



Tech Mahindra

1QFY20 Result Update

Soft quarter, Margin levers intact

Sector: Technology

CMP: ` 640

Recommendation: Buy

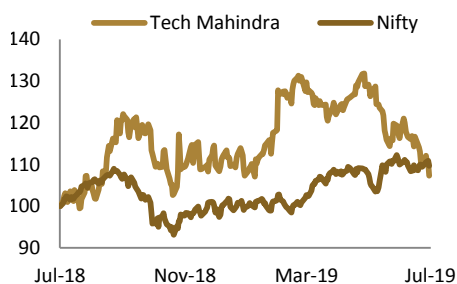
Market statistics

Current stock price (^)	640
Shares O/S (cr.)	96.4
Mcap (` cr)	61,764
52W H/L (^)	846/633
6m avg. volume	3,131,839
Bloomberg	TECHM IN

Shareholding pattern

Promoters	35.90
Domestic Institution	12.04
Foreign Institution	38.94
Non-institution	13.13
of which more than 1%	

Tech Mahindra vs Nifty



Capital efficiency & valuations

Particulars	FY19	FY20E	FY21E
RoE (%)	20.6	18.2	18.3
EPS (^)	48.4	48.2	54.1
CEPS (^)	68.6	71.2	79.2
P/E (x)	14.5	11.9	10.6
P/BV (x)	2.8	2.0	1.8
EV/EBITDA (x)	8.2	6.3	5.3
Income growth (%)	12.9	4.7	8.8
EBITDA growth (%)	34.3	(2.7)	13.4
PAT growth (%)	15.0	(1.6)	12.8

Tech Mahindra's 1QFY20 result was lower-than-expectation operationally both on the revenue and margin front. TechM reported revenues at US\$1,247mn (lower by 1.6% QoQ, down 1% in cc terms). OPM decreased by 324bps QoQ to 15.2% on account of wage hikes, weak revenue trajectory, seasonality in portfolio companies, lower utilization, large deal transition and currency movements. Deal wins remained solid. The management has guided for high-single digit growth in the communication business and mid-single digit growth in the enterprise business in FY20E. With strong deal wins, a healthy deal pipeline and stability in some customers in enterprise vertical, the management expects a strong 2HFY20E. We continue to believe in Tech Mahindra's depth of capabilities in Telecom vertical as well as other verticals. We maintain our Buy recommendation on the stock.

Results lower-than expected: TechM reported revenue of US\$1,247mn (lower by 1.6% QoQ, down 1% in cc terms owing to weak seasonality of Comviva and soft performance of the enterprise vertical. The communication vertical's revenue (that contributed 42% to overall revenue) was down by 3.2% QoQ, while the enterprise business revenue declined by 0.4% QoQ owing to slowdown in manufacturing, BFSI and retail verticals. EBIT margin shrunk by 391 bps QoQ to 11.5% in Q1FY20, below our estimates, owing to wage hike (-100bps), seasonality in portfolio companies (-100bps), lower utilisation (-60bps), visa expenses (-40bps), currency headwinds (-40bps) and deal transition (-20 bps). Net profit declined 15.3% QoQ to Rs.9.6bn led by higher-than-expected other income including forex gains (up 2x QoQ).

Enterprise segment disappointment, large deal wins strong: Excluding Comviva, the management highlighted that the growth in communication business remained flat on cc basis in Q1FY20. Growth in enterprise business was impacted by a 5.5%, 3.9% and a 4.7% QoQ decline in revenue in the manufacturing, BFSI and retail, transport and logistics verticals. Manufacturing revenue decline was due to slow down in auto segment (especially weakness in EV market in China) and Europe. Revenue in other verticals grew by 15% QoQ on account of a strong recovery in growth in the healthcare vertical. Revenue growth in top five and ten accounts declined by 7.7 and 5.6% QoQ. North America grew 0.9% QoQ in Q1FY20, while Europe and RoW declined 5% and 2% QoQ. The company signed significant deals with a total consideration value (TCV) of worth US\$475mn versus US\$408mn/US\$270mn in Q4FY19/Q1FY19.

