

Tech Mahindra

BSE SENSEX
29,048

S&P CNX
8,963

CMP: INR499 TP: INR580 (+16%)

Buy



Stock Info

Bloomberg	TECHM IN
Equity Shares (m)	973
52-Week Range (INR)	557 / 405
1, 6, 12 Rel. Per (%)	1/4/-7
M.Cap. (INR b)	486.0
M.Cap. (USD b)	7.3
Avg Val, INRm	1,100
Free float (%)	63.8

Financials Snapshot (INR b)

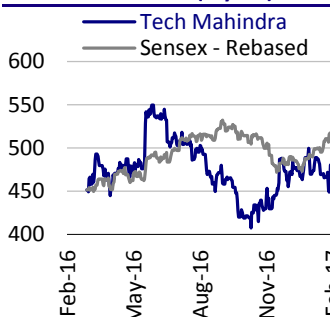
Y/E Mar	2017E	2018E	2019E
Sales	293.7	339.3	371.8
EBITDA	44.6	52.6	58.9
Adj. PAT	29.8	32.6	36.9
Adj. EPS (INR)	33.6	36.7	41.5
EPS Gr. (%)	-4.3	9.4	13.0
BV/Sh.(INR)	175.1	198.2	230.1
RoE (%)	20.1	20.0	19.7
RoCE (%)	16.6	17.1	17.2
P/E (x)	14.9	13.6	12.0
P/BV (x)	2.9	2.5	2.2

Shareholding pattern (%)

As On	Dec-16	Sep-16	Dec-15
Promoter	36.3	36.3	36.5
DII	15.4	10.9	12.3
FII	34.6	39.3	36.8
Others	13.8	13.5	14.5

FII Includes depository receipts

Stock Performance (1-year)



Acquires a Healthcare IT Services Company

TECHM announced the acquisition of The HCI Group (HCI), which is focused on the healthcare provider space and specializes in the implementation of Electronic Medical Records (EMR) software.

- LTM revenue of USD114m would imply addition of 2.6% to FY17E's revenue base (assuming no growth). Single-digit margins, however, would result in it being only mildly EPS accretive.
- TECHM's current Healthcare practice is ~5% of total revenue (with negligible exposure to US provider segment), adding a new segment to its portfolio.
- It is paying <1x revenue for the acquisition (which could go up to ~1.2x subject to meeting performance targets); acquiring 85% stake upfront and the remainder to follow over next three years with a cap on consideration at USD131m.

About The HCI Group

- The HCI Group is a provider of IT services to healthcare providers. It is based out of the US and specializes in EHR/EMR implementation and ancillary services (advisory, support, training, etc.)
- HCI is an implementer for Epic and Cerner, which are leading healthcare software. Apart from the US, it has presence in Europe, ME and APAC, and employs more than 500 people globally.
- Revenue grew 9% to USD76m in CY15, but saw a jump subsequently to USD114m in TTM September 2016. Bulk of TTM growth was organic in nature.

Transaction details

- TECHM would acquire 84.7% of HCI. The remaining 15.3% would be acquired over next three years.
- USD89.5m would be paid upfront in cash. Maximum consideration will be capped at USD130.5m, based on the achievement of revenue and EBITDA targets over this period.
- Enterprise value of USD110m entails payment of ~1x revenue.

Impact on TECHM

- The acquisition would enable TECHM to penetrate the healthcare provider space. At the moment, it classifies Healthcare in its 'Others' segment, which totals ~7% of overall revenue. We reckon Healthcare would form ~5% of total revenue. The acquisition would hence add a vertical to TECHM's portfolio.
- USD89.5m would be paid upfront in cash, and the consequent other income forgone (post tax) is ~1% of earnings.
- Based on the financials, we have revised our revenue estimates for TECHM by 2.5% in each of FY18 and FY19. However, due to single-digit-margins in HCI, higher amortization, and lower other income because of reduced cash, our EPS estimates have changed by merely 0.1/0.6%. Maintain **Buy**.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Exhibit 1: Change in estimates

