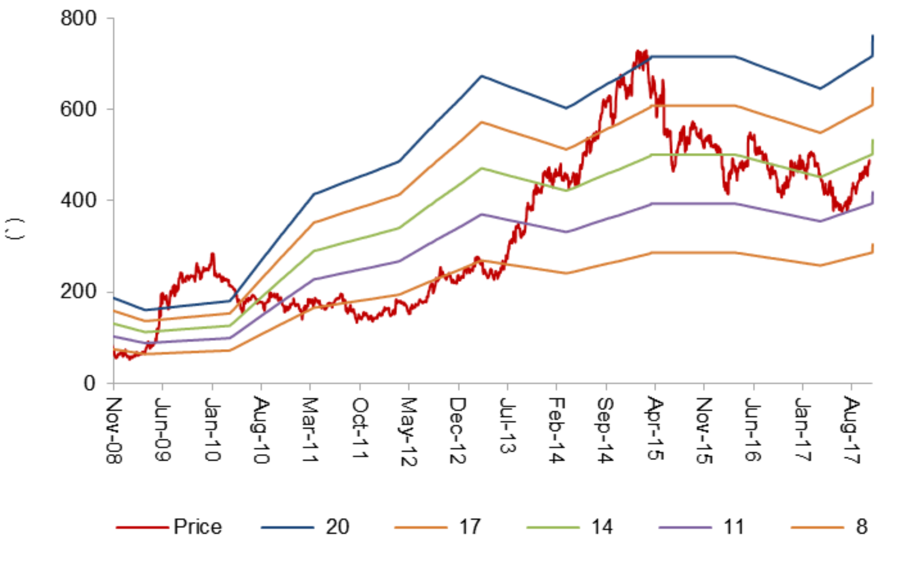
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US$ and INR CAGR of 8.0% and 6.4% respectively over FY2017-19E. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2017 EBDITA margin to drop to 14.4% from 16.3% in FY2016. 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% EBIT levels in future. Given the favorable valuation 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 maintain an Accumulate rating on the stock.**

Exhibit 10: Key assumptions

	FY2018E	FY2019E
Revenue growth (US$)	8.0	8.0
USD-INR rate (realized)	65.0	65.0
Revenue growth (`)	4.8	8.0
EBITDA margin (%)	15.0	15.0
Tax rate (%)	26.0	26.0
EPS growth (%)	8.9	6.9

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 (%)*	FY2019E EBITDA (%)	FY2019E P/E (x)	FY2017-19E EPS CAGR (%)	FY2019E EV/Sales (x)	FY2019E RoE (%)
HCL Tech	Buy	848	1,014	*19.5*	22.1	12.5	6.2	1.8	20.6
Infosys	Buy	952	1,120	*17.7*	26.0	14.4	2.7	2.2	18.7
TCS	Reduce	2,703	2,442	*(9.8)*	26.1	18.8	3.4	3.5	27.8
Tech Mahindra	**Accumulate**	**495**	**526**	***6.2***	**15.0**	**13.2**	**8.6**	**1.2**	**16.2**
Wipro	Neutral	296	-	-	22.3	15.2	5.5	1.7	13.6

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 (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)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Net sales	22,621	26,494	29,141	30,545	32,988
Cost of revenues	15,920	18,323	20,566	21,076	22,762
Gross profit	**6,701**	**8,172**	**8,575**	**9,469**	**10,226**
% of net sales	*29.6*	*30.8*	*29.4*	*31.0*	*31.0*
SG&A expenses	2,549	3,853	4,390	4,887	5,278
% of net sales	*11.3*	*14.5*	*15.1*	*16.0*	*16.0*
EBITDA	**4,153**	**4,318**	**4,184**	**4,582**	**4,948**
% of net sales	*18.4*	*16.3*	*14.4*	*15.0*	*15.0*
Depreciation and amortization	611	762	978	1039	1122
% of net sales	*2.7*	*2.9*	*3.4*	*3.4*	*3.4*
EBIT	**3,541**	**3,556**	**3,206**	**3,543**	**3,827**
% of net sales	*15.7*	*13.4*	*11.0*	*11.6*	*11.6*
Interest expense	30	96	129	129	129
Other inc., net of forex gain/(loss)	106	557	778	778	778
Profit before tax	3,618	4,017	3,855	4,192	4,476
Provision for tax	960	860	1,002	1,090	1,164
% of PBT	*26.5*	*21.4*	*26.0*	*26.0*	*26.0*
PAT	**2,659**	**3,157**	**2,853**	**3,102**	**3,312**
Exceptional item	-	-	-	-	-
Minority interest	31	44	40	40	40
Reported PAT	**2,628**	**3,118**	**2,813**	**3,062**	**3,272**
Adjusted PAT	**2,628**	**3,118**	**2,813**	**3,062**	**3,272**
Fully diluted EPS (`)	**30.2**	**35.8**	**32.3**	**35.2**	**37.6**