Margins to recover going ahead: After reporting an 11.5% EBIT margin in Q1FY20, the management expects FY20E EBIT margin to be at around 13% on the back of some key margin levers. The management believes that the margin contraction in the portfolio companies (-100bps) in Q1FY20 would be recouped through the year, while the impact of a wage hike (-100bps) in Q1FY20 will be recovered by new-age deliveries, productivity and automation initiatives. Other levers which would help in improving margins are improving utilisation (-60bps) from Q2FY20E and the absence of visa costs (-40bps). However, the management highlighted that large deal transition costs and investments in building capabilities and people would affect margins, which can be partially mitigated by revenue growth.

Valuation and Outlook: With continued strong deal wins and a healthy deal pipeline, the management guided that communication (42% of total revenues) growth would be at high-single digits in FY20E and mid-single digit growth in the enterprise vertical. Despite a slow start for the communication business in Q1FY20, the growth in this vertical for remainder quarters would be higher on the back of strong deal wins and conversion rate of deal pipelines. Further, TechM is well placed to capture the significant portion of the 5G capex given its strong IT and network capabilities, investments in platforms, intellectual property (IP) and digital business and investments in partnerships. We maintain our Buy recommendation on the stock.

ANALYST

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**Exhibit 1: Quarterly details**

mn	1QFY19	4QFY19	1QFY20	QoQ (%)	YoY (%)	Comments
Revenues (In US\$mn)	1,224	1,268	1,247	(1.6)	1.9	Top 5/10 clients reported declines of 7.7%/5.6% QoQ
Revenues	82,763	88,923	86,530	(2.7)	4.6	
- Operating costs	69,194	72,536	73,389	1.2	6.1	
EBITDA	13,569	16,387	13,141	(19.8)	(3.2)	Margins were dented by wage hike (-100bps), seasonality in portfolio companies (-100bps), lower utilisation (-60bps), visa expenses (-40bps), currency headwinds (-40bps) and deal transition (-20 bps)
EBITDA margin (%)	16.4	18.4	15.2	(324)bps	(121)bps	
- Interest expense	305	281	454	61.6	48.9	
- Depreciation	2,808	2,704	3,213	18.8	14.4	
+ Other income, net (incl forex)	1,114	1,671	3,413	104.2	206.4	
PBT	11,570	15,073	12,887	(14.5)	11.4	
- Taxes	2,457	3,535	3,318	(6.1)	35.0	Tax rate to remain in the range of ~23-24% for FY20.
Effective tax rate (%)	21.2	23.5	25.7	229bps	451bps	
PAT	9,113	11,538	9,569	(17.1)	5.0	
- Minority interest	(134)	(213)	24	NA	NA	
Consolidated PAT	8,979	11,325	9,593	(15.3)	6.8	
Net margin (%)	10.8	12.7	11.1	(165)bps	24bps	
Reported profits	8,979	11,325	9,593	(15.3)	6.8	

Source: Company

Exhibit 2: Change in estimates

mn	FY20E			FY21E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	5,349	5,235	(2.1)	5,801	5,693	(1.9)
Revenue	374,435	363,687	(2.9)	406,066	395,656	(2.6)
EBITDA margin (%)	18.2	17.0	(110)bps	18.5	17.7	(75)bps
EPS (₹)	52.8	48.2	(8.7)	56.3	54.1	(3.9)

Source: Trust Research

Exhibit 3: Geographical wise Performance

Geographical mix	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
North America	46.8	45.3	46.9	47.4	48.2	47.0	47.4	46.4	47.6
Europe	29.8	30.0	29.8	29.6	30.0	29.6	28.9	28.6	27.6
RoW	23.4	24.7	23.3	23.0	21.8	23.4	23.7	25.0	24.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company

Exhibit 4: Operating mix (%)

Details	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Onsite	63.7	64.1	65.8	67.0	66.6	64.5	65.5	65.2	65.3
Offshore	36.3	35.9	34.2	33.0	33.4	35.5	34.5	34.8	34.7
Utilisation (incl. trainees)	77	81	83	84	81	81	82	82	80

Source: Company



Human Resources: Software Professionals stood at 74,093, BPO at 45,000 and Support staff at 6,680 (4,691 Net employees joined TECHM taking total to 125,773).

