

October 28, 2016

Govind Agarwal
govindagarwal@plindia.com
+91-22-66322300

| | |
|----------------|------------|
| Rating | BUY |
| Price | Rs415 |
| Target Price | Rs525 |
| Implied Upside | 26.5% |
| Sensex | 27,916 |
| Nifty | 8,615 |

(Prices as on October 27, 2016)

Trading data

| | |
|----------------------------|--------|
| Market Cap. (Rs bn) | 362.8 |
| Shares o/s (m) | 874.5 |
| 3M Avg. Daily value (Rs m) | 1049.9 |

Major shareholders

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

Stock Performance

| (%) | 1M | 6M | 12M |
|----------|-------|--------|--------|
| Absolute | (5.8) | (12.6) | (23.6) |
| Relative | (4.7) | (19.7) | (26.0) |

How we differ from Consensus

| EPS (Rs) | PL | Cons. | % Diff. |
|----------|------|-------|---------|
| 2017 | 35.1 | 35.1 | 0.0 |
| 2018 | 36.6 | 40.0 | -8.6 |

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



Source: Bloomberg

Tech Mahindra's (TECHM's) Q2FY17 revenues and margins were ahead of estimates. Revenues grew 5% QoQ in CC terms and organic growth was 2.5%. Revenue growth was aided by recovery in Telecom vertical which grew 2.4%QoQ after a weak performance in the past few quarters. EBIT margins were largely in-line with estimates. Company took a one-time, restructuring charge of US\$13m in the quarter which impacted margins by ~120bps.

Management has indicated improved outlook in Telecom business and Enterprise business remains steady. TECHM signed three large deals in the quarter. We expect gradual recovery in the business, going forward. Stock is inexpensive at 11.5x FY18 EPS and improvement in performance should drive stock returns. Retain "BUY" with a TP of Rs525.

- **Revenue beat; margins in line:** Revenue for Q2FY17 grew by 5/7.5% QoQ/YoY in CC terms and 4/6% QoQ/YoY in USD terms to US\$1,072.4m (PL: US\$1,062m, Cons: US\$1,058m). Organic revenues grew 2.5% QoQ in CC terms. Adjusted EBIT margins for the quarter at 12.7% were in line with estimates. Margins were impacted by 120bps of one-time restructuring costs. Net Profit was Rs6,447m, down 14% QoQ, due to lower other income and higher tax rate. EPS for the quarter was down 14% QoQ at Rs7.4 (PL: Rs8.4)

- **Core telecom growth recovers:** Telecom business recovered in the quarter and grew 2.4% QoQ. While the core telecom business will be stable, LCC will recover in the next few quarters. Manufacturing, Retail and BFS led growth amongst verticals by growing at 10.3/8.8 and 5.8% QoQ respectively. Amongst geographies, growth was led by Europe which grew by 9.1% QoQ followed by North America which grew by 2.5% QoQ. Growth in Manufacturing, BFS and Europe was aided by acquisitions. Company also added seven new clients, increasing the total clients to 825 in Q2FY17.

Key financials (Y/e March)

| | 2015 | 2016 | 2017E | 2018E |
|-----------------|---------|---------|---------|---------|
| Revenues (Rs m) | 226,213 | 264,941 | 286,639 | 307,048 |
| Growth (%) | 20.1 | 17.1 | 8.2 | 7.1 |
| EBITDA (Rs m) | 41,920 | 43,426 | 44,354 | 47,340 |
| PAT (Rs m) | 26,275 | 33,905 | 30,697 | 32,003 |
| EPS (Rs) | 30.0 | 38.8 | 35.1 | 36.6 |
| Growth (%) | (4.3) | 29.0 | (9.5) | 4.3 |
| Net DPS (Rs) | 6.6 | 7.5 | 8.8 | 8.8 |

