

Tech Mahindra

BSE SENSEX
44,150

S&P CNX
12,969

CMP: INR876
TP: INR940 (+7%)
Neutral


Stock Info

Bloomberg	TECHM IN
Equity Shares (m)	919
M.Cap.(INRb)/(USDb)	847.3 / 11.2
52-Week Range (INR)	890 / 461
1, 6, 12 Rel. Per (%)	-3/28/7
12M Avg Val (INR M)	3144

Financials Snapshot (INR b)

Y/E Mar	FY20	FY21E	FY22E
Sales	369	381	425
EBIT Margin (%)	11.6	11.6	11.5
PAT	40	38	40
EPS (INR)	46.3	44.0	46.3
EPS Gr. (%)	(5.9)	(4.6)	5.2
BV/Sh. (INR)	235.6	284.3	312.9

Ratios

RoE (%)	18.5	15.4	14.7
RoCE (%)	13.1	12.0	12.3
Payout (%)	32.7	45.7	32.6

Valuations

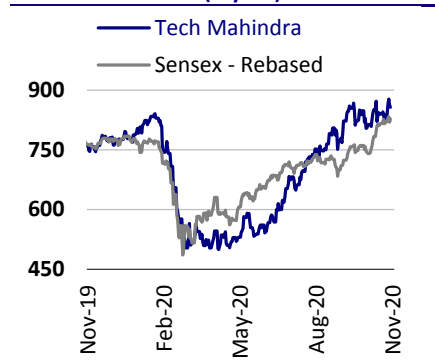
P/E (x)	18.7	19.7	18.7
P/BV (x)	3.7	3.0	2.8
EV/EBITDA (x)	12.9	10.9	9.6
Div Yield (%)	1.7	2.3	1.7

Shareholding pattern (%)

As On	Sep-20	Jun-20	Sep-19
Promoter	35.8	35.8	35.9
DII	14.4	13.2	14.4
FII	38.0	39.6	37.8
Others	11.8	11.3	12.0

FII Includes depository receipts

Stock Performance (1-year)



Focus squarely on 5G, but await clarity on the timeline

We attended Tech Mahindra's (TECHM) Analyst Day, wherein the management shared its refreshed strategy and opportunities in 5G and Cloud migration. Here are the key highlights from the meet:

- Potential opportunity in 5G across both Communications and Enterprise verticals was the key highlight. In addition to IT services and the impact on the business from a move to 5G (open network, micro-segmentation, etc.), it detailed the prospects in businesses like Network Services, product R&D, and on Enterprise network modernization through private networks.
- The management believes there is a large multi-billion dollar opportunity in 5G network services (christened Network Services 3.0), and expects the segment to grow at a faster pace than the overall Communications vertical.
- Despite the massive scale of opportunity, management is circumspect on the timeline, given the continued pressure on telcos' revenues and limited visibility on a pickup. It continues to guide at single-digit growth in FY22.

Refreshed strategy focuses on Cloud and Platforms

- TECHM announced NXT.NOW as the next iteration of its well-established 3-4-3 strategy. NXT.NOW focuses primarily on big bets within UX/CX, Platforms and Cloud businesses. It believes that this strategy is more appropriate in a post COVID world, and has already started to yield results in form of deal wins and record high deal pipeline.
- It plans to right-size its business through portfolio rationalization of non-core offerings, geography and customers, but does not anticipate an impact on near-term revenue. It is also streamlining its market penetration strategy.

Targeting USD100b Cloud opportunity

- In line with INFO's recent commentary, TECHM highlighted the USD500b opportunity in services, part of the USD1t spend expected on Cloud. It is targeting the USD100b sub-set, which includes large deals, Data center monetization (excl. assets), scaling SaaS/IaaS, and automated deployment.

FY22 recovery to be modest

- The management expects FY22 revenue growth to be below 10% as the momentum in Enterprise should be muted by the modest recovery in Communications vertical despite the low base of FY21.
- While it is much more confident of a margin recovery, we remain skeptical due to the recent pickup being led by short-term measures.