	Revised			Earlier			Change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
INR/USD	67.4	70.0	70.4	67.4	70.0	70.4	0.0%	0.0%	0.0%
USD Revenue - m	4,356	4,850	5,281	4,356	4,731	5,154	0.0%	2.5%	2.5%
USD rev Gr.(%)	7.9	11.3	8.9	7.9	8.6	8.9	0bp	274bp	-6bp
EBIDTA Margin (%)	15.2	15.5	15.8	15.2	15.8	16.0	0bp	-30bp	-21bp
EPS - INR	33.6	36.7	41.5	33.6	36.6	41.2	0.0%	0.1%	0.6%

Source: Company, MOSL

Valuation view

- Excluding the seasonal Comviva business and the restructuring networks acquisition of LCC, this was the third quarter of sequential uptick in Telecom business. Last two quarters saw stabilization of Telecom business and return to growth for top-5 accounts, and this quarter saw further improvement with broad-based traction and recovery in margins.
- While Telecom recovery may be gradual, there are some structural strengths in TECHM's business to drive much improved growth over the medium-to-long term:
 1. Success in large deal wins and above-industry growth in the Enterprise segment is an encouraging indicator of improving competitive prowess.
 2. Network management services have potentially expanded the addressable market for TECHM, with directly addressable spend standing at ~USD40b. That may not start playing out until TECHM brings the LCC house in order (revenue has been pruned down to ~USD300-310m annualized in run rate USD430m during acquisition 1 year ago).
 3. TECHM also has a sizeable scale in Engineering services, and the opportunity in the same can be leveraged, especially after the acquisition of Mahindra Engineering Services (MES)
- Profitability took a hit after seeing gradual recovery ensued post 4QFY15. Improvement of operational parameters, cost optimization methods, automation and industrialization, pyramid rationalization, offshoring and integration of acquisitions leave more room for improvement in the medium term. However, with multiple acquisitions integrated at lower margins, we believe TECHM will do well to sustain EBITDA margin in the 16-17% band. Any further uptick would be a function of stronger revival in Telecom growth.
- We expect TECHM to grow its USD revenue at a CAGR of 10% over FY17-19 and EPS at a CAGR of 13% during this period. The stock trades at 13.6/12.0x FY18/19E EPS. TECHM's gradual improvement in business gains further weight with likewise positive commentary by peers too on the segment. We expect that to facilitate some catch up on valuations by TECHM to peers, driving valuation outperformance. Our price target of INR580 discounts FY19E earnings by 14x (in line with historical average). **Buy.**

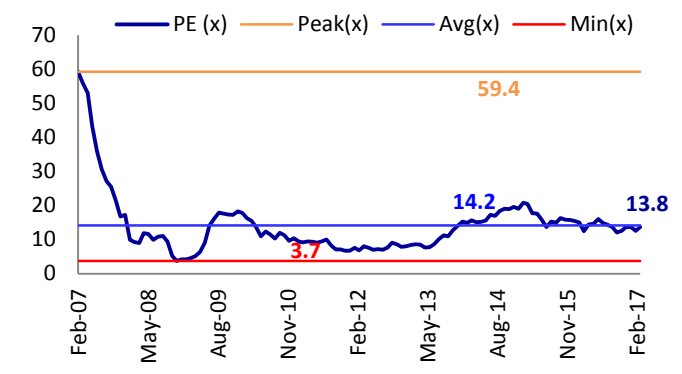
Key Triggers

- Large deal announcements in enterprise segment
- Recovery in Telecom growth
- Sustained margin improvement on account of measures taken

Key Risks

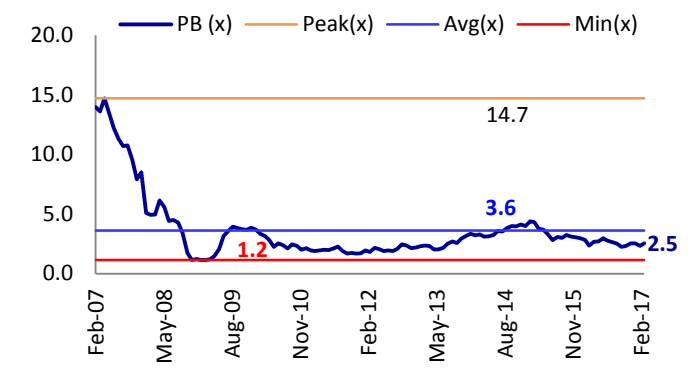
- Adverse visa related regulations as TECHM’s proportion of local resources at onsite is lower than peers
- Currency fluctuations given higher sensitivity to earnings v/s peers
- More adversity in integration of acquisitions