Profitability & Valuation

| | 2015 | 2016 | 2017E | 2018E |
|------------------------|------|------|-------|-------|
| EBITDA margin (%) | 18.5 | 16.4 | 15.5 | 15.4 |
| RoE (%) | 24.6 | 24.9 | 19.0 | 17.2 |
| RoCE (%) | 20.7 | 21.7 | 17.3 | 15.7 |
| EV / sales (x) | 1.5 | 1.3 | 1.1 | 1.0 |
| EV / EBITDA (x) | 8.2 | 7.7 | 7.2 | 6.5 |
| PE (x) | 13.8 | 10.7 | 11.8 | 11.3 |
| P / BV (x) | 3.0 | 2.4 | 2.1 | 1.8 |
| Net dividend yield (%) | 1.6 | 1.8 | 2.1 | 2.1 |

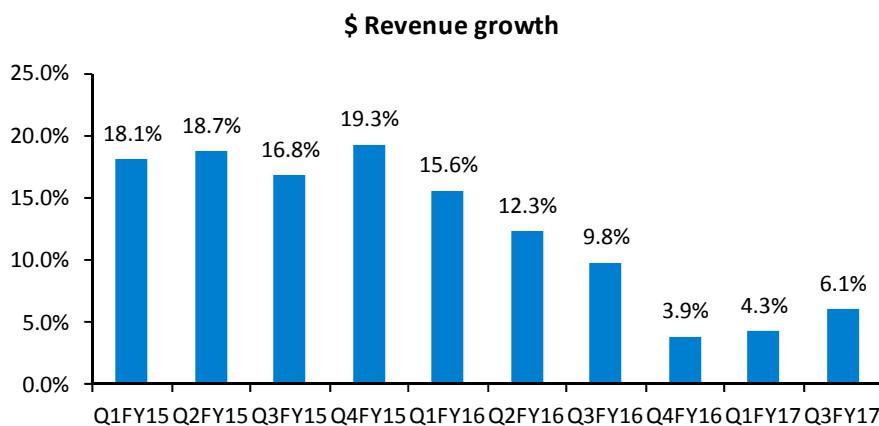
Source: Company Data; PL Research

Exhibit 1: Q2FY17 –(Rs m)- Revenue beat ; Telecom business back on track

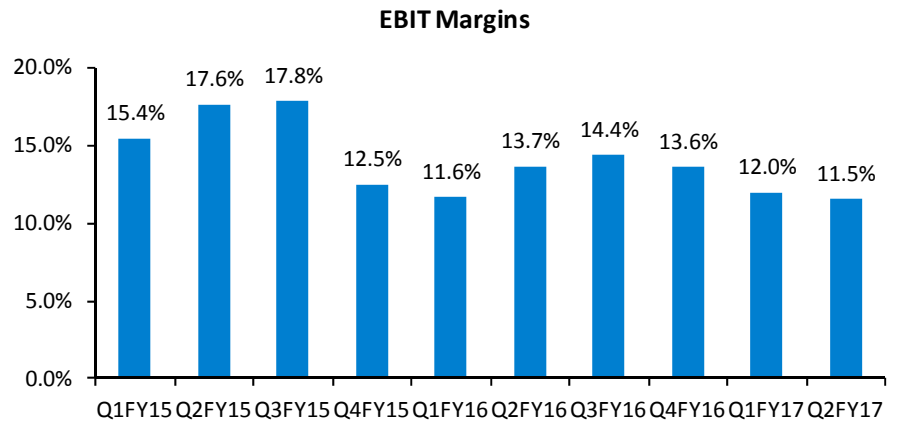
| Y/e March | Q2FY17 | Q1FY17 | QoQ gr. | Q2FY16 | YoY gr. | Cons (e) | PLe | Variance |
|----------------------|--------------|--------------|---------|--------------|---------|--------------|--------------|----------|
| Sales (\$ m) | 1,072.4 | 1,031.5 | 4.0% | 1,011.0 | 6.07% | 1,058.6 | 1,062.4 | 0.9% |
| Sales | 71,674 | 69,209 | 3.6% | 66,155 | 8.3% | 70,783 | 71,035 | 0.9% |
| EBITDA | 10,701 | 10,290 | 4.0% | 11,010 | -2.8% | 10,600 | 10,655 | 0.4% |
| <i>EBITDA Margin</i> | <i>14.9%</i> | <i>14.9%</i> | | <i>16.6%</i> | | <i>15.0%</i> | <i>15.0%</i> | |
| PBT | 9,296 | 10,455 | -11.1% | 10,521 | -11.6% | 9,750 | 9,495 | -2.1% |
| Tax | 2,860 | 2,468 | 15.9% | 2,604 | 9.8% | 2,750 | 2,231 | 28.2% |
| <i>Tax Rate</i> | <i>30.8%</i> | <i>23.6%</i> | | <i>24.8%</i> | | <i>28.2%</i> | <i>23.5%</i> | |
| Net Income | 6,447 | 7,500 | -14.0% | 7,855 | -17.9% | 7,000 | 7,184 | -10.3% |
| EPS (Diluted) (Rs) | 7.4 | 8.6 | -14.0% | 9.0 | -17.9% | 7.9 | 8.2 | -10.1% |