Valuation and view

- We expect a recovery in the Communications vertical (40% of revenue) to precede any re-rating in the stock multiple and hence retain our Neutral rating. We see the need to invest back into the business as the key limitation to its aim of margin improvement.
- TECHM should deliver single-digit growth in FY22 (v/s double-digit growth by its peers), which would lead to a lower P/E multiple. We value the stock at 20x FY22E EPS, at a 25% discount to our target P/E for TCS. Remain Neutral.

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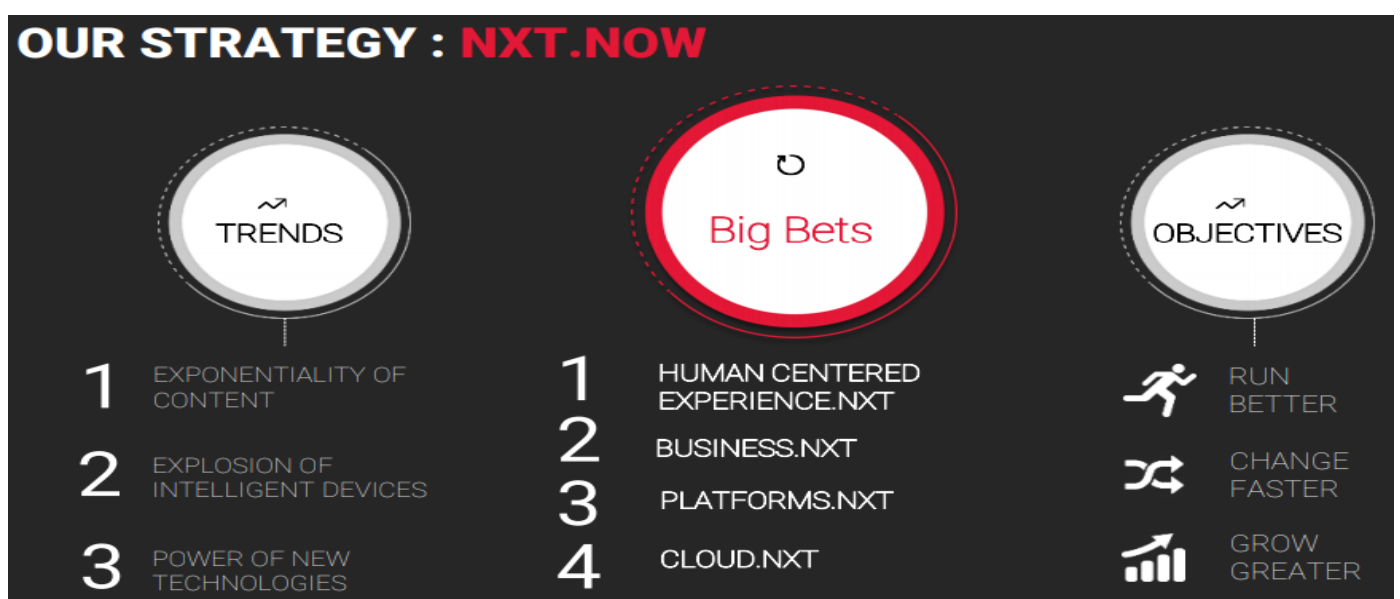
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TECHM's NXT.NOW strategy

- TECHM announced NXT.NOW as the next iteration of its well-established 3-4-3 strategy. NXT.NOW focuses primarily on big bets within UX/CX, Platforms, and Cloud businesses.
- This strategy has been yielding results with CME growth returning, momentum picking up in BFSI, Hi-Tech and Healthcare (expected to be over USD1b), and EBIT margin improving.
- It plans to right-size its business through portfolio rationalization of non-core offerings, geography and customers, but does not anticipate an impact on near-term revenue. It is also streamlining its market penetration strategy.
- Post TECHM's repair phase, which is expected to last for 1-2 quarters more, growth will become predictable and the company will be more agile and technology enabled internally and externally.
- The management has been undertaking M&As to fill gaps in its capabilities over the last two years. Integration and synergies from those is the key focus now.