Balance sheet (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Equity capital	480	436	439	439	439
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	11,768	14,155	15,998	17,782	19,778
Other reserves	0	0	0	-	-
Net worth	12,249	14,591	16,438	18,221	20,217
Secured loans	621	1,002	1,219	1,219	1,219
Unsecured loans	54	-	-	-	-
Total debt	675	1,002	1,219	1,219	1,219
Other long term liability	376	147	537	537	537
Long-term provisions	414	531	620	620	620
Minority interest	160	193	464	504	545
Amount pending investigation	895	1,230	1,230	1,230	1,230
Total capital employed	**14,768**	**17,695**	**20,508**	**22,332**	**24,368**
Gross block	7,811	7,973	11,677	12,677	13,677
Accumulated dep.	(3,477)	(4,239)	(5,217)	(6,256)	(7,377)
Net block	4,334	4,364	6,460	6,422	6,300
Capital WIP	266	629	373	373	373
Total fixed assets	**4,601**	**4,993**	**6,833**	**6,794**	**6,673**
Investments	2,103	1,243	2,396	4,483	6,736
Long term loans and adv.	1,306	1,895	2,435	2,696	3,117
Interest in TML benefit trust	-	-	-	-	-
Deferred tax asset, net	390	532	267	267	267
Other non-current assets	-	0	0	-	-
Inventories	24	40	61	61	61
Sundry debtors	5,206	5,770	5,338	7,980	7,981
Cash and cash equv.	2,405	4,018	3,219	3,444	3,884
Loans and advances	3,813	4,032	5,518	2,999	3,000
Current investments	-	-	-	-	-
Unbilled revenue	-	-	-	-	-
Sundry creditors	(1,654)	(2,276)	(2,312)	(2,658)	(3,057)
Other liabilities	(1,627)	(2,200)	(2,860)	(3,289)	(3,782)
Provision	(1,799)	(355)	(387)	(445)	(512)
Working capital	6,368	9,031	8,577	8,091	7,575
Total capital deployed	**14,768**	**17,695**	**20,508**	**22,332**	**24,368**

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Pretax profit from operations	2,659	3,157	2,853	3,102	3,312
Depreciation	611	762	978	1,039	1,122
Exp. (deffered)/written off/others	-	-	-	-	-
Pre tax cash from operations	3,270	3,919	3,831	4,141	4,434
Other income/prior period ad	106	557	778	778	778
Net cash from operations	3,376	4,475	4,609	4,918	5,211
Tax	(960)	(860)	(1,002)	(1,090)	(1,164)
Cash profits	2,417	3,615	3,607	3,828	4,048
(Inc)/dec in					
Sundry Debtors	(857)	(565)	433	(2,642)	(1)
Inventories	(15)	(16)	(21)	-	-
Loans and advances	(1,197)	(219)	(1,485)	2,519	(1)
Sundry creditors	105	621	36	347	399
Others	212	573	660	429	493
Net trade working capital	(1,752)	394	(377)	652	890
Cashflow from operating activities	**665**	**4,010**	**3,230**	**4,481**	**4,938**
(Inc)/dec in fixed assets	(1,740)	(393)	(1,840)	39	122
(Inc)/dec in investments	(2,067)	860	(1,153)	(2,087)	(2,253)
(Inc)/dec in other non-current assets	16	(0)	0	0	-
Cashflow from investing activities	**(3,791)**	**467**	**(2,992)**	**(2,049)**	**(2,131)**
Inc/(dec) in debt	(311)	(328)	(217)	-	-
Inc/(dec) in deferred revenue	-	-	-	-	-
Inc/(dec) in equity/premium	-	-	-	0	-
Inc/(dec) in minority interest	(16)	(33)	(271)	(40)	(40)
Dividends	(611)	(1,223)	(917)	(1,278)	(1,276)
Others	1,714	(1,281)	369	(889)	(1,051)
Cashflow from financing activities	**775**	**(2,864)**	**(1,037)**	**(2,207)**	**(2,366)**
Cash generated/(utilised)	(2,351)	1,613	(800)	225	440
Cash at start of the year	4,756	2,405	4,018	3,219	3,444
Cash at end of the year	**2405**	**4018**	**3219**	**3444**	**3884**

Key Ratios

Y/E March	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation ratio (x)					
P/E (on FDEPS)	16.4	13.8	15.3	14.1	13.2
P/CEPS	13.3	11.1	11.4	10.5	9.8
P/BVPS	3.5	3.0	2.6	2.4	2.1
Dividend yield (%)	1.0	2.4	2.4	2.4	2.4
EV/Sales	2.1	1.7	1.6	1.5	1.4
EV/EBITDA	11.2	10.5	11.1	10.1	9.2
EV/Total assets	10.1	9.1	6.8	6.8	6.8
Per share data (`)					
EPS	30.2	35.8	32.3	35.2	37.6
Cash EPS	37.2	44.5	43.5	47.1	50.4
Dividend	5.0	12.0	12.0	12.0	12.0
Book value	140.6	167.5	188.7	209.2	232.1
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.7	0.8	0.7	0.7	0.7
Cost of debt (PBT/EBIT)	1.0	1.1	1.2	1.2	1.2
EBIT margin (EBIT/Sales)	0.2	0.1	0.1	0.1	0.1
Asset turnover ratio (Sales/Assets)	4.9	5.3	4.3	4.5	4.9
Leverage ratio (Assets/Equity)	0.4	0.3	0.4	0.4	0.3
Operating ROE (%)	21.5	21.4	17.1	16.8	16.2
Return ratios (%)					
RoCE (pre-tax)	24.0	20.1	15.6	15.9	15.7
Angel RoIC	29.3	27.3	19.0	19.1	19.0
RoE	21.5	21.4	17.1	16.8	16.2
Turnover ratios(x)					
Asset turnover (fixed assets)	4.9	5.3	4.3	4.5	4.9
Receivables days	92	86	70	98	92
Payable days	29	34	30	33	35

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
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):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
		Reduce (-5% to -15%)	*Sell (< -15)*