

May 25, 2016

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| | |
|----------------|------------|
| Rating | BUY |
| Price | Rs479 |
| Target Price | Rs585 |
| Implied Upside | 22.1% |
| Sensex | 25,305 |
| Nifty | 7,749 |

(Prices as on May 24, 2016)

Trading data

| | |
|----------------------------|-------|
| Market Cap. (Rs bn) | 460.5 |
| Shares o/s (m) | 960.8 |
| 3M Avg. Daily value (Rs m) | 74.6 |

Major shareholders

| | |
|----------------|--------|
| Promoters | 36.74% |
| Foreign | 38.11% |
| Domestic Inst. | 11.42% |
| Public & Other | 13.73% |

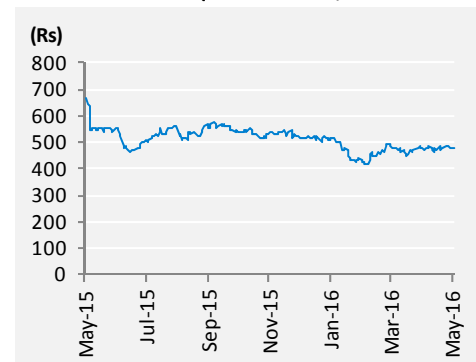
Stock Performance

| (%) | 1M | 6M | 12M |
|----------|-------|--------|--------|
| Absolute | (0.2) | (10.8) | (28.0) |
| Relative | 1.9 | (9.0) | (18.5) |

How we differ from Consensus

| EPS (Rs) | PL | Cons. | % Diff. |
|----------|------|-------|---------|
| 2017 | 35.3 | 36.4 | -2.9 |
| 2018 | 37.6 | 42.1 | -10.6 |

Price Performance (RIC:TEML.BO,BB:TECHM IN)



Source: Bloomberg

Tech Mahindra's (TECHM's) Q4FY16 results were slightly ahead of our estimates driven by revenue beat. Company's revenue growth in FY16 has been impacted by the sluggishness in telecom business (down ~2% YoY in CC terms) while the enterprise business growth was steady at 10%+ YoY. Management has indicated that telecom business has bottomed out and deal flow from large telecom clients has resumed (one US\$300mn deal win in 4Q). Enterprise business remains steady and as a consequence TechM's organic revenue growth will improve in FY17. EBIT margins have also bottomed out for the company and this will drive steady EPS growth. We upgrade TechM to "BUY" with a price target of Rs585 (was Rs565) based on 14x Mar-18 EPS (adjusted for treasury shares). Stock is trading reasonable at 12.5x/11.5x FY17/18E EPS against a possible recovery in earnings. Large deal wins could act as a trigger.

■ **Banking business and Comviva led growth:** Revenue for Q4FY16 grew by 1.3% QoQ in CC terms and 0.8% QoQ in USD terms to US\$1,023m (PL: US\$1,010m, Cons: US\$1,016m). EBITDA margins for the quarter at 16.9% were largely flat and in-line with expectations. Company was able to absorb the impact of wage hikes in the quarter. Margins tailwinds were a) improved efficiency (60bps), b) Comviva business (60bps) and c) currency (30bps) which offset the impact of wage hikes (100bps) and LCC restructuring (50bps). Higher other income and lower tax rate resulted in 25% profit beat in Q4.

■ **Telecom business bottoms out:** FY16 was a challenging year for telecom business driven by M&A between large telecom clients and restructuring in LCC. M&A transactions had slowed down the business and now this headwind is behind us. Company won a large deal in Q4FY16 and expects to close one more in Q1FY17. LCC business after a 20% decline in run rate from US\$400mn to US\$320mn has bottomed out.