Exhibit 1: The new strategy – NXT.NOW – provides greater focus on human centered experience and Cloud

Source: Company, MOFSL

Trends around Experiences, Data and Analytics and AI

- Currently, there are five key themes that are shaping experiences globally: 1) hyper personalization, 2) elastic enterprise, 3) longitudinal book of record, 4) the speed of the human mind, and 5) resilience.
- An increasing number of customers are migrating to the Cloud. By 2022, public Cloud services will be essential for 90% of innovation in Data and Analytics, and by 2023 Cloud-based AI will increase 5x from 2019.
- By the end of 2024, 75% of enterprises will shift from piloting to operationalizing AI, driving a 5x increase in streaming Data and Analytics infrastructure.
- The company's growth strategy is to expand its Data and Analytics and AI footprint across over 1,000 accounts, focus on growth geographies and verticals and take up increased co-innovation with partners/customers startups.
- TECHM is leveraging IPs across the Data and AI value chain and delivered over 100+ AI use cases across enterprises.

Exhibit 2: Market trends in enabling Data Driven and AI First enterprises

Data and Analytics	
Data value management	USD120b by 2025 (at 9.5% CAGR)
Data on Cloud	USD800b by 2025 (at 17.5% CAGR)
Data monetization	USD6.1b by 2025 (at 21.5% CAGR)
AI	
Advanced Analytics	USD60b by 2027 (at 25.3% CAGR)
Cognitive services	USD11b by 2022 (at 42.1% CAGR)
Conversational AI	USD14b by 2025 (at 21.9% CAGR)

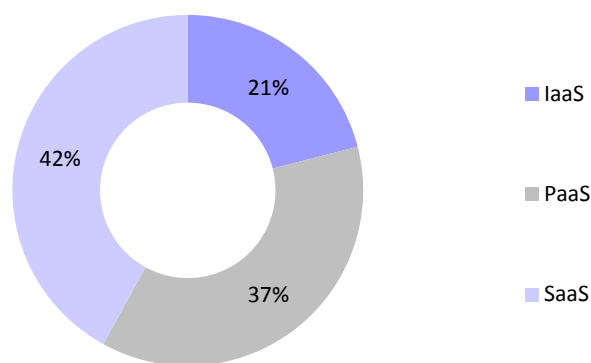
Source: Company, MOFSL

Cloudification of everything

- In line with INFO's recent commentary, TECHM highlighted a USD500b services opportunity, part of the USD1t spend expected on Cloud. It is targeting the USD100b sub-set, which includes large deals, Data center monetization (excl. assets), scaling SaaS/IaaS, and automated deployment.
- Hybrid multi-Cloud is now the new normal with Amazon Web Services (AWS) leading the CSP pack and Azure closing in. Vertical SaaS has been gaining momentum, and focus has shifted to agility and speed of innovation.
- On the list of top priorities for clients is monetizing Data center exits. This is an excellent opportunity as it involves shifting of workload to the Cloud.
- TECHM's deep focus on automation and proven ability to deliver large scale Cloud helps it capture market share in the rapidly increasing industry. It is also looking to reskill 70% of its IT workforce by 2024 under its Reskilling Academy for Cloud Execution (RACE).
- The company currently generates over USD900m revenue from Infrastructure Cloud Services. The same is growing at 22%. It booked TCV of 2x its TTM over the previous period.

Exhibit 3: A similar spend on services will drive total Cloud spend in excess of USD1t

CY24 - \$484b (CAGR 18%)



Source: Company, MOFSL

5G technology – A paradigm shift

- Potential opportunity in 5G across both Communications and Enterprise verticals was the highlight of the meet. In addition to IT services and the impact on the business from a move to 5G (open network, micro-segmentation, etc.), it detailed the prospects in businesses like Network Services, product R&D, and on Enterprise network modernization through private networks.
- With the introduction of 5G, intense activity is being seen in Europe, America and Asia, with a new set of companies being created to take advantage of this new network.
- Besides improved connectivity, 5G will drive greater customer experience, something which the telecom industry needed. It would revolve around themes like Open Platform, hyper-personalization, cost reduction, and service agility.
- The management believes there is a large multi-billion dollar opportunity in 5G network services (christened Network Services 3.0), and expects the segment to grow at a faster pace than the overall Communications vertical.
- The company sees opportunities across five well defined areas:
 - Breaking up the supply chain into an open 5G network
 - Network on the Cloud
 - Intelligent operations by leveraging technology
 - Digital OSS
 - Enterprise network modernization
- TECHM has also identified scalable offerings in 5G for Enterprise: 1) private IT networks, 2) Multi-Access Edge Compute (MEC), and 3) industry applications pack including pre-integrated solutions.

