

Q3FY21 result review  
and reco change

## Technology

Target price: Rs1,010

## Earnings revision

(%)	FY21E	FY22E	FY23E
Sales	↑ 0.3	↓ 1.2	↑ 1.2
EBIT	↑ 5.9	↑ 0.5	↓ 5.3
EPS	↑ 5.9	↑ 0.6	↓ 4.6

## Target price revision

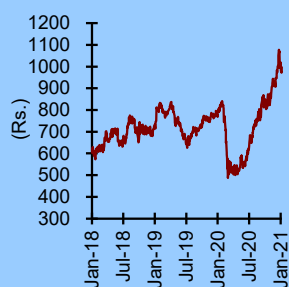
Rs1,010 from Rs1,155

## Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	35.8	35.8	35.8
Institutional investors	52.6	52.4	52.6
MF and others	8.1	9.1	8.4
FIs / Banks	0.2	0.1	0.1
Insurance Cos.	4.5	5.1	4.9
FII	39.8	38.1	39.2
Others	11.6	11.8	11.6

Source: www.nseindia.com

## Price chart



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INDIA

## Tech Mahindra

Limited scope for further surprises

HOLD

Downgrade from BUY

Rs961

The key rationale behind our earlier BUY rating on TechM was the potential surprise on the pace of margin expansion (refer our note – [Pace of margin expansion may surprise](#)). In-line with our thesis, EBIT margin expansion of ~600 bps over H2CY20 (to 15.9%) came in significantly faster-than-street expectations. This was led by (1) headcount / mix / portfolio company rationalisation and (2) transient Covid-led industry tailwinds. Ceteris paribus, the current profitability level leaves very little further upside. In fact, given the impending cost headwinds (e.g. talent related, reversal of some expenses like travel), we see a higher likelihood of margin contraction than further expansion. Relatively (1) higher exposure to asset-heavy verticals (e.g. communications, manufacturing), (2) higher client concentration and (3) potential for delays in enterprise 5G use case adoption should translate into continued growth underperformance vs Tier-I over FY21E-23E. Given the limited scope for surprises and the not-so-undemanding valuations (as earlier, CMP implies 16x FY22E EPS), we downgrade the stock to HOLD.

- **In-line and subdued revenue growth; margin beat.** Revenue growth of 2.8% (QoQ, CC) during Q3FY21 was underwhelming in the context of strong growth reported by the industry during Q3. Growth was led by communications (+3.6% QoQ, CC) and manufacturing (+4.2% QoQ, USD) verticals. Across key geographies, Europe recovered well (+8.5%). It should be noted these three segments witnessed sharp revenue decline in Jun-20 followed by a subdued Sep-20 providing scope for a strong recovery during the current quarter. Across service lines, BPO continued to outperform IT services by a wide margin in terms of growth. Reported EBIT margin of 15.9% was ~130-170bps ahead of our / consensus expectations. (1) Reduction in overall headcount (2% QoQ) and consequent rise in utilisation (+200bps QoQ), (2) offshore shift and (3) operating leverage led to this margin expansion.
- **Should underperform on growth; margins have more or less plateaued.** The company announced net new deal wins of US\$455mn, closer to pre-Covid run-rate. Given the funnel and pace of deal closure / conversion, management is optimistic on acceleration in the deal activity. Despite the street optimism around network services benefitting due to preparatory / rollout work of 5G, we expect TechM to continue underperforming Tier I on growth. This should be led by (1) relatively higher exposure to asset-intensive verticals (e.g. communications, manufacturing) and (2) potential for delays in enterprise 5G use case adoption led by reprioritisation of capital. While potential surprise on the pace of margin expansion was the key rationale behind our earlier BUY rating, EBIT margin of 15-16% in steady state (above guidance of 15%) is now mostly priced in. With margins more or less plateauing and given the impending cost headwinds (elaborated in our earlier [note](#)), we see higher likelihood of disappointments (vs surprises). Downgrade to HOLD.