Key financials (Y/e March)

| | 2015 | 2016 | 2017E | 2018E |
|-----------------|---------|---------|---------|---------|
| Revenues (Rs m) | 226,213 | 264,941 | 286,460 | 309,804 |
| Growth (%) | 20.1 | 17.1 | 8.1 | 8.1 |
| EBITDA (Rs m) | 41,920 | 43,426 | 48,135 | 51,888 |
| PAT (Rs m) | 26,275 | 31,169 | 33,940 | 36,161 |
| EPS (Rs) | 27.3 | 32.4 | 35.3 | 37.6 |
| Growth (%) | (12.9) | 18.6 | 8.9 | 6.5 |
| Net DPS (Rs) | 6.0 | 7.5 | 8.8 | 8.8 |

Profitability & Valuation

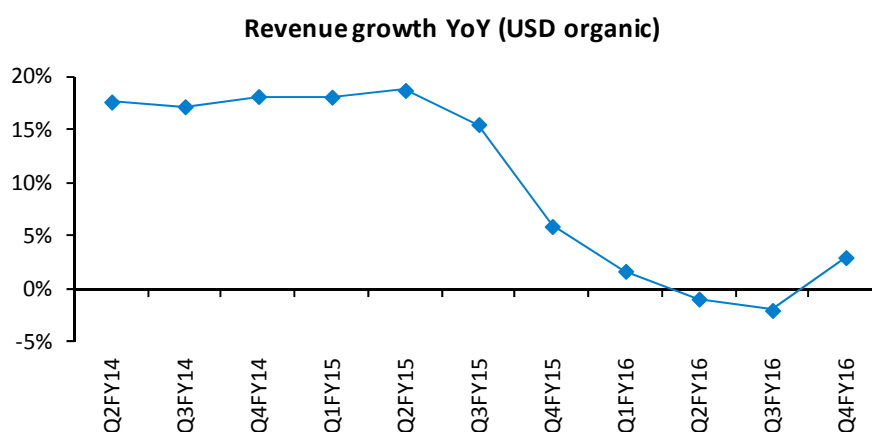
| | 2015 | 2016 | 2017E | 2018E |
|------------------------|------|------|-------|-------|
| EBITDA margin (%) | 18.5 | 16.4 | 16.8 | 16.7 |
| RoE (%) | 24.5 | 23.1 | 21.2 | 19.4 |
| RoCE (%) | 20.7 | 20.2 | 18.8 | 17.5 |
| EV / sales (x) | 2.0 | 1.6 | 1.5 | 1.3 |
| EV / EBITDA (x) | 10.6 | 10.0 | 8.7 | 7.7 |
| PE (x) | 17.5 | 14.8 | 13.6 | 12.7 |
| P / BV (x) | 3.8 | 3.1 | 2.7 | 2.3 |
| Net dividend yield (%) | 1.2 | 1.6 | 1.8 | 1.8 |

Source: Company Data; PL Research

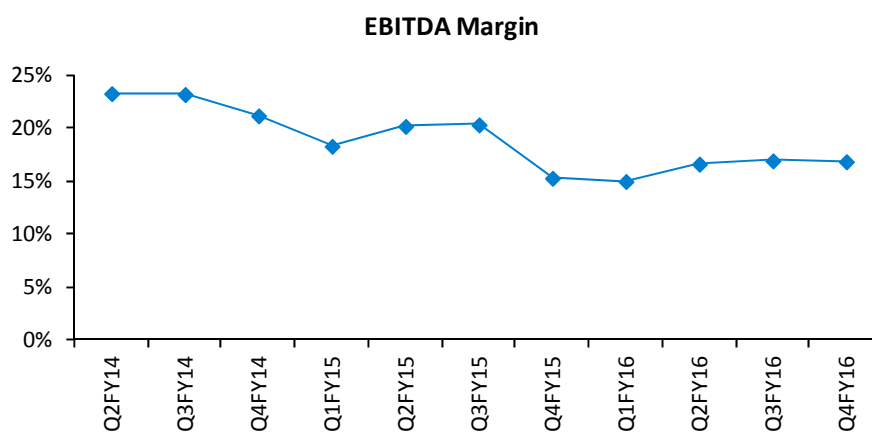
Exhibit 1: Q4FY16 – Operating performance in-line; Higher other income and lower tax rate drive significant profit beat (Rs m)

