

## TECH MAHINDRA

IT - SERVICES

# HOLD

Target Price: Rs 431

### EBITDA margin disappoints

TechM reported in-line revenue in Q4FY17 (up ~1% QoQ in cc terms). EBITDA margin at 12% (370 bps QoQ decline) was much below our estimates due to exit of loss-making contracts (~180 bps impact, one-off), re-alignment of legacy business (~140 bps impact; will recover in 2-3 quarters) and INR appreciation (~40 bps impact). Resultant PAT at Rs 5.9 bn was down 31% QoQ.

**TSP segment steady, Enterprise business holds momentum; margin to improve from Q2FY18:** Management shared Telecom service provider segment has stabilized. Enterprise segment (~54% share) grew 3% QoQ in Q4 and will grow higher than the industry. Digital revenues are ~20%. Q1FY18 to absorb visa costs and weak seasonality of Comviva business. Margin should improve from Q2FY18.

CMP : Rs 429  
Potential Upside : 0%

#### MARKET DATA

No. of Shares : 975mn  
Free Float : 64%  
Market Cap : Rs419bn  
52-week High / Low : Rs557 / Rs405  
Avg. Daily vol. (6mth) : 3.0 mn shares  
Bloomberg Code : TECHM IB Equity  
Promoters Holding : 36%  
FII / DII : 37% / 13%

### Key highlights

- Multiple margin levers exist in the form of higher utilization, campus recruits becoming billable, automation benefits and higher profitability in acquisitions/ portfolio companies. Campus hires recruited in FY17 will ramp up in FY18 and be deployed in projects. On automation, management shared ~25K people (~21%) have been certified on automation. Note: VAS business sees loss in Q1, in Q3 it achieves YTD break even, and Q4 is seasonally strong. The deferrals in project that happened in Q4FY17 are likely to come back in FY18
- Telecom vertical (~46% share) saw ~1% QoQ degrowth, whereas Enterprise vertical (54% share) grew ~3% QoQ. TCV of large deal wins stands at USD 325 mn (Q3FY17: USD 350 mn). In the Telecom vertical, communication service provider business has stabilized, whereas network sub-segment is still in restructuring mode and pain is expected to continue up to 2 quarters. Annualized revenue for LCC is ~ USD 250 mn (Q4 annualized revenue run rate: USD 200-220 mn and close to the bottom).

### Financial summary (Consolidated)

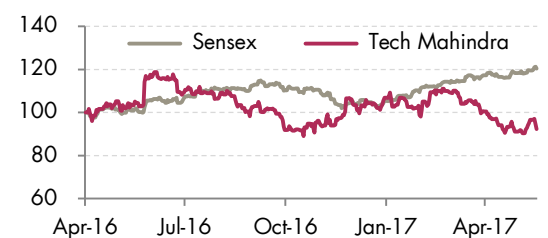
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	264,941	291,408	306,034	342,744
Adj PAT (Rs mn)	30,764	28,048	28,726	34,809
Con. EPS* (Rs)	-	-	34	38
EPS (Rs)	35	32	32	39
Change YOY (%)	17.0	(8.8)	2.3	21.1
P/E (x)	12.4	13.6	13.3	11.0
RoE (%)	23.1	18.2	16.6	18.7
RoCE (%)	25.5	21.2	18.9	21.7
EV/E (x)	9.0	9.6	8.6	7.1
DPS (Rs)	13	10	11	13