Exhibit 2: TECHM 1-year forward P/E chart



Source: Company, MOSL

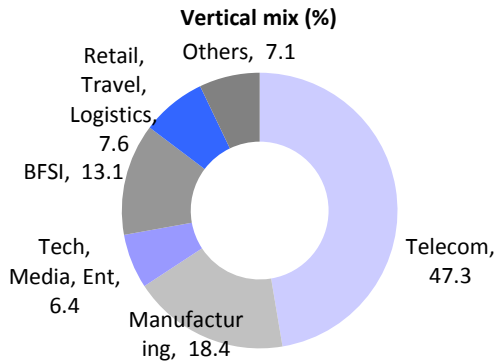
Exhibit 3: TECHM 1-year forward P/B chart



Source: Company, MOSL

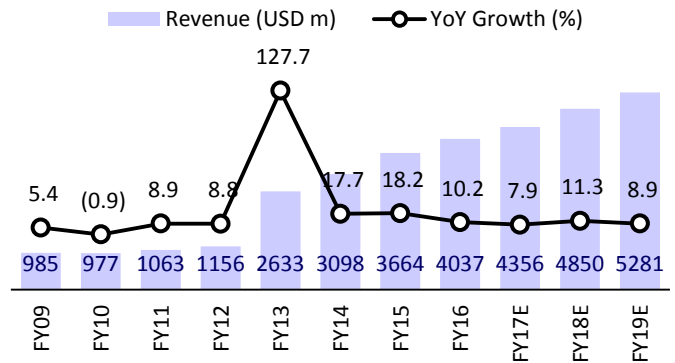
Story in charts

Exhibit 4: Telecom prowess reflected in vertical mix



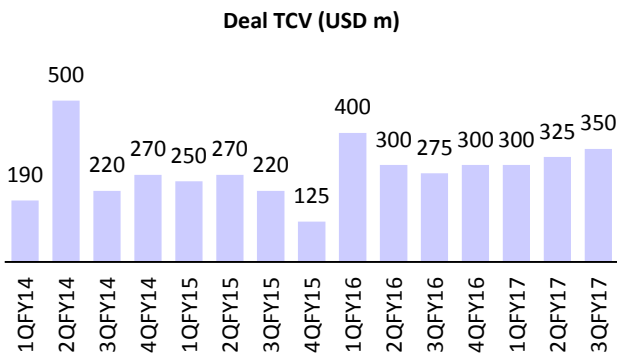
Source: Company, MOSL

Exhibit 5: Scale and diversity lent by Satyam acquisition



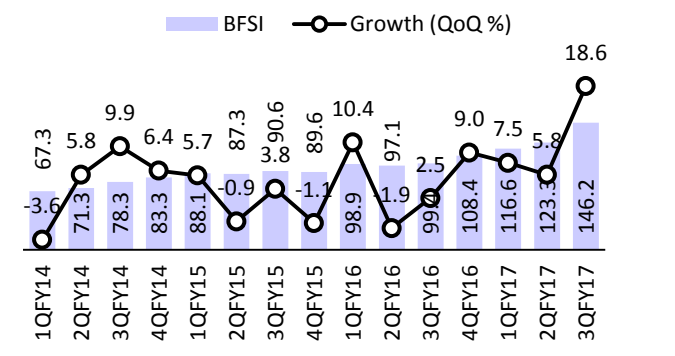
Source: Company, MOSL

Exhibit 6: LTM deal wins up 16% YoY



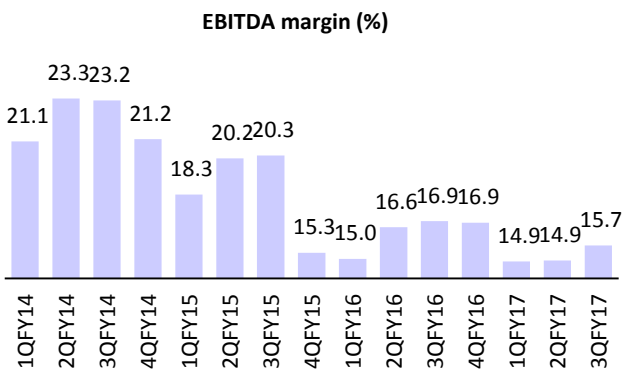
Source: Company, MOSL

Exhibit 7: BFSI showing increased momentum



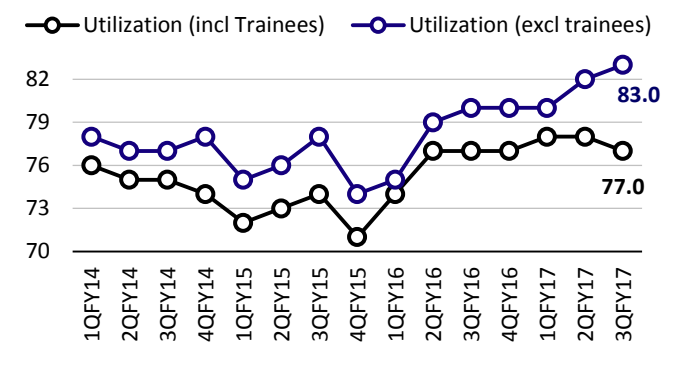
Source: Company, MOSL

Exhibit 8: Margin recovery has begun after a sharp fall



Source: Company, MOSL

Exhibit 9: Significantly aided by utilization



Source: Company, MOSL

Exhibit 10: Operating metrics

Operating metrics	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17
Revenue by geography (%)										
Americas	49.1	48.8	45.4	47.7	48.9	47.8	46.8	49.0	48.3	46.7
Europe	31.2	31.4	29.8	29.4	29.3	28.9	28.5	28.28	29.7	29.4
Rest of World	19.8	19.8	24.8	22.9	21.9	23.2	24.7	22.78	22	23.9
Vertical Split (%)										
Telecom	52	50.9	55.3	52.7	52.9	51.3	50.9	49.24	48.4	47.3
Manufacturing	17.7	19.7	16.5	17.1	16.7	17.1	17.1	18.14	19.2	18.4
Tech Media Entertainment	8.3	7.3	7	7.3	8.2	7.4	7.5	7.5	7.2	6.4
BFSI	9.7	9.8	9.1	10	9.6	9.8	10.6	11.3	11.5	13.1
Retail Transport Logistics	6.2	6.4	6.2	6.5	6.0	6.8	6.2	6.5	6.8	7.6
Others	6.1	5.9	5.9	6.5	6.6	7.6	7.7	7.3	6.8	7.1
Onsite-offshore mix (%)										
Onsite	55.2	55.3	61.1	61.0	61.7	62.7	63.2	63.4	63.5	63.9
Offshore	44.8	44.7	38.9	39.0	38.3	37.3	36.8	36.6	36.5	36.1