| Y/e March | Q4FY16 | Q3FY16 | QoQ gr. | Q4FY15 | YoY gr. | Cons (e) | PLe | Variance |
|----------------------|--------------|--------------|---------|--------------|---------|--------------|--------------|----------|
| Sales (\$ m) | 1,022.6 | 1,014.7 | 0.8% | 984.1 | 3.9% | 1,016.9 | 1,009.5 | 1.3% |
| Sales | 68,837 | 67,011 | 2.7% | 61,168 | 12.5% | 68,624 | 68,125 | 1.0% |
| EBITDA | 11,613 | 11,358 | 2.2% | 9,367 | 24.0% | 11,349 | 11,485 | 1.1% |
| <i>EBITDA Margin</i> | <i>16.9%</i> | <i>16.9%</i> | | <i>15.3%</i> | | <i>16.5%</i> | <i>16.9%</i> | |
| PBT | 10,765 | 10,017 | 7.5% | 6,735 | 59.8% | 9,537 | 10,249 | 5.0% |
| Tax | 1,571 | 2,327 | -32.5% | 1,845 | -14.9% | 2,062 | 3,082 | -49.0% |
| <i>Tax Rate</i> | <i>14.6%</i> | <i>23.2%</i> | | <i>27.4%</i> | | <i>21.6%</i> | <i>30.1%</i> | |
| Net Income | 8,959 | 7,593 | 18.0% | 4,721 | 89.8% | 7,475 | 7,167 | 25.0% |
| EPS (Diluted) (Rs) | 9.1 | 7.7 | 18.1% | 4.8 | 89.6% | 8.2 | 7.3 | 24.7% |

Source: Company Data, Bloomberg, PL Research

Exhibit 2: Revenue growth improved on YoY basis


Source: Company Data, PL Research

Exhibit 3: EBITDA Margin largely stable


Source: Company Data, PL Research

Exhibit 4: Rest of World contributed to growth

| USD growth | Revenue contribution | QoQ gr. | YoY gr. |
|---------------|----------------------|---------|---------|
| North America | 46.8% | -1.3% | 7.1% |
| Europe | 28.5% | -0.6% | -0.6% |
| RoW | 24.7% | 7.3% | 3.5% |

Source: Company Data, PL Research

Exhibit 5: Banking vertical led growth both QoQ and YoY

| USD growth | Revenue contribution | QoQ gr. | YoY gr. |
|------------------------------------|----------------------|---------|---------|
| Telecom | 50.9% | 0.0% | -4.4% |
| Manufacturing | 17.1% | 0.8% | 7.7% |
| Technology, Media & Entertainment | 7.5% | 2.1% | 11.3% |
| BFSI | 10.6% | 9.0% | 21.0% |
| Retail, Transportation & Logistics | 6.2% | -8.1% | 3.9% |
| Others | 7.7% | 2.1% | 33.4% |

Source: Company Data, PL Research

Exhibit 6: Top clients remain sluggish

| USD growth | Revenue contribution | QoQ gr. | YoY gr. |
|----------------|----------------------|---------|---------|
| Top 5 Clients | 27.9% | -0.6% | -12.4% |
| Top 10 Clients | 39.0% | -0.5% | -10.7% |
| Top 20 Clients | 51.9% | 0.0% | -4.9% |