Exhibit 5: Employee strength at TECHM

Details	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Software Professionals	78,996	75,587	73,460	72,437	72,462	72,534	71,785	71,477	74,093
BPO employees	30,322	35,287	35,496	34,190	34,700	39,407	43,439	43,081	45,000
Sales & Support	6,662	6,351	6,285	6,180	6,390	6,450	6,618	6,524	6,680
Total employees	115,980	117,225	115,241	112,807	113,552	118,391	121,842	121,082	125,773

Source: Company

Client Concentration: The Company added 1/4 client each QoQ in the US\$50mn+ and US\$5mn+ to take the clients total to 21 and 160 respectively. Revenue growth in top five and ten accounts declined by 7.7 and 5.6% QoQ.

Exhibit 6: Client details

Vertical Mix	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
No. of Active Clients	864	885	903	913	926	930	935	938	941
> \$1 million clients	377	390	389	392	396	407	416	425	429
> \$5 million clients	139	147	154	156	154	157	157	156	160
> \$10 million clients	74	81	83	85	86	86	88	83	81
> \$20 million clients	41	40	40	44	47	45	46	50	49
> \$50 million clients	14	14	16	16	16	17	18	20	21
Top 5 clients (%)	26	25	23	23	22	23	23	23	21
Top 10 clients (%)	36	35	33	33	33	33	32	32	31
Top 20 clients (%)	49	46	45	46	46	46	44	45	44

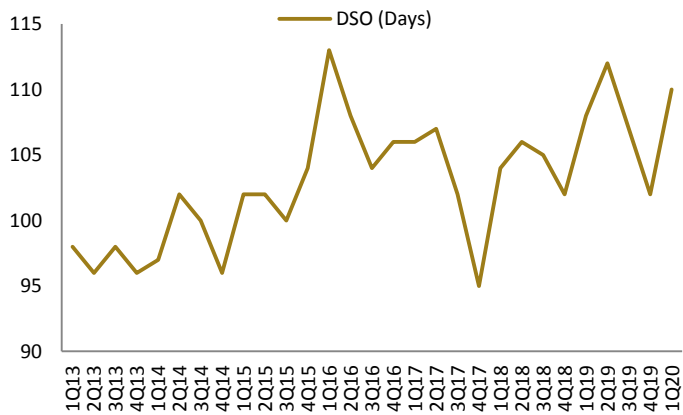
Source: Company

Exhibit 7: Vertical-wise breakup

Employees	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Telecom	45.2	43.7	42.8	41.6	39.6	41.5	41.1	42.7	42.0
Manufacturing	19.3	19.0	19.1	19.3	20.1	20.1	20.5	20.2	19.4
Technology, Media & Ent.	6.0	5.9	6.5	7.3	7.2	7.3	7.0	7.5	7.6
BFSI	14.4	14.1	13.3	13.0	13.6	13.5	13.4	13.1	12.8
Retail, Transport & Logistics	6.8	7.2	7.1	6.2	6.1	6.5	6.7	6.4	6.2
Others	8.3	10.1	11.2	12.6	13.4	11.1	11.3	10.1	12.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

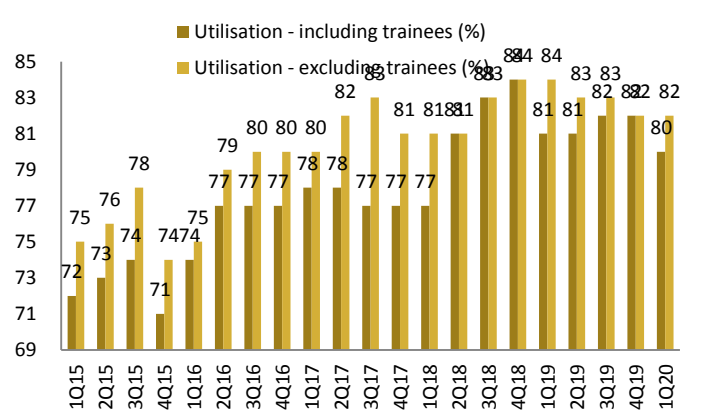
Source: Company

Exhibit 8: DSO days increased 8 days QoQ (incl. unbilled)



