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Tech Mahindra

Company Update

Acquires BIO Agency, not the best fit

Sector: Technology

CMP: ₹532

Recommendation: Buy

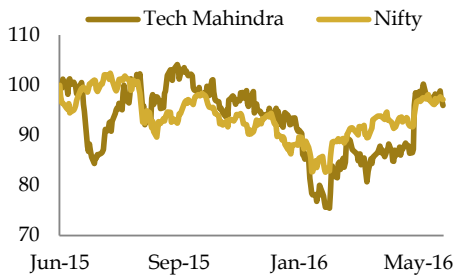
Market statistics

Current stock price (₹)	532
Shares O/S (cr.)	97.1
Mcap (₹ cr)	51,293
52W H/L (₹)	582/407
6m avg. volume	1,997,667
Bloomberg	TECHM.IN

Shareholding pattern

Promoters	36.44
Domestic Institution	36.11
Foreign Institution	12.82
Non-institution	14.63
of which more than 1%	
<i>Europacific Growth Fund</i>	6.39
<i>Life insurance focused Bluechip Equity Fund</i>	3.23

Tech Mahindra vs Nifty



Capital efficiency & valuations

Particulars	FY16	FY17E	FY18E
RoE (%)	21.4	19.8	20.0
EPS (₹)	32.4	34.8	40.9
CEPS (₹)	40.3	44.1	50.5
P/E (x)	15.5	15.3	13.0
P/BV (x)	2.9	2.8	2.4
EV/EBITDA (x)	9.1	8.7	7.0
Income growth (%)	17.9	7.7	13.2
EBITDA growth (%)	5.3	13.4	16.0
PAT growth (%)	20.0	7.4	17.5

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Tech Mahindra (TechM) has announced acquisition of acquisition of user interface/customer experience focused firm, The BIO Agency (BIO), for an EV of GBP40mn. The company specializes in Digital transformation and innovation. The recent acquisitions namely, Pininfarina, Target Group and BIO would have a dilutive impact on earnings due to amortization charges under new Ind-AS. We retain our BUY on the stock.

Acquires BIO Agency - user interface/customer experience focused firm in UK: TECHM announced acquisition of BIO Agency - user interface/customer experience focused firm in UK. It is expected to complete by first week of July'2016. BIO Agency had a revenue of GBP 12.5mn for FY16 (ending in Apr'16). It had revenues of GBP7.3mn and GBP 6.3mn in FY15 and FY14 respectively. BIO is a strong player in user interface/customer experience area in the digital transformation space and its work spans across verticals.

Consideration. TechM announced the acquisition for an EV of ~GBP40mn. TechM will pay GBP22mn upfront with GBP18mn of deferred on performance during the period 2017-19. The management of BIO will also be awarded consideration based on revenues they bring to Tech Mahindra over the next three years. This structure will likely ensure continuity of the management, which is important to make the acquisition work for TECHM.

Client details of BIO Agency. The company has worked for clients across the spectrum (**Financial Services** - Fidelity, Invesco, Lloyds Banking Group, MoneyCorp, Santander, Travelex, Western Union. **Retail & FMCG** - Bobbi Brown, Bottlegreen, Clinique, Coca-Cola, Dixons, Games Workshop, Hotel Chocolat, Halfords, Le Creuset, LG, Next, Phones4U, Pringles, Selfridges. **Service Brands** - Accor Hotels, Easyjet, EDF Energy, ibis Hotels, Mercure Hotels. **Publishing, Broadcasting and Telecoms** - BBC, Boomerang, Cartoon Network, Deluxe, Freesat, Hachette, Microsoft, Orange, Universal. **B2B** - Arrow, CHEP, Fidelity, Hibu/Yell, Invesco, MoneyCorp, Travelex. **Not for Profit** - National Trust, NHS, PDSA, Wateraid.

Synergies. The BIO Agency services brands across Financial Services, Retail, Property, Travel, and Technology sectors and the acquisition will help TECHM make inroads into the Fortune 100/500 Telecommunications and Enterprise clients. The acquisition will open up more clients for BIO globally (especially in Europe and the US), scaling their offerings and enabling new services and deeper "Digital Change". This will significantly help enhance BIO's offering both in people, turnover and market impact. BIO will continue to further invest into its people and its propriety thinking. BIO has the potential to grow 18-20% in the foreseeable future and it can bring in additional revenues in IT services for TECHM.

Inorganic initiatives should be used to fill up gaps in technology; maintain Buy: TechM has used acquisitions smartly in the past five years to diversify/grow its revenue base and maintain its leadership position/skills in the telecom vertical. By and large, acquisitions have been integrated well by the company. However, acquisitions in the past couple of years have been faster and not all of them were best strategic fits).