Source: Company Data, PL Research

Exhibit 7: Headcount details

| Client data | Q1FY15 | Q2FY15 | Q3FY15 | Q4FY15 | Q1FY16 | Q2FY16 | Q3FY16 | Q4FY16 |
|--|---------------|---------------|---------------|----------------|----------------|----------------|----------------|----------------|
| Software Professionals | 65,336 | 67,365 | 68,742 | 74,048 | 73,046 | 73,046 | 72,828 | 72,125 |
| BPO Professionals | 21,936 | 22,433 | 23,566 | 22,693 | 24,394 | 24,394 | 28,279 | 27,254 |
| Sales & Support | 5,457 | 5,511 | 5,701 | 6,540 | 6,233 | 6,233 | 6,030 | 6,053 |
| TOTAL | 92,729 | 95,309 | 98,009 | 103,281 | 103,673 | 103,673 | 107,137 | 105,432 |
| Net addition | | | | | | | | |
| Software Professionals | 4,339 | 2,029 | 1,377 | 5,306 | (1,002) | (1,002) | (218) | (921) |
| BPO Professionals | 106 | 497 | 1,133 | (873) | 1,701 | 1,701 | 3,885 | 2,860 |
| Sales & Support | (1,157) | 54 | 190 | 839 | (307) | (307) | (203) | (180) |
| TOTAL | 3,288 | 2,580 | 2,700 | 5,272 | 392 | 392 | 3,464 | 1,759 |
| <i>Net Addition (% of prev-qtr end head-count)</i> | <i>3.7%</i> | <i>2.8%</i> | <i>2.8%</i> | <i>5.4%</i> | <i>0.4%</i> | <i>0.4%</i> | <i>3.3%</i> | <i>1.7%</i> |
| <i>Attrition</i> | <i>16.0%</i> | <i>18.0%</i> | <i>19.0%</i> | <i>19.0%</i> | <i>19.0%</i> | <i>20.0%</i> | <i>20.0%</i> | <i>21.0%</i> |

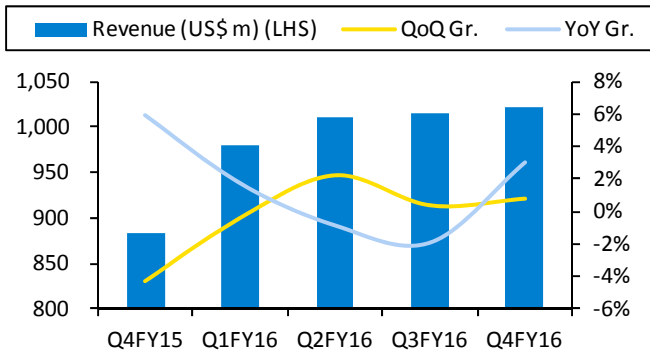
Source: Company Data, PL Research

Exhibit 8: Overview of the company's operating metrics over the last few quarters