Source: Company Data, Bloomberg, PL Research

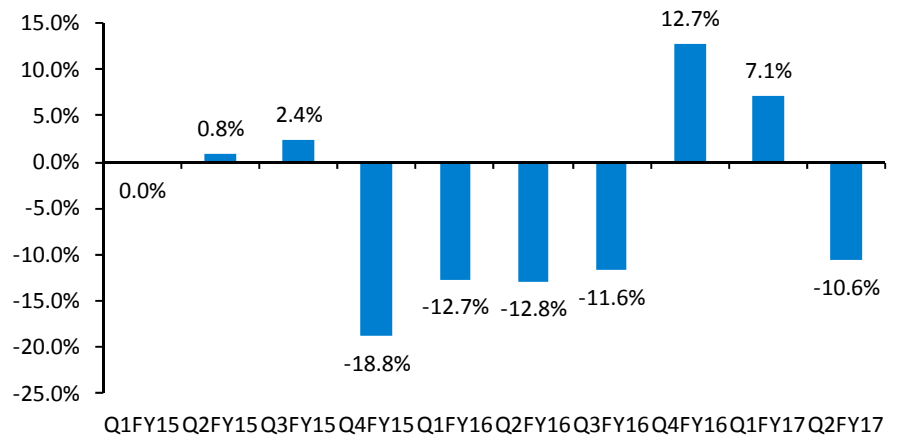
- Revenues for the quarter grew by 4/6%, respectively, on QoQ/YoY basis, which is higher than our estimates by 1%
- EBITDA Margins were impacted by US\$13m (120bps) of one-time restructuring costs and hence, were at 14.9% for the quarter. However, excluding the restructuring costs, margins were at 16.1%, which was 40bps ahead of our estimates.
- As a consequence of the one-time cost, EBITDA was at Rs10,701m (up 4% QoQ, -2.8% YoY).
- EBIT was impacted this quarter due to growth in depreciation & amortization by ~20% due to amortization on acquisitions and higher capital expenditure over the last few quarters.
- EPS for the quarter declined by 14% QoQ at Rs 7.4

Exhibit 2: Revenue growth improved on YoY basis


Source: Company Data, PL Research

Exhibit 3: EBIT Margin impacted by higher depreciation charges


Source: Company Data, PL Research

Exhibit 4: USD EBIT growth YoY declines


Source: Company Data, PL Research

Exhibit 5: Europe contributed to the growth

| USD growth | Revenue contribution | QoQ gr. | YoY gr. |
|---------------|----------------------|---------|---------|
| North America | 48.3% | 2.5% | 4.8% |
| Europe | 29.7% | 9.1% | 7.5% |
| RoW | 22.0% | 0.3% | 6.6% |

