

BUY

TP: Rs 1,040 | ▲19%

TECH MAHINDRA

| IT Services

| 01 December 2020

Analyst meet takeaways – Growth acceleration ahead

In its analyst meet today, Tech Mahindra (TECHM) emphasised its focus on reviving growth and appeared optimistic about demand traction and margins. Though the 5G timeline stands delayed, management is confident of growth acceleration in FY22 and is targeting a 15% EBIT margin. BFSI, manufacturing and HLS verticals are seeing a growth uptick. Cloud TCV has risen 2x TTM YoY. Factoring guidance given in the analyst meet, we raise FY22/FY23 EPS by 7%/10% and revise our Sep'21 TP to Rs 1,040 (vs. Rs 980). Retain BUY.

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Huge 5G opportunity: Despite 5G timeline delays due to Covid-19, TECHM has identified key areas of collaboration with communication service providers (CSP) such as: (1) supply chain transformation, (2) open network on cloud, (3) intelligent & cognitive managed operations, (4) digital OSS, and (5) enterprise network modernisation. 5G is potentially a ~US\$ 130bn market, which will be shared by OEMs, CSPs and IT companies. This still gives TECHM enough room for growth.

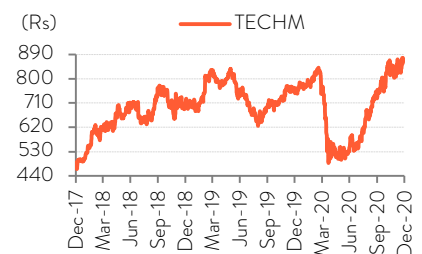
Within 5G, the areas of 'open 5G network' and 'network on cloud' are expected to grow at 65-70% and 20-25% CAGR respectively over CY20-CY25. TECHM has developed a network automation and managed services framework called 'Netops.ai' as its own organic product in the 5G field.

Growth acceleration in FY22: TECHM has entered a repair phase in H2FY21 following the Covid outbreak and management expects growth to accelerate in FY22. Its enterprise segment (60% of revenue) is seeing increased demand from the BFSI, manufacturing and HLS verticals. TECHM expects to achieve at least high-single-digit YoY growth (ex-5G). Management also has an ambitious EBIT margin target of 15% for FY22 (vs. 11.6% in FY20). BPS segment's uplifted margins are expected to sustain in the near-to-midterm due to cost reductions coming from relaxed work-from-home guidelines.

Ticker/Price	TECHM IN/Rs 877
Market cap	US\$ 10.4bn
Shares o/s	873mn
3M ADV	US\$ 64.5mn
52wk high/low	Rs 890/Rs 471
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	347,421	368,677	385,822	448,388	506,640
EBITDA (Rs mn)	63,368	57,261	66,649	85,553	97,783
Adj. net profit (Rs mn)	42,975	42,505	45,483	55,259	63,907
Adj. EPS (Rs)	47.7	48.3	51.7	62.8	72.7
Adj. EPS growth (%)	11.9	1.2	7.0	21.5	15.6
Adj. ROAE (%)	21.4	19.8	19.4	21.0	21.6
Adj. P/E (x)	18.4	18.1	17.0	14.0	12.1
EV/EBITDA (x)	12.0	13.3	11.4	8.7	7.2

Source: Company, BOBCAPS Research

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Other analyst meet highlights

- Experience-oriented BPS:** BPS is expected to grow at 11.2% CAGR to US\$ 219bn (FY20-FY24) and will be more experience-oriented going forward. Market trends for experiences include hyperpersonalisation and elastic enterprise. Currently, most enterprises are focused on processing more volumes at reduced cost using automation.
- Big bets:** TECHM's big bets in AI and data are data value management, data on cloud, data monetisation, advanced analytics, cognitive services, and conversational AI. Its cloud bets are large AMS deals, data centre carveouts, scaling SaaS and hyperscalers.
- M&A strategy:** Mad*Pow, Born, Cerium, Zen3 Infosolutions and Tenzing have been TECHM's major acquisitions in the last 24 months, filling white spaces in its portfolio. The company's acquisition strategy is based on the two pillars of integration and synergy. While management plans to be cautious in terms of capital allocation, it will still use the M&A strategy to fill capability gaps needed to maintain growth.

FIG 1 – 5G OPPORTUNITIES

5G Opportunities	Potential market size (US\$ bn)	CY20-25 CAGR (%)
Open 5G network	40-50	65-70
Network on cloud	8-10	20-25
Intelligent and cognitive managed operations	10-15	15-20
Digital OSS	5-8	10-12
Enterprise network modernisation	>50	12-14

Source: BOBCAPS Research, Company

Valuation methodology

We believe that telecom is a relatively resilient industry in the current environment (see our report [Deep Dive 2: Telecom tech spends resilient – upgrade TECHM](#)). 5G-driven traction will boost the communications vertical, which forms nearly 40% of TECHM’s revenues. With the onset of Covid-19, 5G adoption timelines have shifted to FY22 onwards but demand is coming from adjacent areas such as supply chain transformation, open network on cloud, intelligent & cognitive managed operations, digital OSS, and enterprise network modernisation.