| Revenue by verticals (%) | Q1FY15 | Q2FY15 | Q3FY15 | Q4FY15 | Q1FY16 | Q2FY16 | Q3FY16 | Q4FY16 |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Telecom | 50.7% | 52.0% | 50.9% | 55.3% | 52.7% | 52.9% | 51.3% | 50.9% |
| Manufacturing | 17.8% | 17.7% | 19.7% | 16.5% | 17.1% | 16.7% | 17.1% | 17.1% |
| Technology, Media & Entertainment | 8.9% | 8.3% | 7.3% | 7.0% | 7.3% | 8.2% | 7.4% | 7.5% |
| BFSI | 10.3% | 9.7% | 9.8% | 9.1% | 10.0% | 9.6% | 9.8% | 10.6% |
| Retail, Transportation & Logistics | 6.3% | 6.2% | 6.4% | 6.2% | 6.5% | 6.0% | 6.8% | 6.2% |
| Others | 6.0% | 6.1% | 6.0% | 6.0% | 6.5% | 6.6% | 7.6% | 7.7% |
| Revenue by geography (%) | | | | | | | | |
| North America | 46.8% | 49.1% | 48.8% | 45.4% | 47.7% | 48.9% | 47.8% | 46.8% |
| Europe | 31.1% | 31.2% | 31.4% | 29.8% | 29.4% | 29.3% | 28.9% | 28.5% |
| RoW | 22.1% | 19.8% | 19.8% | 24.8% | 22.9% | 21.9% | 23.2% | 24.7% |
| Revenue by clients (%) | | | | | | | | |
| Top 5 | 37.0% | 40.0% | 37.0% | 33.1% | 33.0% | 32.0% | 28.3% | 27.9% |
| Top 10 | 50.0% | 51.0% | 49.0% | 45.4% | 44.0% | 43.0% | 39.5% | 39.0% |
| Top 20 | 62.0% | 63.0% | 61.0% | 56.7% | 57.0% | 57.0% | 52.3% | 51.9% |
| Client Count | | | | | | | | |
| No. of Active Clients | 632 | 649 | 674 | 767 | 770 | 788 | 801 | 807 |
| % of repeat business | 98.8% | 97.1% | 94.7% | 82.2% | 98.6% | 96.8% | 95.7% | 96.3% |
| No. of Million \$ Clients | | | | | | | | |
| >1m | 242 | 245 | 254 | 291 | 296 | 298 | 326 | 319 |
| >5m | 80 | 86 | 88 | 96 | 101 | 102 | 105 | 112 |
| >10m | 51 | 50 | 51 | 56 | 60 | 62 | 63 | 63 |
| >20m | 29 | 30 | 32 | 35 | 36 | 36 | 37 | 40 |
| >50m | 11 | 12 | 13 | 13 | 13 | 14 | 14 | 14 |
| Other details | | | | | | | | |
| DSO Days | 102 | 102 | 100 | 104 | 113 | 108 | 104 | 106 |

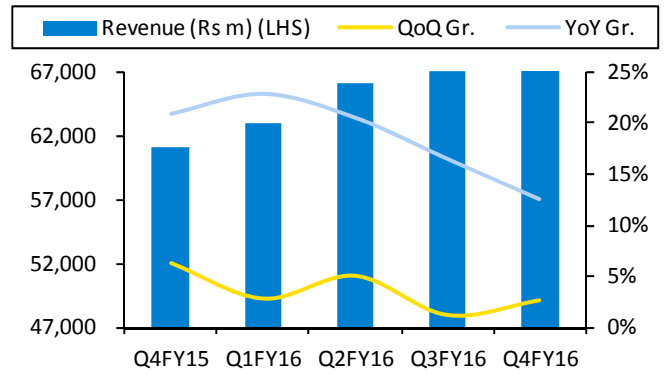
Source: Company Data, PL Research

Exhibit 9: USD revenue (Organic) growth trend



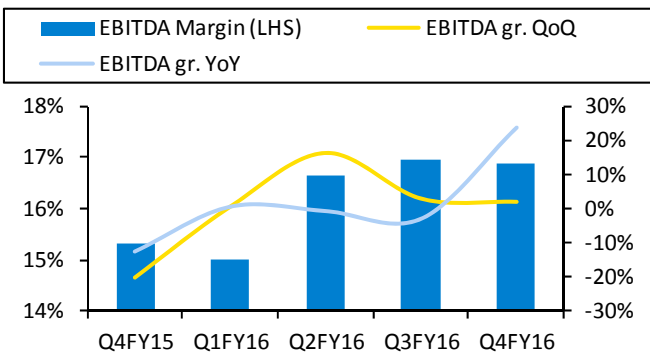
Source: Company Data, PL Research

Exhibit 10: INR Revenue movement over the last few quarters



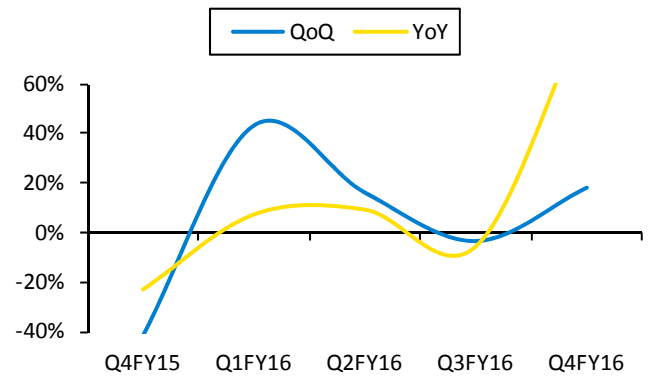
Source: Company Data, PL Research

Exhibit 11: EBITDA growth and margin trend



Source: Company Data, PL Research

Exhibit 12: PAT growth trend over the course of last few quarters



Source: Company Data, PL Research

Income Statement (Rs m)