Valuation & Outlook. The acquisition size of BIO Agency is small. We believe that Tech Mahindra has hit an execution sweet spot. Multiples can re-rate if the company improves working capital management, ensuring solid FCF generation. We are not changing our estimates, but are confident about the business prospects of TECHM. TECHM valuations are inexpensive compared to its peers and risk reward is attractive. **We retain our BUY rating on the stock.**

Financials

Income Statement (₹ mn)

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Revenues	188,314	224,779	264,941	285,329	323,048
Op. Expenses	146,477	183,635	221,605	236,196	266,059
EBITDA	41,837	41,144	43,336	49,133	56,989
Other Income	1,129	1,006	5,322	5,200	5,450
Depreciation	5,222	6,079	7,620	8,976	9,261
EBIT	37,744	36,071	41,038	45,357	53,179
Interest	797	297	871	1,020	750
PBT	36,947	35,774	40,167	44,337	52,429
Tax	7,525	9,472	8,600	10,433	12,583
PAT	29,423	26,302	31,567	33,903	39,846
Minority	864	(24)	(387)	(400)	(400)
Adj Pat	30,287	26,278	31,180	33,503	39,446

Key Parameters

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Per share (₹)					
EPS	32.4	27.4	32.4	34.8	40.9
CEPS	38.0	33.7	40.3	44.1	50.5
BVPS	111.5	140.4	162.1	188.5	221.2
DPS	5.0	6.0	12.0	7.0	7.0
Payout (%)	18.8	25.9	43.4	23.6	20.0
Valuation (x)					
P/E	14.2	23.4	15.5	15.3	13.0
P/BV	4.1	4.6	2.9	2.8	2.4
EV/EBITDA	9.4	13.6	9.1	8.7	7.0
Dividend Yield (%)	1.1	0.9	2.6	1.3	1.3
Return ratio (%)					
EBITDA Margin	22.2	18.3	16.4	17.2	17.6
PAT Margin	15.6	11.7	11.9	11.9	12.3
ROAE	33.6	21.8	21.4	19.8	20.0
ROACE	39.1	28.1	26.4	25.2	25.8
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)
Debt/EBITDA	0.1	0.1	0.0	0.0	0.0
Interest Coverage	47.4	121.5	47.1	44.5	70.9
Current ratio	2.3	2.1	2.1	2.4	2.6
Growth Ratios (%)					
Income growth	31.4	19.4	17.9	7.7	13.2
EBITDA growth	36.6	(1.7)	5.3	13.4	16.0
PAT growth	37.1	(10.6)	20.0	7.4	17.5
Turnover Ratios					
F.A Turnover x	6.6	7.8	8.2	8.3	8.9
Debtors Days	96	92	86	83	85
Payable days	41	46	41	38	39

Balance Sheet (₹ mn)

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Equity Share Capital	2,335	4,804	4,839	4,843	4,850
Reserves & Surplus	101,789	129,989	151,142	176,753	208,304
Total Shareholders Fund	104,124	134,793	155,981	181,596	213,154
Minority Interest	1,438	1,601	2,020	2,020	2,020
Non-current liabilities	4,255	1,100	1,934	2,216	2,953
Long term Borrowings	190	460	1,967	1,967	1,967
Deferred tax liabilities	(3,830)	(3,901)	(5,575)	(5,575)	(5,575)
Other LT liabilities & prov	7,895	4,541	5,542	5,824	6,560
Current Liabilities	45,749	57,086	69,560	72,766	80,948
Short-term borrowings	334	6,286	8,055	8,055	8,055
Trade payables	14,722	20,587	22,755	23,943	26,970
Other cur liabilities & Prov	30,693	30,213	38,750	40,768	45,923
Total Liabilities	155,566	194,580	229,495	258,598	299,074
Assets					
Non-current Assets	50,147	72,054	80,044	83,354	87,783
Fixed assets	22,121	27,717	32,383	34,383	36,383
Non-current investments	18,679	31,276	30,601	30,601	30,601
Long-term loans & adv	9,137	12,755	16,766	17,980	20,356
Other non-current assets	210	306	294	391	443
Current assets	105,419	122,526	149,451	175,244	211,291
Current investments	2,525	8,041	11,690	11,690	11,690
Trade receivables	43,486	52,059	57,705	62,538	70,805
Inventories	98	245	414	469	531
Cash & bank balances	33,149	24,049	40,138	58,334	80,472
Short-term loans & adv	14,544	18,728	17,084	18,761	21,242
Other current assets	11,617	19,404	22,420	23,452	26,552
Total Assets	155,566	194,580	229,495	258,598	299,074

Cash flow Statement

Year End-March	FY14	FY15	FY16	FY17E	FY18E
PBT	36,947	35,774	40,167	44,337	52,429
Depreciation	4,869	6,008	5,946	8,976	9,261
Interest Exp	797	297	871	1,020	750
Others	864	(24)	(387)	(400)	(400)
CF before W.cap	43,477	42,055	46,597	53,933	62,039
Inc/dec in W.cap	12,266	22,374	(519)	5,418	7,420
Op CF after W.cap	31,211	19,681	47,117	48,515	54,619
Less Taxes	7,525	9,472	8,600	10,433	12,583
Net CF From Operations	23,687	10,209	38,517	38,081	42,036
Inc/(dec) in F.A + CWIP	7,484	11,675	12,286	10,976	11,261
(Pur)/sale of Investments	14,047	18,113	2,974	-	-
Others	(797)	(297)	(871)	(1,020)	(750)
CF from Invst Activities	(22,328)	(30,085)	(16,130)	(11,996)	(12,011)
Loan Raised/(repaid)	(8,002)	6,222	3,276	-	-
Equity Raised	10,626	11,299	3,939	4	7
Dividend	5,463	6,745	13,513	7,892	7,895
CF from Fin Activities	(2,839)	10,776	(6,298)	(7,888)	(7,888)
Net inc/(dec) in cash	(1,480)	(9,100)	16,089	18,197	22,137
Op. bal of cash	34,629	33,202	24,049	40,138	58,334
Cl. balance of cash	33,202	24,049	40,138	58,334	80,472



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