Source: Company Data, PL Research

Exhibit 6: Manufacturing, BFS and retail led growth

| USD growth | Revenue contribution | QoQ gr. | YoY gr. |
|------------------------------------|----------------------|---------|---------|
| Telecom | 48.4% | 2.3% | -3.0% |
| Manufacturing | 19.2% | 10.3% | 22.0% |
| Technology, Media & Entertainment | 7.2% | -0.2% | -6.9% |
| BFSI | 11.5% | 5.8% | 27.1% |
| Retail, Transportation & Logistics | 6.8% | 8.8% | 20.2% |
| Others | 6.8% | -3.2% | 9.3% |

Source: Company Data, PL Research

Exhibit 7: Growth across all clients QoQ

| USD growth | Revenue contribution | QoQ gr. | YoY gr. |
|----------------|----------------------|---------|---------|
| Top 5 Clients | 28.5% | 2.9% | -5.5% |
| Top 10 Clients | 39.9% | 3.7% | -1.6% |
| Top 20 Clients | 51.7% | 2.2% | -2.1% |

Source: Company Data, PL Research

Exhibit 8: Headcount details

| Client data | Q3FY15 | Q4FY15 | Q1FY16 | Q2FY16 | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 |
|--|---------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Software Professionals | 68,742 | 74,048 | 73,046 | 73,046 | 72,828 | 72,125 | 73,590 | 78,404 |
| BPO Professionals | 23,566 | 22,693 | 24,394 | 24,394 | 28,279 | 27,254 | 27,326 | 27,669 |
| Sales & Support | 5,701 | 6,540 | 6,233 | 6,233 | 6,030 | 6,053 | 6,300 | 6,813 |
| TOTAL | 98,009 | 103,281 | 103,673 | 103,673 | 107,137 | 105,432 | 107,216 | 112,886 |
| Net addition | | | | | | | | |
| Software Professionals | 1,377 | 5,306 | (1,002) | (1,002) | (218) | (921) | 1,465 | 4,814 |
| BPO Professionals | 1,133 | (873) | 1,701 | 1,701 | 3,885 | 2,860 | 72 | 343 |
| Sales & Support | 190 | 839 | (307) | (307) | (203) | (180) | 247 | 513 |
| TOTAL | 2,700 | 5,272 | 392 | 392 | 3,464 | 1,759 | 1,784 | 5,670 |
| <i>Net Addition (% of prev-qtr end head-count)</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>1.7%</i> | <i>5.3%</i> |
| Attrition | 19.0% | 19.0% | 19.0% | 20.0% | 20.0% | 21.0% | 21% | 19% |

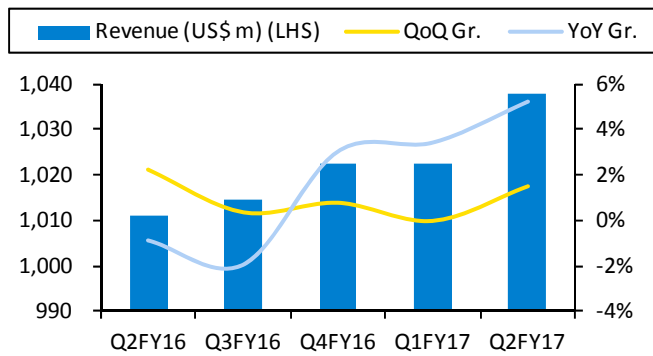
Source: Company Data, PL Research

Exhibit 9: Overview of the company's operating metrics over the last few quarters