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|----------------------------|----------------|----------------|----------------|----------------|
| Net Revenue | 226,213 | 264,941 | 286,460 | 309,804 |
| Raw Material Expenses | 151,186 | 183,575 | 197,790 | 214,717 |
| Gross Profit | 75,027 | 81,367 | 88,670 | 95,087 |
| Employee Cost | — | — | — | — |
| Other Expenses | 33,107 | 37,940 | 40,535 | 43,200 |
| EBITDA | 41,920 | 43,426 | 48,135 | 51,888 |
| Depr. & Amortization | 6,114 | 7,620 | 8,511 | 9,557 |
| Net Interest | 691 | 961 | 675 | 675 |
| Other Income | 1,065 | 5,322 | 5,940 | 6,137 |
| Profit before Tax | 36,180 | 40,167 | 44,889 | 47,792 |
| Total Tax | 9,596 | 8,600 | 10,549 | 11,231 |
| Profit after Tax | 26,584 | 31,567 | 34,340 | 36,561 |
| Ex-Od items / Min. Int. | 309 | 398 | 400 | 400 |
| Adj. PAT | 26,275 | 31,169 | 33,940 | 36,161 |
| Avg. Shares O/S (m) | 960.8 | 960.8 | 960.8 | 960.8 |
| EPS (Rs.) | 27.3 | 32.4 | 35.3 | 37.6 |

Cash Flow Abstract (Rs m)

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|---------------------|----------|----------|----------|----------|
| C/F from Operations | 23,974 | 27,650 | 38,695 | 41,609 |
| C/F from Investing | (20,804) | (10,598) | (14,323) | (15,490) |
| C/F from Financing | (7,899) | 2,395 | (8,420) | (8,420) |
| Inc. / Dec. in Cash | (4,729) | 19,448 | 15,952 | 17,699 |
| Opening Cash | 14,519 | 12,060 | 31,508 | 47,459 |
| Closing Cash | 12,060 | 31,508 | 47,459 | 65,158 |
| FCFF | 5,852 | 16,654 | 23,972 | 25,719 |
| FCFE | 12,074 | 16,654 | 23,972 | 25,719 |

Key Financial Metrics

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|-------------------------|--------|-------|-------|-------|
| Growth | | | | |
| Revenue (%) | 20.1 | 17.1 | 8.1 | 8.1 |
| EBITDA (%) | 0.2 | 3.6 | 10.8 | 7.8 |
| PAT (%) | (10.4) | 18.6 | 8.9 | 6.5 |
| EPS (%) | (12.9) | 18.6 | 8.9 | 6.5 |
| Profitability | | | | |
| EBITDA Margin (%) | 18.5 | 16.4 | 16.8 | 16.7 |
| PAT Margin (%) | 11.6 | 11.8 | 11.8 | 11.7 |
| RoCE (%) | 20.7 | 20.2 | 18.8 | 17.5 |
| RoE (%) | 24.5 | 23.1 | 21.2 | 19.4 |
| Balance Sheet | | | | |
| Net Debt : Equity | (0.1) | (0.2) | (0.2) | (0.3) |
| Net Wrkng Cap. (days) | 35 | 42 | 42 | 42 |
| Valuation | | | | |
| PER (x) | 17.5 | 14.8 | 13.6 | 12.7 |
| P / B (x) | 3.8 | 3.1 | 2.7 | 2.3 |
| EV / EBITDA (x) | 10.6 | 10.0 | 8.7 | 7.7 |
| EV / Sales (x) | 2.0 | 1.6 | 1.5 | 1.3 |
| Earnings Quality | | | | |
| Eff. Tax Rate | 26.5 | 21.4 | 23.5 | 23.5 |
| Other Inc / PBT | 2.9 | 13.2 | 13.2 | 12.8 |
| Eff. Depr. Rate (%) | 10.2 | 10.8 | 10.0 | 9.5 |
| FCFE / PAT | 46.0 | 53.4 | 70.6 | 71.1 |