Source: Company, Trust

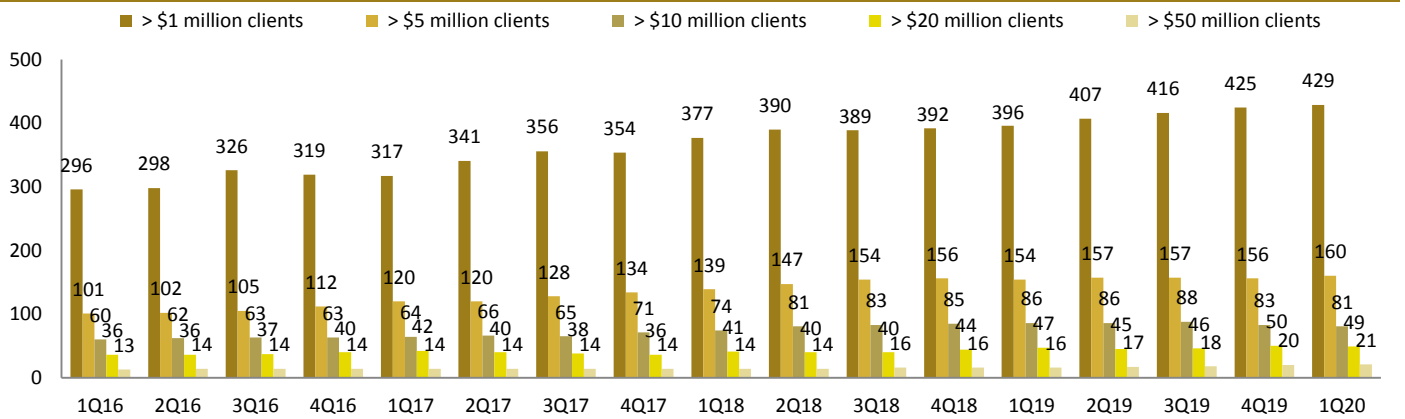
Exhibit 9: Utilization has limited room as a margin lever



Source: Company, Trust



Exhibit 10: TECHM added 1/4 clients respectively QoQ in the US\$50mn+ and US\$5mn+ bracket



Source: Company, Trust



Financials

Income Statement (₹ mn)

Year End-March	FY17	FY18	FY19	FY20E	FY21E
Revenues	291,408	307,730	347,421	363,687	395,656
Op. Expenses	249,565	260,560	284,053	302,041	325,750
EBITDA	41,843	47,170	63,368	61,645	69,906
Other Income	7,775	14,092	5,342	9,752	10,002
Depreciation	9,781	10,849	11,292	13,638	14,923
EBIT	39,837	50,413	57,418	57,759	64,985
Interest	1,286	1,624	1,332	1,636	1,391
PBT	38,551	48,789	56,086	56,123	63,594
Tax	9,785	10,925	12,544	13,262	15,263
PAT	28,766	37,864	43,542	42,861	48,331
Minority	(357)	137	(567)	96	96
Adj Pat	28,386	38,001	42,975	42,957	48,427

Key Parameters

Year End-March	FY17	FY18	FY19	FY20E	FY21E
Per share (₹)					
EPS	32.3	43.0	48.4	48.2	54.1
CEPS	48.9	62.0	68.6	71.2	79.2
BVPS	218.6	247.2	282.1	314.0	349.6
DPS	9.0	14.0	14.0	16.0	18.0
Payout (%)	32.5	38.1	33.8	38.8	38.9
Valuation (x)					
P/E	11.8	13.2	14.5	11.9	10.6
P/BV	2.0	2.6	2.8	2.0	1.8
EV/EBITDA	6.2	8.7	8.2	6.3	5.3
Dividend Yield (%)	1.3	2.2	1.8	2.5	2.8
Return ratio (%)					
EBITDA Margin	14.4	15.3	18.2	17.0	17.7
PAT Margin	9.9	12.3	12.5	11.8	12.2
ROAE	17.4	20.8	20.6	18.2	18.3
ROACE	22.8	26.4	26.6	23.7	23.9
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.2)	(0.2)	(0.4)	(0.5)	(0.5)
Debt/EBITDA	0.1	0.2	0.0	0.0	0.0
Interest Coverage	31.0	31.0	43.1	35.3	46.7
Current ratio	2.6	2.3	2.1	2.3	2.4
Growth Ratios (%)					
Income growth	10.0	5.6	12.9	4.7	8.8
EBITDA growth	(2.0)	12.7	34.3	(2.7)	13.4
PAT growth	(7.1)	31.6	15.0	(1.6)	12.8
Turnover Ratios					
F.A Turnover x	8.2	9.0	11.3	11.1	11.4
Debtors Days	70	79	78	75	76
Payable days	36	29	30	33	33