Market Cap	Rs930bn/US\$12.8bn
Reuters/Bloomberg	TEML.NS/TECHM IN
Shares Outstanding (mn)	967.6
52-week Range (Rs)	1078/487
Free Float (%)	65.2
FII (%)	39.2
Daily Volume (US\$'000)	63,242
Absolute Return 3m (%)	18.2
Absolute Return 12m (%)	25.6
Sensex Return 3m (%)	16.9
Sensex Return 12m (%)	15.0

Year to March	2020	2021E	2022E	2023E
Revenue (Rs mn)	368,677	380,804	405,821	455,611
Net Income (Rs mn)	40,330	46,688	52,264	57,840
EPS (Rs)	45.9	53.0	59.3	65.7
% Chg YoY	(5.9)	15.6	11.8	10.7
P/E (x)	20.8	18.0	16.1	14.5
CEPS (Rs)	59.2	69.9	76.4	84.9
EV/E (x)	14.4	11.0	9.6	8.3
Dividend Yield (%)	1.6	1.6	2.1	2.6
RoCE (%)	13.1	15.1	15.2	15.3
RoE (%)	18.5	19.9	19.6	19.4

**Table 1: Q3FY21 result review**

(Rs mn, year ending March 31)

	Q3FY21	Q2FY21	Q3FY20	%chg (QoQ)	%chg (YoY)
<b>Revenues (US\$)</b>	<b>1,309</b>	<b>1,265</b>	<b>1,353</b>	<b>3.4</b>	<b>(3.3)</b>
Re/\$	73.7	74.1	71.4	(0.5)	3.3
<b>Net Sales</b>	<b>96,471</b>	<b>93,718</b>	<b>96,546</b>	<b>2.9</b>	<b>(0.1)</b>
Cost of Services	64,708	64,245	67,312	0.7	(3.9)
SG&A	12,808	12,443	13,601	2.9	(5.8)
<b>Total Expenses</b>	<b>77,516</b>	<b>76,688</b>	<b>80,913</b>	<b>1.1</b>	<b>(4.2)</b>
<b>EBITDA</b>	<b>18,954</b>	<b>17,030</b>	<b>15,633</b>	<b>11.3</b>	<b>21.2</b>
Depreciation	3,584	3,717	3,848	(3.6)	(6.9)
<b>EBIT</b>	<b>15,371</b>	<b>13,313</b>	<b>11,785</b>	<b>15.5</b>	<b>30.4</b>
Interest Expense	421	399	550	5.5	(23.5)
Other Income	2,209	1,175	3,496	88.0	(36.8)
Share of profit / (Loss) from associate	5	4	5	25.0	-
<b>Recurring pre-tax income</b>	<b>17,164</b>	<b>14,093</b>	<b>14,736</b>	<b>21.8</b>	<b>16.5</b>
Taxation	4,263	3,462	3,629	23.1	17.5
Minority Interest	197	15	352	1,213.3	(44.0)
<b>Recurring Net Income</b>	<b>13,098</b>	<b>10,646</b>	<b>11,459</b>	<b>23.0</b>	<b>14.3</b>
Extraordinaries	-	-	-	-	-
<b>Reported Net Income</b>	<b>13,098</b>	<b>10,646</b>	<b>11,459</b>	<b>23.0</b>	<b>14.3</b>
<b>Recurring adj. diluted EPS (Rs.)</b>	<b>14.9</b>	<b>12.1</b>	<b>13.0</b>	<b>22.8</b>	<b>14.1</b>
<b>Ratios (%)</b>					
EBITDA margin	19.6	18.2	16.2		
EBIT margin	15.9	14.2	12.2		
Effective tax rate	24.8	24.6	24.6		
Recurring Net profit margins	13.6	11.4	11.9		