| Revenue by verticals (%) | Q3FY15 | Q4FY15 | Q1FY16 | Q2FY16 | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Telecom | 50.9% | 55.3% | 52.7% | 52.9% | 51.3% | 50.9% | 49.2% | 48.4% |
| Manufacturing | 19.7% | 16.5% | 17.1% | 16.7% | 17.1% | 17.1% | 18.1% | 19.2% |
| Technology, Media & Entertainment | 7.3% | 7.0% | 7.3% | 8.2% | 7.4% | 7.5% | 7.5% | 7.2% |
| BFSI | 9.8% | 9.1% | 10.0% | 9.6% | 9.8% | 10.6% | 11.3% | 11.5% |
| Retail, Transportation & Logistics | 6.4% | 6.2% | 6.5% | 6.0% | 6.8% | 6.2% | 6.5% | 6.8% |
| Others | 6.0% | 6.0% | 6.5% | 6.6% | 7.6% | 7.7% | 7.3% | 6.8% |
| Revenue by geography (%) | | | | | | | | |
| North America | 48.8% | 45.4% | 47.7% | 48.9% | 47.8% | 46.8% | 49.0% | 48.3% |
| Europe | 31.4% | 29.8% | 29.4% | 29.3% | 28.9% | 28.5% | 28.3% | 29.7% |
| RoW | 19.8% | 24.8% | 22.9% | 21.9% | 23.2% | 24.7% | 22.8% | 22.0% |
| Revenue by clients (%) | | | | | | | | |
| Top 5 | 37.0% | 33.1% | 33.0% | 32.0% | 28.3% | 27.9% | 28.8% | 28.5% |
| Top 10 | 49.0% | 45.4% | 44.0% | 43.0% | 39.5% | 39.0% | 40.0% | 39.9% |
| Top 20 | 61.0% | 56.7% | 57.0% | 57.0% | 52.3% | 51.9% | 52.6% | 51.7% |
| Client Count | | | | | | | | |
| No. of Active Clients | 674 | 767 | 770 | 788 | 801 | 807 | 818 | 825 |
| % of repeat business | 94.7% | 82.2% | 98.6% | 96.8% | 95.7% | 96.3% | 96.3% | 95.6% |
| No. of Million \$ Clients | | | | | | | | |
| >1m | 254 | 291 | 296 | 298 | 326 | 319 | 317 | 341 |
| >5m | 88 | 96 | 101 | 102 | 105 | 112 | 120 | 120 |
| >10m | 51 | 56 | 60 | 62 | 63 | 63 | 64 | 66 |
| >20m | 32 | 35 | 36 | 36 | 37 | 40 | 42 | 40 |
| >50m | 13 | 13 | 13 | 14 | 14 | 14 | 14 | 14 |
| Other details | | | | | | | | |
| DSO Days | 100 | 104 | 113 | 108 | 104 | 106 | 106 | 107 |