Balance Sheet (₹ mn)

Year End-March	FY17E	FY18	FY19	FY20E	FY21E
Equity Share Capital	4,388	4,417	4,437	4,457	4,477
Reserves & Surplus	172,288	196,315	210,711	236,981	266,551
Total Shareholders Fund	176,676	200,732	215,148	241,438	271,028
Minority Interest	4,641	5,091	4,777	4,777	4,777
Non-current liabilities	12,745	13,617	5,141	9,246	10,285
Long term Borrowings	3,853	7,711	2,086	2,086	2,086
Deferred tax liabilities	(2,579)	(5,708)	(6,080)	(6,080)	(6,080)
Other LT liabilities & prov	11,471	11,613	9,135	13,240	14,279
Current Liabilities	63,929	79,167	103,312	108,780	116,380
Short-term borrowings	8,342	9,549	11,961	11,961	11,961
Trade payables	23,117	20,368	24,893	26,480	28,559
Other cur liabilities & Prov	32,470	49,250	66,458	70,338	75,860
Total Liabilities	257,991	298,607	328,378	364,241	402,470
Assets					
Non-current Assets	94,726	117,537	112,720	115,826	120,721
Fixed assets	35,457	34,115	30,700	32,700	34,700
Non-current investments	35,181	56,966	50,195	50,195	50,195
Long-term loans & adv	9	52	43	50	54
Other non-current assets	24,079	26,404	31,782	32,881	35,772
Current assets	163,265	181,070	215,658	248,415	281,750
Current investments	21,647	34,449	65,899	65,899	65,899
Trade receivables	53,377	64,979	69,586	72,737	79,131
Inventories	611	659	752	797	867
Cash & bank balances	20,013	19,661	20,427	47,205	68,645
Other current assets	63,331	59,822	58,994	61,777	67,207
Total Assets	257,991	298,607	328,378	364,241	402,470

Cash flow Statement

Year End-March	FY17	FY18	FY19	FY20E	FY21E
PBT	38,551	48,789	56,086	56,123	63,594
Depreciation	12,524	7,720	10,920	13,638	14,923
Interest Exp	1,286	1,624	1,332	1,636	1,391
Others	(380)	137	(567)	96	96
CF before W.cap	51,981	58,270	67,771	71,493	80,004
Inc/dec in W.cap	132	(6,450)	(10,014)	(2,488)	6,150
Op CF after W.cap	51,849	64,721	77,785	73,981	73,854
Less Taxes	9,785	10,925	12,544	13,262	15,263
Net CF From Operations	42,064	53,796	65,241	60,718	58,591
Inc/(dec) in F.A + CWIP	14,603	9,507	7,877	15,638	16,923
(Pur)/sale of Investments	25,105	34,587	23,179	-	-
Others	(1,286)	(1,624)	(1,332)	(1,636)	(1,391)
CF from Invst Activities	(40,994)	(45,718)	(32,388)	(17,274)	(18,314)
Loan Raised/(repaid)	2,174	5,065	(3,213)	-	-
Equity Raised	3,047	975	(14,338)	20	20
Dividend	10,256	14,470	(14,536)	16,687	18,857
CF from Fin Activities	(5,035)	(8,430)	(32,086)	(16,667)	(18,837)
Net inc/(dec) in cash	(3,965)	(352)	766	26,778	21,440
Op. bal of cash	23,978	20,013	19,661	20,427	47,205
Cl. balance of cash	20,013	19,661	20,427	47,205	68,645



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