Source: Company data, I-Sec research

**Table 2: Change in estimates**

	Revised			Earlier			Change		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Rs/USD	74.2	73.0	74.5	74.4	76.0	77.5	-0.4%	-3.9%	-3.9%
USD Revenue (mn)	5,136	5,559	6,116	5,099	5,404	5,811	0.7%	2.9%	5.2%
Growth (%)	(0.9)	8.3	10.0	(1.6)	6.0	7.5	70bps	230bps	250bps
EBIT margin - Overall (%)	14.1	14.8	14.5	13.4	14.5	15.5	70bps	30bps	-100bps
PAT (Rs bn)	47	52	58	44	52	60	6.1%	0.8%	-4.4%
EPS (Rs)	53.0	59.3	65.7	50.1	59.0	68.8	5.9%	0.6%	-4.6%

Source: Company data, I-Sec research

**Table 3: Q3FY21 actuals vs estimates**

Rs Bn	Dec-20A	Sep-20	QoQ	Dec-19	YoY	Dec-20E	%diff	Consensus	%diff
Revenue (US\$ mn)	1,309	1,265	3.4%	1,353	-3%	1,291	1.4%	1,297	1%
USD revenue growth	3.4%	4.8%	-140bps	5.1%	-170bps	2.0%	140bps	2.5%	90bps
Revenue (Rs mn)	96,471	93,718	3%	96,546	0%	95,267	1%	95,750	1%
EBIT	15,371	13,313	15%	11,785	30%	13,533	14%	13,980	10%
EBIT margins	15.9%	14.2%	170bps	12.2%	370bps	14.2%	170bps	14.6%	130bps
Net Income	13,098	10,646	23%	11,459	14%	11,433	15%	11,394	15%
Adj EPS (Rs/ share)	14.9	12.1	23%	13.0	14%	13.0	14%	13.0	15%

Source: Company data, I-Sec research

## Financial summary

Table 4: Profit and loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Revenues (US\$mn)</b>	<b>5,182</b>	<b>5,136</b>	<b>5,559</b>	<b>6,116</b>
<b>Operating Revenues (Sales)</b>	<b>3,68,677</b>	<b>3,80,804</b>	<b>4,05,821</b>	<b>455,611</b>
Operating Expenses	3,11,416	3,12,180	3,30,835	372,690
<b>EBITDA</b>	<b>57,261</b>	<b>68,624</b>	<b>74,986</b>	<b>82,921</b>
% margins	15.5	18.0	18.5	18.2
Depreciation & Amortisation	14,458	14,831	15,075	16,925
<b>EBIT</b>	<b>42,803</b>	<b>53,793</b>	<b>59,911</b>	<b>65,996</b>
% margins	11.6	14.1	14.8	14.5
Net other income	10,005	7,613	8,575	9,908
<b>Recurring PBT</b>	<b>52,808</b>	<b>61,406</b>	<b>68,485</b>	<b>75,904</b>
Less: Taxes	11,604	15,305	17,010	18,852
Add: Extraordinaries Inc/(Exp)	(2,175)	-	-	-
Less: Minority Interest/Income from Associates	1,301	586	788	788
<b>Net Income (Reported)</b>	<b>40,330</b>	<b>46,688</b>	<b>52,264</b>	<b>57,840</b>

Source: Company data, I-Sec research

Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>LIABILITIES</b>				
<b>Shareholders' funds</b>	<b>2,18,131</b>	<b>2,34,692</b>	<b>2,66,501</b>	<b>2,98,773</b>
Minority Interest	3,933	3,721	2,933	2,145
Non-current liabilities	52,405	46,543	46,543	46,543
Current Liabilities	86,762	92,229	98,077	1,09,707
Amounts pending investigation	12,304	12,304	12,304	12,304
<b>Total Liabilities</b>	<b>3,73,535</b>	<b>3,89,489</b>	<b>4,26,358</b>	<b>4,69,472</b>
<b>ASSETS</b>				
Fixed Assets	89,221	89,952	79,720	68,231
Other non-current assets	52,591	55,862	55,862	55,862
<b>Total non-current assets</b>	<b>1,41,812</b>	<b>1,45,815</b>	<b>1,35,582</b>	<b>1,24,093</b>
Current Assets	2,31,723	2,43,674	2,90,777	3,45,378
<b>Total Assets</b>	<b>3,73,535</b>	<b>3,89,489</b>	<b>4,26,358</b>	<b>4,69,472</b>