Source: \*Consensus broker estimates, Company, Axis Capital

### Key drivers (USD mn)

	FY16	FY17	FY18E	FY19E
Sales	4,037	4,351	4,708	5,170
% change YoY	10%	8%	8%	10%

### Price performance



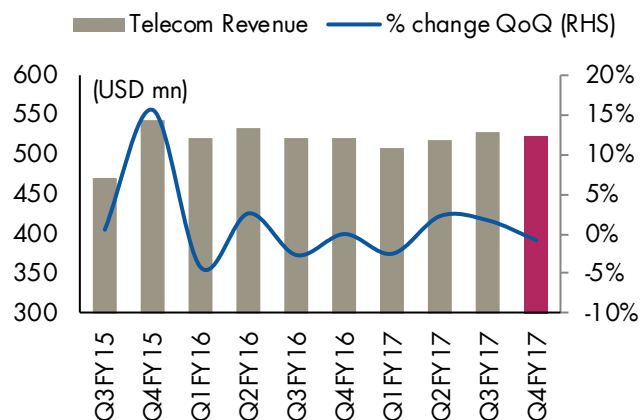
**Exhibit 1: Results update (Rsmn)**

	Quarter ended					12 months ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	FY18E	FY17	% Chg
<b>Net Sales</b>	<b>74,950</b>	<b>68,837</b>	<b>8.9</b>	<b>75,575</b>	<b>(0.8)</b>	<b>306,034</b>	<b>291,408</b>	<b>5.0</b>
EBIDTA	8,987	11,510	(21.9)	11,865	(24.3)	42,532	41,843	1.6
Other income	2,378	1,603	-	1,552	-	5,922	7,414	-
<b>PBIDT</b>	<b>11,365</b>	<b>13,113</b>	<b>(13.3)</b>	<b>13,417</b>	<b>(15.3)</b>	<b>48,453</b>	<b>49,257</b>	<b>(1.6)</b>
Depreciation	2,835	2,174	-	2,480	-	9,181	9,781	-
Interest	318	340	-	349	-	1,098	1,286	-
<b>PBT</b>	<b>8,212</b>	<b>10,599</b>	<b>-</b>	<b>10,588</b>	<b>-</b>	<b>38,175</b>	<b>38,190</b>	<b>-</b>
Tax	2,316	1,806	-	2,141	-	9,544	9,785	-
Minority Interest	17	225	-	(111)	-	95	(357)	-
<b>Adjusted PAT</b>	<b>5,879</b>	<b>8,568</b>	<b>(31.4)</b>	<b>8,558</b>	<b>(31.3)</b>	<b>28,726</b>	<b>28,048</b>	<b>2.4</b>
Extra ordinary income/ (exp.)	0	13	-	2	-	0	(23)	-
<b>Reported PAT</b>	<b>5,879</b>	<b>8,581</b>	<b>(31.5)</b>	<b>8,560</b>	<b>(31.3)</b>	<b>28,726</b>	<b>28,025</b>	<b>2.5</b>
No. of shares (mn)	889	889	-	889	-	889	888	-
EBIDTA margin (%)	12.0	16.7	-	15.7	-	13.9	14.4	-
PBIDT margin (%)	15.2	19.0	-	17.8	-	15.8	16.9	-
<b>EPS - annualized (Rs.)</b>	<b>26.4</b>	<b>38.6</b>	<b>(31.4)</b>	<b>38.5</b>	<b>(31.4)</b>	<b>32.3</b>	<b>31.6</b>	<b>2.3</b>

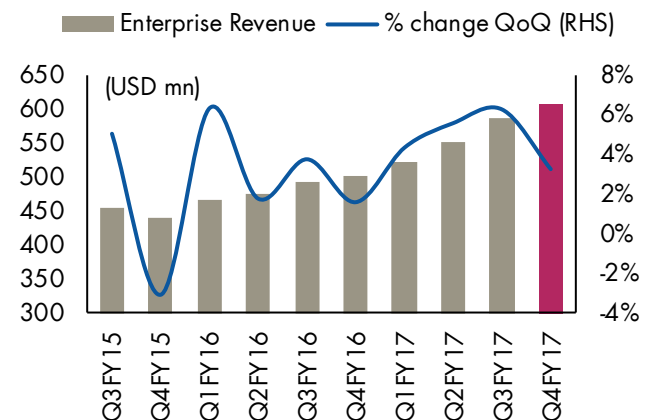
Source: Company, Axis Capital

**Estimates and valuations**

We expect FY18/19 revenue of USD 4.7 bn/5.2 bn. Incorporating higher than expected decline in margin and INR appreciation, our FY18E/ FY19E EPS stand at Rs 32/39 (FY18E YoY growth in low single digit of 3%). We rollover our target price to FY19E and value the company at Rs 431 (11x FY19E). With limited upside, we rate the company as HOLD. The stock trades at 13x/11x FY18/19

**Exhibit 2: Core telecom performance**


Source: Company, Axis Capital

**Exhibit 3: Enterprise momentum**


Source: Company, Axis Capital

#### Exhibit 4: Clientele

	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
≥ \$1 million clients	291	296	298	326	319	317	341	356	354
≥ \$5 million clients	96	101	102	105	112	120	120	128	134
≥ \$10 million clients	56	60	62	63	63	64	66	65	71
≥ \$20 million clients	35	36	36	37	40	42	40	38	36
≥ \$50 million clients	13	13	14	14	14	14	14	14	14

Source: Company, Axis Capital

#### Exhibit 5: Vertical performance

(USD mn)	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Manufacturing	162	169	169	174	175	187	206	205	217
Technology, media & entertainment	69	72	83	75	77	77	77	71	70
Banking, financial services & insurance	90	99	97	99	108	117	123	146	159
Retail, transport & logistics	61	64	61	69	63	67	73	85	74
Others	59	64	67	77	79	75	73	79	87
Total	441	469	476	494	502	523	552	587	607

