



Tech Mahindra Company Update

Sector: Technology

CMP: ₹536

Acquires Target Group, BPaaS provider into BFSI

Recommendation: Buy

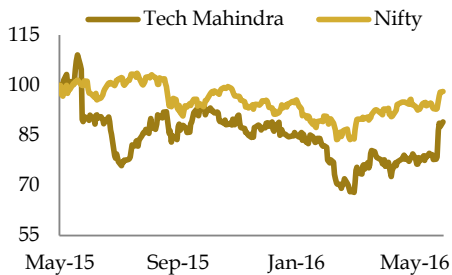
Market statistics

Current stock price (₹)	536
Shares O/S (cr.)	97.0
Mcap (₹ cr)	52,784
52W H/L (₹)	582/407
6m avg. volume	1,983,979
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	15.4	13.1
P/BV (x)	2.9	2.8	2.4
EV/EBITDA (x)	9.1	8.8	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

ANALYST

Naushil Shah

+91-22 4224 5125

naushil.shah@trustgroup.co.in

Tech Mahindra (TechM) has announced acquisition of Target Group, a UK-based provider of platform based services in area of lending and investment products for an EV of GBP120mn. Target had CY15 revenues of GBP51mn and has reported 20% revenue CAGR in past 3 years. We believe the acquisition is in the right direction to augment financial services capability along with addition of platform based, non-linear offerings, though it being slightly expensive. We retain our BUY on the stock.

Acquires Target Group Limited - BpaaS provider in BFSI: TECHM announced acquisition of Target Group – a provider of BPaaS solutions to clients in Banking, Asset Management, Government and Insurance sectors. It is expected to complete by October'16. Target works with 50+ Financial Institutions including Goldman Sachs, Credit Suisse, Morgan Stanley amongst others. Target's BPaaS software solution provides transactions support in areas of lending & full loan cycle, back office administration in Investment servicing, manage insurance distribution channels.

Consideration. TechM announced the acquisition for an EV of ~GBP120mn. TechM will pay GBP91mn upfront (inclusive of equity value and debt/loan notes/payment obligations of Target Group, GBP64mn upfront and rest loan notes) with GBP16.3bn of deferred to be paid in 2017. In addition, management is rolling over 7.6% of their equity value in the company (value at GBP6.8bn at present) as second deferred consideration, to be paid out based on performance during the period 2017-19.

Details of Target group. Target Group has trailing (2015) revenues of GBP51mn with EBITDA margins in high teens. The company's profitability has increased to being comparable to that of TECHM (~16%), up from 6.3% in CY13 and 11.9% in CY14. The company has shown a revenue growth of 32.9%/10.6% in 2014/2015 and has 740 employees globally. Target had 529 employees in CY13 including 85 in sales and 528 employees in CY14 including 69 in sales. ~98% of the company's revenues is billed in GBP. The company is headquartered in UK. ~50% of its revenues in CY15 came from the platforms business. TechM's management expects growth for Target Group at 5-7ppt higher than Indian IT growth rates, going forward.

Synergies. TechM's banking, financial services and insurance (BFSI) offering will reach the US\$500mn, a critical benchmark for positioning and invites to large deals. It will also give them a BPaaS offering in addition to marquee client names in the BFSI vertical where they can cross sell their other services. A large addressable market of US\$45-60bn in UK BFSI alone should provide sufficient headroom to grow. TECHM also intends to cross sell its services to Target's clients, in addition to re-engineering the platform to explore other markets factoring the regulatory requirements.

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 (The last acquisition of LCC done by Tech M has seen multiple disappointments on revenue growth potential, margins and now even scale down of business).

Valuation & Outlook: Deal valuation is slightly expensive. The acquisition size of Target Group is small (would increase TECHM FY18E revenue by just ~2%). 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	15.4	13.1
P/BV	4.1	4.6	2.9	2.8	2.4
EV/EBITDA	9.4	13.6	9.1	8.8	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



Institutional Equity Team

Names	Designation	Sectors	Email ID's	Desk-Number
Naren Shah	Head Of Equity		naren.shah@trustgroup.co.in	+91-22-4084-5074
Institutional Sales				
Sriram Rangarajan	Sales		sriram.rangarajan@trustgroup.co.in	+91-22-4224-5216
Vivek Kumar	Sales		vivek.kumar@trustgroup.co.in	+91-22-4224-5197
Sales Trading & Dealing				
Rajesh Ashar	Sales Trader		rajesh.ashar@trustgroup.co.in	+91-22-4224-5123
Nitin Dalvi	Dealer		nitin.dalvi@trustgroup.co.in	+91-22-4084-5089
Dealing Desk			trustfin@bloomberg.net	+91-22-4084-5089
Research Team				
Binyam Taddese	Analyst	Rates & Credit Research	binyam.taddese@trustgroup.co.in	+91-22-4224-5037
Naushil Shah	Analyst	Technology, Media & Telecom	naushil.shah@trustgroup.co.in	+91-22-4224-5125
Naveen Trivedi	Analyst	Consumer Staple & Durable	naveen.trivedi@trustgroup.co.in	+91-22-4224-5181
Shashwat Nanda	Analyst	Rates & Credit Research	shashwat.nanda@trustgroup.co.in	+91-22-4224-5038
Tejas Sarvaiya	Analyst	Seeds, Exchanges & MidCap	tejas.sarvaiya@trustgroup.co.in	+91-22-4084-5064
Ritu Chaudhary	Associate	Consumer Durable	ritu.chaudhary@trustgroup.co.in	+91-22-4224-5183

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