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|-------------------------------|----------------|----------------|----------------|----------------|
| Shareholder's Funds | 122,489 | 146,839 | 172,759 | 200,899 |
| Total Debt | 6,746 | 6,746 | 6,746 | 6,746 |
| Other Liabilities | 18,446 | 18,446 | 18,446 | 18,446 |
| Total Liabilities | 147,681 | 172,031 | 197,951 | 226,091 |
| Net Fixed Assets | 28,723 | 34,077 | 39,888 | 45,822 |
| Goodwill | 17,283 | 17,283 | 17,283 | 17,283 |
| Investments | 21,028 | 21,028 | 21,028 | 21,028 |
| Net Current Assets | 63,685 | 82,681 | 102,789 | 124,997 |
| <i>Cash & Equivalents</i> | <i>24,049</i> | <i>31,508</i> | <i>47,459</i> | <i>65,158</i> |
| <i>Other Current Assets</i> | <i>90,436</i> | <i>105,614</i> | <i>114,192</i> | <i>123,497</i> |
| <i>Current Liabilities</i> | <i>50,800</i> | <i>54,440</i> | <i>58,862</i> | <i>63,658</i> |
| Other Assets | 16,962 | 16,962 | 16,962 | 16,962 |
| Total Assets | 147,681 | 172,031 | 197,951 | 226,091 |

Quarterly Financials (Rs m)

| Y/e March | Q1FY16 | Q2FY16 | Q3FY16 | Q4FY16 |
|--------------------------|---------------|---------------|---------------|---------------|
| Net Revenue | 62,938 | 66,155 | 67,011 | 68,837 |
| EBITDA | 9,445 | 11,010 | 11,358 | 11,613 |
| <i>% of revenue</i> | <i>15.0</i> | <i>16.6</i> | <i>16.9</i> | <i>16.9</i> |
| Depr. & Amortization | 1,733 | 1,974 | 1,736 | 2,177 |
| Net Interest | 214 | 173 | 244 | 330 |
| Other Income | 1,366 | 1,658 | 639 | 1,659 |
| Profit before Tax | 8,864 | 10,521 | 10,017 | 10,765 |
| Total Tax | 2,098 | 2,604 | 2,327 | 1,571 |
| Profit after Tax | 6,762 | 7,855 | 7,593 | 8,959 |
| Adj. PAT | 6,762 | 7,855 | 7,593 | 8,971 |

Key Operating Metrics

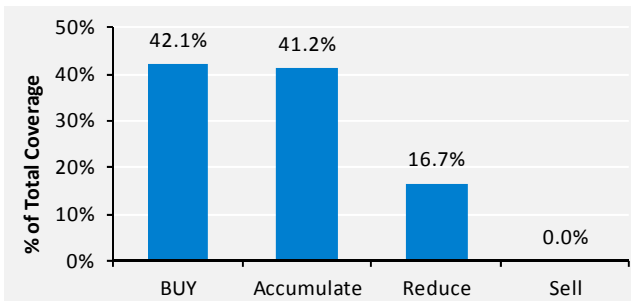
| Y/e March | 2015 | 2016 | 2017E | 2018E |
|-------------------|-------|-------|-------|-------|
| Revenue (US\$ mn) | 3,686 | 4,037 | 4,340 | 4,694 |

Source: Company Data, PL Research.

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| | | |
|--------------------------|---|--|
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