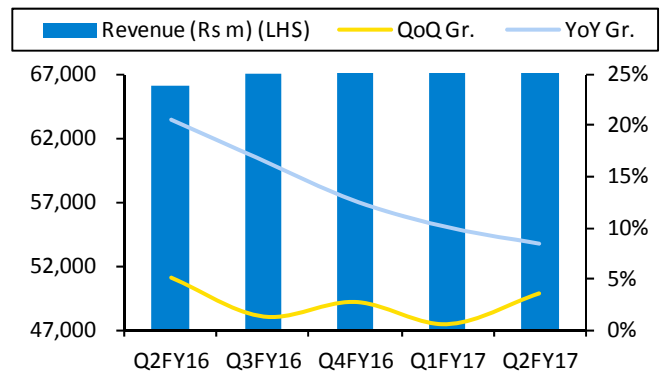
Source: Company Data, PL Research

Exhibit 10: USD revenue (Organic) growth trend



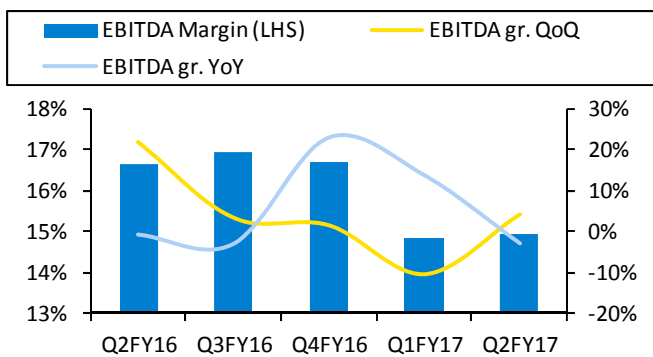
Source: Company Data, PL Research

Exhibit 11: INR Revenue movement over the last few quarters



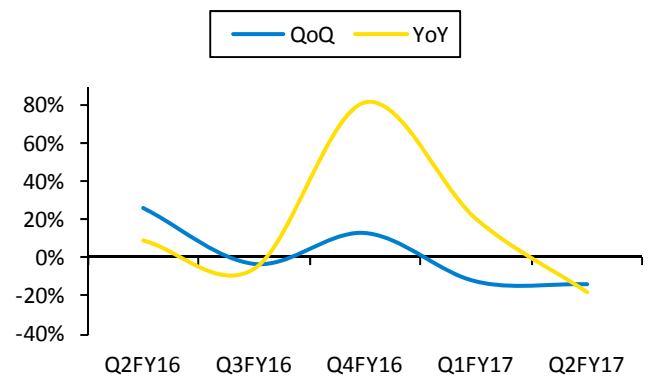
Source: Company Data, PL Research

Exhibit 12: EBITDA growth and margin trend



Source: Company Data, PL Research

Exhibit 13: 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 | 286,639 | 307,048 |
| Raw Material Expenses | 151,186 | 183,575 | 201,515 | 216,670 |
| Gross Profit | 75,027 | 81,367 | 85,124 | 90,378 |
| Employee Cost | — | — | — | — |
| Other Expenses | 33,107 | 37,940 | 40,771 | 43,038 |
| EBITDA | 41,920 | 43,426 | 44,354 | 47,340 |
| Depr. & Amortization | 6,114 | 7,620 | 8,257 | 9,043 |
| Net Interest | 691 | 961 | 675 | 675 |
| Other Income | 1,065 | 5,322 | 6,195 | 5,191 |
| Profit before Tax | 36,180 | 40,167 | 41,617 | 42,814 |
| Total Tax | 9,596 | 5,864 | 9,780 | 10,061 |
| Profit after Tax | 26,584 | 34,303 | 31,837 | 32,753 |
| Ex-Od items / Min. Int. | 309 | 398 | 1,140 | 750 |
| Adj. PAT | 26,275 | 33,905 | 30,697 | 32,003 |
| Avg. Shares O/S (m) | 874.5 | 874.5 | 874.5 | 874.5 |
| EPS (Rs.) | 30.0 | 38.8 | 35.1 | 36.6 |

Cash Flow Abstract (Rs m)

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|---------------------|----------|----------|----------|----------|
| C/F from Operations | 23,974 | 30,385 | 35,903 | 37,854 |
| C/F from Investing | (20,804) | (10,598) | (14,332) | (15,352) |
| C/F from Financing | (7,899) | 3,054 | (7,652) | (7,652) |
| Inc. / Dec. in Cash | (4,729) | 22,842 | 13,919 | 14,849 |
| Opening Cash | 14,519 | 12,060 | 34,902 | 48,820 |
| Closing Cash | 12,060 | 34,902 | 48,820 | 63,670 |
| FCFF | 5,852 | 19,390 | 20,431 | 21,751 |
| FCFE | 12,074 | 19,390 | 20,431 | 21,751 |

Key Financial Metrics

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|-------------------------|--------|-------|-------|-------|
| Growth | | | | |
| Revenue (%) | 20.1 | 17.1 | 8.2 | 7.1 |
| EBITDA (%) | 0.2 | 3.6 | 2.1 | 6.7 |
| PAT (%) | (10.4) | 29.0 | (9.5) | 4.3 |
| EPS (%) | (4.3) | 29.0 | (9.5) | 4.3 |
| Profitability | | | | |
| EBITDA Margin (%) | 18.5 | 16.4 | 15.5 | 15.4 |
| PAT Margin (%) | 11.6 | 12.8 | 10.7 | 10.4 |
| RoCE (%) | 20.7 | 21.7 | 17.3 | 15.7 |
| RoE (%) | 24.6 | 24.9 | 19.0 | 17.2 |
| Balance Sheet | | | | |
| Net Debt : Equity | (0.1) | (0.2) | (0.2) | (0.3) |
| Net Wrkng Cap. (days) | 35 | 42 | 43 | 43 |
| Valuation | | | | |
| PER (x) | 13.8 | 10.7 | 11.8 | 11.3 |
| P / B (x) | 3.0 | 2.4 | 2.1 | 1.8 |
| EV / EBITDA (x) | 8.2 | 7.7 | 7.2 | 6.5 |
| EV / Sales (x) | 1.5 | 1.3 | 1.1 | 1.0 |
| Earnings Quality | | | | |
| Eff. Tax Rate | 26.5 | 14.6 | 23.5 | 23.5 |
| Other Inc / PBT | 2.9 | 13.2 | 14.9 | 12.1 |
| Eff. Depr. Rate (%) | 10.2 | 10.8 | 9.7 | 9.0 |
| FCFE / PAT | 46.0 | 57.2 | 66.6 | 68.0 |