#### % change QoQ

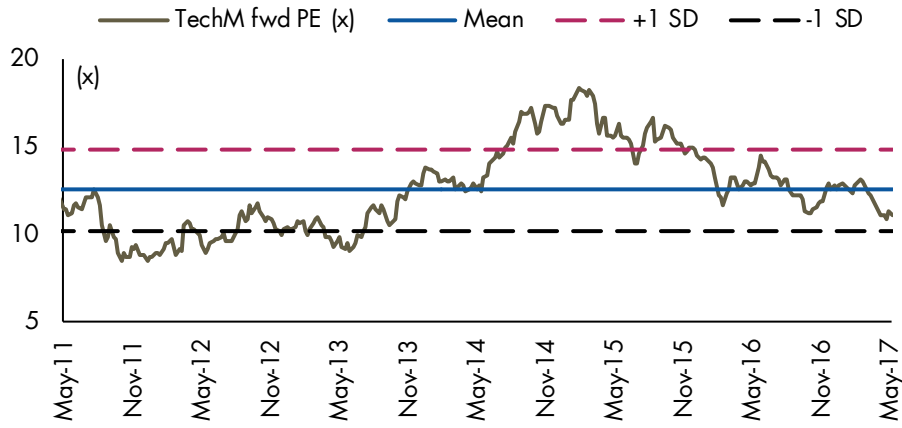
Manufacturing	-11%	4%	0%	3%	1%	7%	10%	0%	6%
Technology, media & entertainment	2%	5%	15%	-9%	2%	1%	0%	-7%	-2%
Banking, financial services & insurance	-1%	10%	-2%	2%	9%	8%	6%	19%	9%
Retail, transport & logistics	3%	5%	-6%	14%	-8%	6%	9%	16%	-13%
Others	6%	9%	4%	16%	2%	-4%	-3%	9%	10%

Source: Company, Axis Capital

#### Exhibit 6: Client metrics

	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
<b>Revenue Concentration (%)</b>									
Top 5	33%	33%	32%	28%	28%	29%	29%	28%	27%
Top 10	45%	44%	43%	40%	39%	40%	40%	38%	38%
Top 20	57%	57%	56%	52%	52%	53%	52%	51%	49%
Remaining clients	43%	43%	44%	48%	48%	47%	48%	50%	51%
<b>Revenue Concentration (USD mn)</b>									
Top 5	325	326	324	284	285	297	306	310	301
Top 10	443	435	435	406	399	413	428	429	425
Top 20	561	564	566	528	531	543	554	564	554
Remaining clients	423	425	445	487	492	489	518	552	577
<b>% change QoQ</b>									
Top 5	-5.0%	0.5%	-0.9%	-12.2%	0.4%	4.1%	2.9%	1.5%	-3.0%
Top 10	-2.2%	-1.7%	-0.1%	-6.6%	-1.7%	3.5%	3.7%	0.2%	-0.8%
Top 20	-0.5%	0.5%	0.4%	-6.8%	0.6%	2.2%	2.2%	1.7%	-1.7%
Remaining clients	17.4%	0.5%	4.6%	9.5%	1.0%	-0.6%	5.9%	6.7%	4.4%

Source: Company, Axis Capital

**Exhibit 7: P/E valuation**


Source: Bloomberg, Axis Capital

## Financial summary (Consolidated)

### Profit & loss (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	264,941	291,408	306,034	342,744
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>264,941</b>	<b>291,408</b>	<b>306,034</b>	<b>342,744</b>
Cost of goods sold	(183,241)	(205,661)	(220,658)	(242,821)
Gross profit	81,700	85,747	85,376	99,923
<i>Gross margin (%)</i>	<i>31</i>	<i>29</i>	<i>28</i>	<i>29</i>
Total operating expenses	(38,377)	(43,904)	(42,845)	(49,012)
<b>EBITDA</b>	<b>43,323</b>	<b>41,843</b>	<b>42,532</b>	<b>50,911</b>
<i>EBITDA margin (%)</i>	<i>16</i>	<i>14</i>	<i>14</i>	<i>15</i>
Depreciation	(7,617)	(9,781)	(9,181)	(10,282)
<b>EBIT</b>	<b>35,706</b>	<b>32,062</b>	<b>33,351</b>	<b>40,629</b>
Net interest	(971)	(1,286)	(1,098)	(1,098)
Other income	5,266	7,414	5,922	7,350
<b>Profit before tax</b>	<b>40,001</b>	<b>38,190</b>	<b>38,175</b>	<b>46,881</b>
Total taxation	(8,835)	(9,785)	(9,544)	(12,189)
<i>Tax rate (%)</i>	<i>22</i>	<i>26</i>	<i>25</i>	<i>26</i>
Profit after tax	31,166	28,405	28,631	34,692
Minorities	(402)	(357)	95	117
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	30,764	28,048	28,726	34,809
<i>Adj. PAT margin (%)</i>	<i>12</i>	<i>10</i>	<i>9</i>	<i>10</i>
Net non-recurring items	26	(23)	-	-
Reported net profit	30,790	28,025	28,726	34,809