Source: Company data, I-Sec research

Table 6: Quarterly trend

(Rs mn, year ending March 31)

	Mar-20	Jun-20	Sep-20	Dec-20
Net sales	94,902	91,063	93,718	96,471
% growth (YoY)	6.7	5.2	3.3	-0.1
Recurring EBITDA	13,478	13,005	17,030	18,954
Margin (%)	14.2	14.3	18.2	19.6
Other income	2,320	3,658	776	1,788
Extraord Inc / (Loss)	-2,175	-	-	-
Recurring Net Income	10,214	9,723	10,646	13,098

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>OCF before W Cap changes</b>	<b>59,623</b>	<b>64,339</b>	<b>70,626</b>	<b>78,974</b>
Working Capital Inflow / (Outflow)	(21,853)	9,302	(2,557)	(2,691)
Capex	(30,304)	(15,562)	(4,842)	(5,436)
<b>Free Cash flow</b>	<b>7,466</b>	<b>58,079</b>	<b>63,227</b>	<b>70,847</b>
Cash Flow from other Invst Act (Ex Capex)	-	-	-	-
Proceeds from Issue of Share Capital and buyback	1	1	1	1
Inc/(Dec) in Borrowings and lease liabilities	28,368	(6,074)	(788)	(788)
Dividend paid	(15,317)	(15,341)	(20,455)	(25,568)
Others	(3,961)	(3,407)	(4,075)	(4,998)
<b>Increase/(Decrease) in Cash</b>	<b>16,557</b>	<b>33,258</b>	<b>37,910</b>	<b>39,494</b>

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Per Share Data (Rs)</b>				
Earnings per share (Adjusted Diluted Recurring)	45.9	53.0	59.3	65.7
Earnings per share (Basic Reported)	46.3	53.4	59.8	66.2
Cash earnings per share	59.2	69.9	76.4	84.9
Dividend per share	15.0	15.0	20.0	25.0
Book Value per share	236	267	303	339
<b>Growth Ratios (%)</b>				
Operating Income (Sales) - US\$	4.3	(0.9)	8.3	10.0
Operating Income (Sales)	6.1	3.3	6.6	12.3
EBITDA	-9.6	19.8	9.3	10.6
Recurring Net Income	(1.1)	9.8	11.9	10.7
Diluted Recurring EPS	(5.9)	15.6	11.8	10.7
Diluted Recurring CEPS	(3.9)	18.1	9.4	11.0
<b>Valuation Ratios (x)</b>				
P/E	20.8	18.0	16.1	14.5
P/CEPS	16.2	13.7	12.6	11.3
P/BV	4.1	3.6	3.2	2.8
EV / EBITDA	14.4	11.0	9.6	8.3
EV / Sales	2.2	2.0	1.8	1.5
<b>Operating Ratio</b>				
Gross margin/Sales (%)	25.6	27.6	28.6	28.8
SG&A/Sales (%)	14.0	13.5	13.8	14.3
Other Income / PBT (%)	18.9	12.4	12.5	13.1
Effective Tax Rate (%)	22.0	24.9	24.8	24.8
Fixed Asset Turnover (x) on average	4.1	4.2	5.1	6.7
Receivables (days) on average	115	98	99	99
D/E Ratio (x)	0.1	0.1	0.1	0.1
<b>Return/Profitability Ratio (%)</b>				
Recurring Net Income Margins	11.5	12.3	12.9	12.7
RoCEex Cash	13.1	15.1	15.2	15.3
RoNW	18.5	19.9	19.6	19.4
Dividend Payout Ratio	32.7	28.3	33.7	38.1
Dividend Yield	1.6	1.6	2.1	2.6
EBITDA Margin	15.5	18.0	18.5	18.2

Source: Company data, I-Sec research

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