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|-------------------------------|----------------|----------------|----------------|----------------|
| Shareholder's Funds | 122,058 | 149,802 | 173,987 | 199,087 |
| Total Debt | 6,746 | 6,746 | 6,746 | 6,746 |
| Other Liabilities | 18,446 | 18,446 | 18,446 | 18,446 |
| Total Liabilities | 147,250 | 174,994 | 199,179 | 224,279 |
| Net Fixed Assets | 28,723 | 34,077 | 40,152 | 46,462 |
| Goodwill | 17,283 | 17,283 | 17,283 | 17,283 |
| Investments | 21,028 | 21,028 | 21,028 | 21,028 |
| Net Current Assets | 63,685 | 86,075 | 104,185 | 122,976 |
| <i>Cash & Equivalents</i> | <i>24,049</i> | <i>34,902</i> | <i>48,820</i> | <i>63,670</i> |
| <i>Other Current Assets</i> | <i>90,436</i> | <i>105,614</i> | <i>114,263</i> | <i>122,398</i> |
| <i>Current Liabilities</i> | <i>50,800</i> | <i>54,440</i> | <i>58,899</i> | <i>63,092</i> |
| Other Assets | 16,962 | 16,962 | 16,962 | 16,962 |
| Total Assets | 147,681 | 175,425 | 199,610 | 224,711 |

Quarterly Financials (Rs m)

| Y/e March | Q3FY16 | Q4FY16 | Q1FY17 | Q2FY17 |
|--------------------------|---------------|---------------|---------------|---------------|
| Net Revenue | 67,011 | 68,837 | 69,209 | 71,674 |
| EBITDA | 11,358 | 11,510 | 10,290 | 10,701 |
| <i>% of revenue</i> | <i>16.9</i> | <i>16.7</i> | <i>14.9</i> | <i>14.9</i> |
| Depr. & Amortization | 1,736 | 2,174 | 2,019 | 2,447 |
| Net Interest | 244 | 340 | 274 | 345 |
| Other Income | 639 | 1,603 | 2,458 | 1,387 |
| Profit before Tax | 10,017 | 10,599 | 10,455 | 9,296 |
| Total Tax | 2,327 | 1,806 | 2,468 | 2,860 |
| Profit after Tax | 7,593 | 8,581 | 7,500 | 6,447 |
| Adj. PAT | 7,593 | 8,581 | 7,500 | 6,447 |

Key Operating Metrics

| Y/e March | 2015 | 2016 | 2017E | 2018E |
|-------------------|-------|-------|-------|-------|
| Revenue (US\$ mn) | 3,686 | 4,037 | 4,278 | 4,583 |

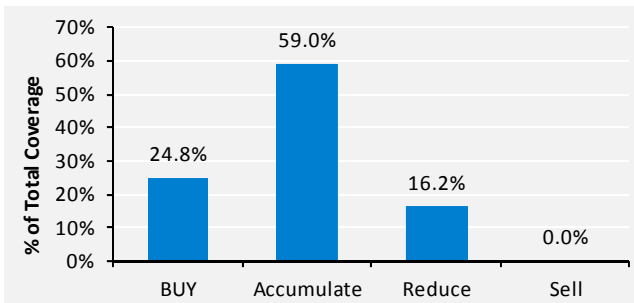
Source: Company Data, PL Research.

Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

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