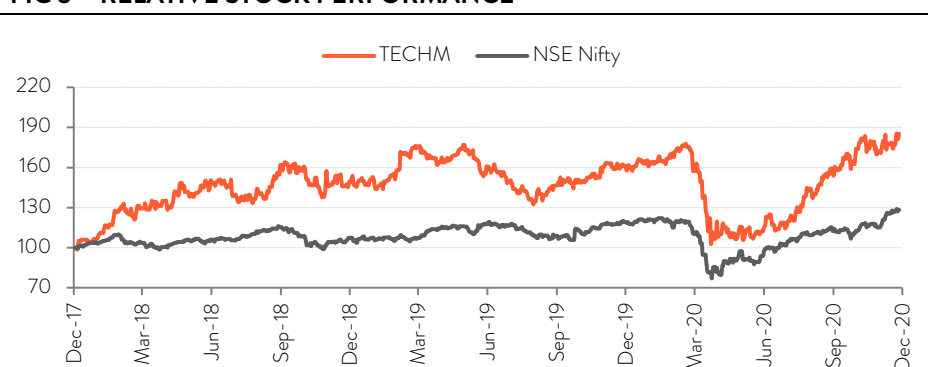
Incorporating management’s guidance of accelerated growth and the elevated EBIT margin target of 15% for FY22, we raise FY22/FY23 EPS by 7%/10%. Our Sep’21 target price changes to Rs 1,040 (Rs 980 earlier), set at an unchanged target P/E of 15.7x – in line with the last five-year average. Reiterate BUY.

FIG 2 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change	Old	New	Change	Old	New	Change
US\$ Revenues (US\$ mn)	5,126	5,126	0.0	5,749	5,749	0.0	6,428	6,495	1.0
YoY growth (%)	(1)	(1)	-	12.1	12.1	-	11.8	13.0	-
Revenues	385,822	385,822	0.0	448,388	448,388	0.0	501,377	506,640	1.0
EBITDA	66,649	66,649	0.0	81,088	85,553	5.5	90,275	97,783	8.3
EBITDA margins (%)	17.3	17.3	-	18.1	19.1	-	18.0	19.3	-
EBIT margins (%)	13.2	13.2	-	14.0	15.0	-	13.8	15.1	-
Net Profits	45,483	45,483	0.0	51,911	55,259	6.5	57,976	63,907	10.2
EPS (Rs)	51.7	51.7	0.0	59.0	62.8	6.5	65.9	72.7	10.2

Source: BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Slow growth in communication business
- Lack of synergy among portfolio companies
- Prolonged delay in 5G timelines

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	347,421	368,677	385,822	448,388	506,640
EBITDA	63,368	57,261	66,649	85,553	97,783
Depreciation	11,292	14,458	15,591	18,395	21,279
EBIT	52,076	42,803	51,059	67,158	76,504
Net interest income/(expenses)	(1,332)	(1,919)	(1,527)	(1,550)	(1,650)
Other income/(expenses)	5,342	11,924	9,787	5,898	8,182
Exceptional items	0	0	0	0	0
EBT	55,431	52,753	59,343	71,546	83,076
Income taxes	12,544	11,604	14,843	17,886	20,769
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(567)	1,301	1,007	1,640	1,640
Reported net profit	42,975	42,505	45,483	55,259	63,907
Adjustments	0	0	0	0	0
Adjusted net profit	42,975	42,505	45,483	55,259	63,907

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	90,744	103,830	100,419	116,704	131,865
Provisions	9,753	11,055	10,570	12,285	13,881
Debt funds	14,047	24,282	24,282	24,282	24,282
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,437	4,359	4,359	4,359	4,359
Reserves & surplus	203,184	217,705	243,039	273,412	308,789
Shareholders' fund	207,621	222,064	247,398	277,771	313,148
Total liabilities and equities	334,469	373,535	394,974	443,346	495,480
Cash and cash eq.	20,427	30,167	62,975	101,047	145,515
Accounts receivables	69,586	75,772	76,107	88,449	99,940
Inventories	752	358	358	358	358
Other current assets	88,020	121,702	115,943	121,086	125,874
Investments	77,926	61,046	61,046	61,046	61,046
Net fixed assets	71,667	76,047	70,102	62,917	54,304
CWIP	2,763	501	501	501	501
Intangible assets	28,163	33,877	33,877	33,877	33,877
Deferred tax assets, net	6,091	8,443	8,443	8,443	8,443
Other assets	0	0	0	0	0
Total assets	334,469	373,535	394,975	443,346	495,480