Client metrics										
No. of active clients	649	674	767	770	788	801	807	818	825	837
% of repeat business	97	95	82	99	97	96	96.3	96.3	95.6	93.4
No. of Million \$ clients										
USD1m+	245	254	291	296	298	326	319	317	341	356
USD5m+	86	88	96	101	102	105	112	120	120	128
USD10m+	50	51	56	60	62	63	63	64	66	65
USD20m+	30	32	35	36	36	37	40	42	40	38
USD50m+	12	13	13	13	14	14	14	14	14	14
Client concentration (%)										
Top client										
Top 5 Clients	40	37	33	33	32	28	28	28.8	28.5	27.8
Top 6-10	11	12	12	11	11	12	11	11.2	11.4	10.6
Top 11-20	12	12	12	13	13	12	13	12.6	11.8	12.1
Headcount (end of period)										
Software professionals	66,175	67,592	72,952	71,997	71,657	71,892	72,125	73,590	78,404	80,858
BPO	22,433	23,566	22,693	24,394	26,513	28,279	27,254	27,326	27,669	29,372
Sales and Support	6,701	6,851	7,636	7,282	7,065	6,966	6,053	6,300	5,670	6,865
Total	95,309	98,009	103,281	103,673	105,235	107,137	105,432	107,216	111,743	117,095
IT Attrition (LTM) (%)										
IT Attrition (LTM) (%)	18	19	19	19	20	20	21	21	19	18
IT Utilization (%)										
IT Utilization (%)	73	74	71	74	77	77	77	78	78	77
IT Utilization (excluding trainees) (%)										
IT Utilization (excluding trainees) (%)	76	78	74	75	79	80	80	80	82	83
Receivable Days (DSO)-Including Unbilled										
Receivable Days (DSO)-Including Unbilled	102	100	104	113	108	104	106	106	107	102
Borrowings (USD m)										
Borrowings (USD m)	10.2	10.2	112	125.7	130.2	134.3	164.8	200	206.3	211
Cash and Cash Equivalent (USD m)										
Cash and Cash Equivalent (USD m)	556	668.4	514	526.3	532.5	746.8	783.3	851.2	600.7	728.9
Capital Expenditure (USD m)										
Capital Expenditure (USD m)	38.5	53.5	30.9	41.4	40.0	19.3	63.8	23.5	50.4	28.1