### Balance sheet (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	4,839	4,388	4,388	4,388
Reserves & surplus	138,838	159,984	176,951	186,276
Net worth	143,677	164,372	181,339	190,664
Borrowing	10,022	12,195	12,195	12,195
Other non-current liabilities	17,846	17,669	18,425	19,159
<b>Total liabilities</b>	<b>173,565</b>	<b>198,877</b>	<b>216,504</b>	<b>226,532</b>
Gross fixed assets	85,722	116,668	122,789	129,644
Less: Depreciation	(42,276)	(52,057)	(61,238)	(63,711)
Net fixed assets	43,446	64,611	61,551	65,933
Add: Capital WIP	6,294	3,729	6,000	6,000
Total fixed assets	49,740	68,340	67,551	71,933
Total Investment	13,538	29,061	29,061	29,061
Debtors	57,705	53,377	56,176	62,915
Cash & bank	40,138	32,186	70,231	73,853
Loans & advances	17,084	33,608	33,538	37,561
Current liabilities	61,505	61,788	86,167	96,924
Net current assets	65,526	79,640	96,057	99,702
Other non-current assets	44,761	21,836	23,836	25,836
<b>Total assets</b>	<b>173,565</b>	<b>198,877</b>	<b>216,504</b>	<b>226,532</b>

Source: Company, Axis Capital

### Cash flow (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	40,001	38,190	38,175	46,881
Depreciation & Amortisation	7,617	9,781	9,181	10,282
<i>Chg in working capital</i>	<i>2,885</i>	<i>(22,066)</i>	<i>21,629</i>	<i>(24)</i>
<b>Cash flow from operations</b>	<b>29,673</b>	<b>32,740</b>	<b>53,373</b>	<b>37,432</b>
<i>Capital expenditure</i>	<i>(9,547)</i>	<i>(28,381)</i>	<i>(8,392)</i>	<i>(6,855)</i>
<b>Cash flow from investing</b>	<b>(4,526)</b>	<b>(36,490)</b>	<b>(2,470)</b>	<b>495</b>
<i>Equity raised/ (repaid)</i>	<i>4,814</i>	<i>(451)</i>	-	-
<i>Debt raised/ (repaid)</i>	<i>3,276</i>	<i>2,173</i>	-	-
<i>Dividend paid</i>	<i>(14,416)</i>	<i>(10,678)</i>	<i>(11,759)</i>	<i>(13,830)</i>
<b>Cash flow from financing</b>	<b>(7,271)</b>	<b>(10,265)</b>	<b>(12,857)</b>	<b>(14,928)</b>
Net chg in cash	17,876	(14,015)	38,046	22,999

### Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	35	32	32	39
CEPS (Rs)	43	43	43	51
DPS (Rs)	13	10	11	13
Dividend payout ratio (%)	38	32	34	33
<b>GROWTH</b>				
Net sales (%)	18	10	5	12
EBITDA (%)	5	(3)	2	20
Adj net profit (%)	17	(9)	2	21
FDEPS (%)	17.0	(8.8)	2.3	21.1
<b>PERFORMANCE</b>				
RoE (%)	23.1	18.2	16.6	18.7
RoCE (%)	25.5	21.2	18.9	21.7
<b>EFFICIENCY</b>				
Asset turnover (x)	2.4	2.2	2.2	2.6
Sales/ total assets (x)	1.2	1.2	1.1	1.1
Receivable days	79	67	67	67
Payable days	62	76	75	75
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.1	0.1	0.1	0.1
<b>Net debt/ equity (x)</b>	<b>(0.2)</b>	<b>(0.1)</b>	<b>(0.3)</b>	<b>(0.3)</b>
Current ratio (x)	2.1	2.3	2.1	2.0
<b>VALUATION</b>				
PE (x)	12.4	13.6	13.3	11.0
<b>EV/ EBITDA (x)</b>	<b>9.0</b>	<b>9.6</b>	<b>8.6</b>	<b>7.1</b>
EV/ Net sales (x)	1.5	1.4	1.2	1.1
PB (x)	2.7	2.3	2.1	2.0

Source: Company, Axis Capital

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