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	50,112	55,607	60,091	72,054	83,586
Interest expenses	(745)	(13,843)	(11,314)	(7,448)	(9,832)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(10,574)	(13,356)	1,528	514	479
Other operating cash flows	5,527	17,667	0	0	0
Cash flow from operations	44,320	46,075	50,306	65,121	74,232
Capital expenditures	(7,793)	(15,386)	(9,646)	(11,210)	(12,666)
Change in investments	(23,216)	(16,880)	0	0	0
Other investing cash flows	9,967	13,843	11,314	7,448	9,832
Cash flow from investing	(21,042)	(18,423)	1,668	(3,762)	(2,834)
Equities issued/Others	(1,747)	0	0	0	0
Debt raised/repaid	(4,504)	0	0	0	0
Interest expenses	(1,354)	0	0	0	0
Dividends paid	(14,907)	(17,912)	(19,166)	(23,286)	(26,930)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(22,512)	(17,912)	(19,166)	(23,286)	(26,930)
Changes in cash and cash eq.	766	9,740	32,808	38,072	44,468
Closing cash and cash eq.	20,427	30,167	62,975	101,047	145,515

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	47.7	48.3	51.7	62.8	72.7
Adjusted EPS	47.7	48.3	51.7	62.8	72.7
Dividend per share	14.0	16.9	18.1	22.0	25.4
Book value per share	230.6	252.5	281.3	315.9	356.1

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.2	2.1	2.0	1.7	1.4
EV/EBITDA	12.0	13.3	11.4	8.7	7.2
Adjusted P/E	18.4	18.1	17.0	14.0	12.1
P/BV	3.8	3.5	3.1	2.8	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	77.5	80.6	76.6	77.2	76.9
Interest burden (PBT/EBIT)	106.4	123.2	116.2	106.5	108.6
EBIT margin (EBIT/Revenue)	15.0	11.6	13.2	15.0	15.1
Asset turnover (Revenue/Avg TA)	108.8	104.1	100.4	107.0	107.9
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
Adjusted ROAE	21.4	19.8	19.4	21.0	21.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	12.9	6.1	4.7	16.2	13.0
EBITDA	34.3	(9.6)	16.4	28.4	14.3
Adjusted EPS	11.9	1.2	7.0	21.5	15.6
Profitability & Return ratios (%)					
EBITDA margin	18.2	15.5	17.3	19.1	19.3
EBIT margin	15.0	11.6	13.2	15.0	15.1
Adjusted profit margin	12.4	11.5	11.8	12.3	12.6
Adjusted ROAE	21.4	19.8	19.4	21.0	21.6
ROCE	19.3	15.1	17.0	23.2	27.5
Working capital days (days)					
Receivables	71	72	72	67	68
Inventory	1	1	0	0	0
Payables	104	114	117	109	111
Ratios (x)					
Gross asset turnover	4.7	5.0	5.3	6.7	8.6
Current ratio	1.8	2.0	2.3	2.4	2.6
Net interest coverage ratio	(39.1)	(22.3)	(33.4)	(43.3)	(46.4)
Adjusted debt/equity	0.0	0.0	(0.2)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

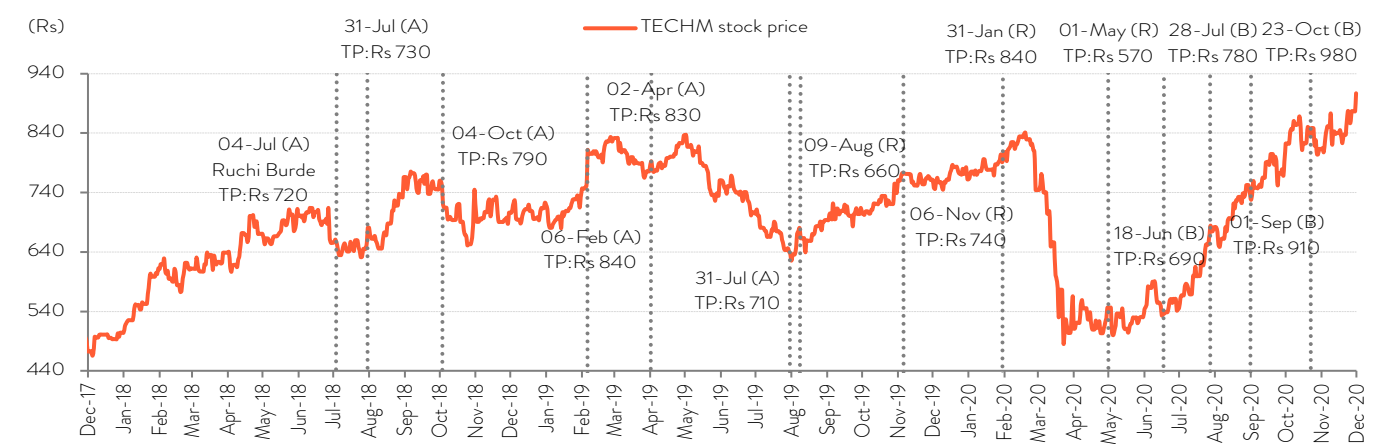
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): TECH MAHINDRA (TECHM IN)



B – Buy, A – Add, R – Reduce, S – Sell

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