Source: Company, MOSL

Exhibit 11: Operating metrics

Operating metrics	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17
Rupee USD Rate										
Period closing rate	61.5	63.04	62.5	63.64	65.58	66.15	66.26	67.52	66.61	67.92
Period average Rate	60.94	62.15	62.07	63.63	65.40	66.03	67.49	67.04	66.86	67.7
Proportion of Revenues From Major Currencies										
USD	51.5	51.1	51.1	51.1	52.4	51.3	49.3	50.0	48.9	48.6
GBP	16.1	14.9	12.9	13.2	12.7	11.4	10.8	10.4	11	12
EURO	10.3	11.9	12.6	11.7	11.8	11.3	11.3	11.2	12.7	11.5
AUD	6.4	5.8	4.6	5	4.5	4.7	4.5	4.7	4.6	4.4
Others	15.6	16.4	18.9	18.9	18.5	21.3	24.1	23.7	22.7	23.5
Consolidated Hedge Position										
GBP In Mn	123.3	108	187.3	185	166.8	173.3	177.9	185.5	192.6	226.7
Strike rate (INR)	99.9	103.7	102.1	103	105.8	106.9	108.4	107.1	104.8	100.2
USD In Mn	1224.2	1582.5	1370.2	1459.3	1504.5	1341.7	1297.2	1246.6	1087.9	1123.2
Strike rate (INR)	63	65.2	66	66.6	68.5	69.5	71.1	71.5	72.4	72.5
Verticals (QoQ)										
Telecom	7.9	0.5	15.7	-4.2	2.6	-2.7	0.0	-2.4	2.2	1.7
Manufacturing	4.6	14.3	-10.8	4.2	-0.2	2.8	0.8	7.0	10.0	-0.3
Tech Media Entertainment	-1.9	-9.7	2.1	4.8	14.8	-9.4	2.1	0.9	-0.2	-7.5
BFSI	-0.9	3.8	-1.1	10.4	-1.9	2.5	9.0	7.5	5.8	18.6
Retail Transport Logistics	3.6	6.0	3.1	4.6	-4.9	13.7	-8.1	5.8	8.8	16.3
Others	7.0	-0.7	6.5	9.9	4.6	15.6	2.1	-4.4	-3.2	8.7
Total	5.2	2.7	6.5	0.5	2.2	0.4	0.8	0.9	3.9	4.1
Revenue by geography (QoQ)										
Americas	10.4	2.1	-0.9	5.6	4.8	-1.9	-1.3	5.6	2.5	0.6
Europe	5.6	3.4	1.0	-0.8	1.9	-1.0	-0.6	0.1	9.2	3.0
Rest of World	-5.7	2.7	33.4	-7.2	-2.2	6.3	7.3	-7.0	0.4	13.1
Total	5.3	2.6	6.5	0.5	2.3	0.2	0.9	0.9	3.9	4.1
Client concentration (QoQ)										
Top 5	13.8	-5.0	-5.0	0.5	-0.9	-12.2	0.4	4.1	2.9	1.5
Top 6-10	-11.0	12.0	6.5	-7.9	2.2	9.5	-6.8	1.8	5.8	-3.2
Top 11-20	5.2	2.7	6.5	8.9	2.2	-7.4	8.3	-1.5	-2.6	6.7
Net additions										
Software professionals	2,029	1,377	5,306	-1,002	-401	183	-703	1,465	4,814	2,454
BPO	497	1,133	-873	1,701	2,119	1,766	-1,025	72	343	1,703
Sales and Support	54	190	839	-307	-156	-47	23	247	-630	1,195
Total	2,580	2,700	5,272	392	1,562	1,902	-1,705	1,784	4,527	5,352

Source: Company, MOSL

Financials and Valuations

Key assumption

	2012	2013	2014	2015	2016	2017E	2018E	2019E
INR/USD Rate	47.5	54.4	60.8	61.4	65.6	67.4	70.0	70.4
Revenues (USD m)	2,463	2,633	3,098	3,664	4,037	4,356	4,850	5,281
Total Headcount	74,116	83,109	89,441	103,281	105,432	114,980	125,118	135,660
Net Addition		8,993	6,332	13,840	2,151	9,548	10,138	10,542
Per Capita Productivity (USD)		31,678	34,638	35,471	38,294	37,889	38,762	38,928
Utilization incl. Trainees (%)		73.1	73.1	69.9	74.0	73.1	72.5	73.2

Income Statement

(INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Net Sales	54,897	143,320	188,313	224,779	264,941	293,739	339,291	371,778
Change (%)	13.4	161.1	31.4	19.4	17.9	10.9	15.5	9.6
EBITDA	9,194	30,631	41,836	41,536	43,426	44,595	52,643	58,852
EBITDA Margin (%)	16.7	21.4	22.2	18.5	16.4	15.2	15.5	15.8
Depreciation	1,614	3,896	5,221	6,079	7,620	9,476	11,072	11,411
EBIT	7,580	26,735	36,615	35,457	35,806	35,118	41,571	47,441
Interest	1,413	922	673	689	961	1,376	1,429	1,223
Other Income	1,368	2,121	1,129	1,006	5,322	5,339	3,097	2,504
Extraordinary items	-1,618	-2,940	-1,117	0	0	0	0	0
PBT	5,917	24,994	35,954	35,774	40,167	39,082	43,239	48,722
Tax	1,438	6,479	9,790	9,472	8,600	9,744	10,161	11,450
Tax Rate (%)	24.3	25.9	27.2	26.5	21.4	24.9	23.5	23.5
Min. Int. & Assoc. Share	714	301	336	310	412	463	458	400
Reported PAT	9,299	18,214	25,828	25,992	31,155	28,875	32,620	36,873
Adjusted PAT	10,918	19,554	26,945	25,992	31,155	28,875	32,620	36,873
Change (%)	24.2	79.1	37.8	-3.5	19.9	-7.3	13.0	13.0

Balance Sheet

(INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Share Capital	1,275	2,316	2,335	4,804	4,839	4,383	4,383	4,383
Reserves	42,032	66,214	89,469	117,682	138,824	148,680	168,936	196,793
Net Worth	43,307	68,530	91,804	122,486	143,663	153,063	173,319	201,176
Debt	11,266	14,702	8,420	11,287	15,564	21,751	18,516	18,425
Deferred Tax	-998	-3,477	-3,830	-3,901	-5,575	-4,059	-4,059	-4,059
Total Capital Employed	53,575	93,408	110,151	143,780	167,990	187,603	204,623	232,389
Gross Fixed Assets	6,868	22,318	28,606	40,329	43,446	63,481	66,025	66,614
Less: Acc Depreciation	0	0	0	0	0	0	0	0
Net Fixed Assets	6,868	22,318	28,606	40,329	43,446	63,481	66,025	66,614
Capital WIP	1,629	2,595	0	5,677	6,294	3,485	3,485	3,485
Investments	35,876	14,174	14,718	21,028	24,934	25,913	36,783	40,283
Current Assets	20,437	95,541	112,241	127,545	154,821	159,624	177,786	214,898
Inventory	0	0	0	0	0	0	0	0
Debtors	13,172	33,688	43,486	52,059	57,705	64,366	73,257	79,737
Cash & Bank	2,418	34,629	33,202	24,049	40,138	27,473	32,065	59,286
Loans & Adv, Others	4,847	27,224	35,554	51,438	56,978	67,785	72,464	75,875
Curr Liabs & Provns	11,235	41,220	45,415	50,800	61,505	64,900	79,455	92,891
Curr. Liabilities	10,377	8,577	14,722	20,587	22,755	26,796	30,678	33,896
Provisions	858	32,643	30,693	30,213	38,750	38,104	48,777	58,995
Net Current Assets	9,202	54,321	66,827	76,745	93,316	94,724	98,331	122,007
Total Assets	53,575	93,408	110,151	143,779	167,990	187,603	204,623	232,389

Financials and Valuations

Ratios

Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Basic (INR)								
EPS	17.6	22.0	30.7	29.3	35.1	32.5	36.7	41.5
Cash EPS	20.7	28.2	36.9	36.1	43.7	43.1	49.2	54.3
Book Value	84.9	81.4	112.3	142.2	165.6	175.1	198.2	230.1
DPS	1.0	5.0	5.0	6.0	12.0	12.0	12.0	8.8
Payout (incl. Div. Tax.)	5.7	23.1	16.3	20.5	34.2	36.9	32.7	21.1
Valuation(x)								
P/E				17.0	14.2	15.4	13.6	12.0
Cash P/E				13.8	11.4	11.6	10.2	9.2
Price / Book Value				3.5	3.0	2.9	2.5	2.2
EV/Sales				1.8	1.5	1.4	1.2	1.0
EV/EBITDA				9.7	9.1	9.5	7.7	6.4
Dividend Yield (%)				1.2	2.4	2.4	2.4	1.8
Profitability Ratios (%)								
RoE	26.0	32.6	36.4	24.5	23.4	20.1	20.0	19.7
RoCE	13.6	28.7	26.3	20.5	20.1	16.6	17.1	17.2
RoIC	36.6	65.1	46.5	30.0	25.7	19.7	20.5	23.5
Turnover Ratios (%)								
Fixed Asset Turnover (x)	3.9	5.8	7.0	6.0	5.5	5.0	5.0	5.3
Debtors (No. of Days)	85	60	75	78	76	76	74	75
Leverage Ratios (%)								
Net Debt/Equity (x)	0.2	-0.3	-0.3	-0.1	-0.2	0.0	-0.1	-0.2

Cash Flow Statement

(INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Adjusted EBITDA	9,194	30,631	41,836	41,536	43,426	44,595	52,643	58,852
Non cash opr. exp (inc)	-5,502	-16,372	-7,901	-9,496	-8,987	-9,291	-10,620	-11,850
(Inc)/Dec in Wkg. Cap.	7,778	-7,608	-12,302	-8,874	5,456	-11,268	-2,158	3,545
Tax Paid	0	0	0	0	0	0	0	0
Other operating activities	0	37,353	0	0	0	0	0	0
CF from Op. Activity	11,470	44,004	21,634	23,167	39,895	24,035	39,865	50,548
(Inc)/Dec in FA & CWIP	-2,836	-3,099	-7,854	-21,365	-17,357	-9,786	-10,531	-11,156
Free cash flows	8,634	40,905	13,780	1,802	22,538	14,249	29,334	39,392
(Pur)/Sale of Invt	-6,796	-1,940	-8,539	-9,050	10,611	-5,763	-3,672	-774
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-9,632	-5,039	-16,393	-30,415	-6,746	-15,549	-14,203	-11,930
Inc/(Dec) in Net Worth	-528	1,032	19	2,469	35	-456	0	0
Inc / (Dec) in Debt	-961	-7,036	-1,305	2,396	-3,469	-7,315	-1,337	-1,132
Interest Paid	0	0	0	0	0	0	0	0
Divd Paid (incl Tax) & Others	-597	-750	-5,381	-6,771	-13,626	-12,364	-12,364	-9,016
CF from Fin. Activity	-2,086	-6,754	-6,668	-1,905	-17,060	-20,135	-13,701	-10,147
Inc/(Dec) in Cash	-248	32,211	-1,427	-9,154	16,089	-11,649	11,962	28,471
Add: Opening Balance	2,666	2,418	34,629	33,202	24,048	40,138	28,489	40,451
Closing Balance	2,418	34,629	33,202	24,048	40,138	28,489	40,451	68,922

NOTES

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