Exhibit 4: Network Services 3.0 – Open, Cloud-native and AI driven

	Market opportunity	CAGR (FY20-25)
Open 5G network	USD40-50b	65-70%
Network on the Cloud	USD8-10b	20-25%
Intelligent and cognitive managed operations	USD10-15b	15-20%
Digital OSS	USD5-8b	10-12%
Enterprise network modernization	>USD50b	12-14%

Source: Company, MOFSL

Expect single-digit growth and expanding margins

- The management talked about the acceleration in digital transformation, which will speed up growth of IT services. Due to the fundamental shift in mindset, demand scenario will be elongated, rather than a one-time change.
- The Communications portfolio is expected to accelerate going into next year, even without 5G, though not at double-digits. On the Enterprise side, the strong momentum and funnel will place the company a little below the double-digit number on an overall basis.
- In terms of margins, it is targeting an FY22 EBIT margin of 15%, on the back of a better onsite-offshore ratio and sub-contractor expenses. This target factors in return of travel and other discretionary costs and assumes a normalized state of salary hikes.

Valuation and view

- We expect a recovery in the Communications vertical (40% of revenue) to precede any re-rating in the stock multiple and hence retain our Neutral rating. We see the need to invest back into the business as the key limitation to its aim of margin improvement.
- TECHM should deliver single-digit growth in FY22 (v/s double-digit growth by its peers), which would lead to a lower P/E multiple. We value the stock at 20x FY22E EPS, at a 25% discount to our target P/E for TCS. Remain Neutral.

Financials and valuations

Income Statement							(INR b)	
Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Sales	225	265	291	308	347	369	381	425
Change (%)	19.4	17.9	10.0	5.6	12.9	6.1	3.4	11.5
COGS	151	183	206	215	234	260	268	298
SGA expenses	33	39	44	45	50	52	54	62
Total Expenses	184	222	250	261	284	311	321	359
EBITDA	41	43	42	47	63	57	60	66
% of Net Sales	18.3	16.1	14.4	15.3	18.2	15.5	15.7	15.5
Depreciation	6	8	10	11	11	14	16	17
Other Income	1	4	6	12	4	10	6	4
PBT	36	39	39	49	56	53	51	53
Tax	9	8	10	11	13	12	12	13
Rate (%)	26.5	20.9	25.4	22.4	22.4	22.0	24.5	24.0
PAT	26	31	29	38	44	41	38	40
Minority interest	0	0	0	0	0	-1	0	0
PAT before EO	26	31	28	38	43	43	38	40
Change (%)	-10.6	18.0	-7.4	33.9	13.1	-1.1	-9.5	5.2
Extraordinary Items (EO)	0	0	0	0	0	-2	0	0
Reported PAT	26	31	28	38	43	40	38	40
Change (%)	-13.2	16.7	-7.4	33.9	13.1	-6.2	-4.6	5.2

Balance Sheet							(INR b)	
Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Share Capital	5	5	4	4	4	4	4	4
Reserves	118	141	160	184	198	214	246	271
Net Worth	122	146	164	188	203	218	250	275
Minority Interest	2	2	5	5	5	4	4	4
Loans	7	11	14	24	20	25	17	17
Other LT liabilities	4	5	10	5	3	28	27	27
Amount pending invest.	12	12	12	12	12	12	12	12
Capital Employed	148	176	205	235	243	287	310	335
Applications								
Assets	40	43	68	79	73	89	89	83
Investments	25	3	4	2	5	5	5	5
Other non-current assets	5	23	25	42	40	48	47	47
Curr. Assets	123	150	163	181	216	232	259	301
Debtors	70	80	78	90	99	116	101	112
Cash & Bank Balance	32	52	54	78	97	88	123	150
Other Current Assets	21	18	31	13	19	27	35	39
Current Liab. & Prov	51	48	56	70	91	87	90	100
Net Current Assets	72	102	108	111	124	145	169	200
Application of Funds	148	176	205	235	243	287	310	335

Financials and valuations

Ratios

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Basic (INR)								
EPS	27.8	35.4	32.5	43.2	49.2	46.3	44.0	46.3
Diluted EPS	27.0	34.5	32.0	42.7	48.8	45.9	43.8	46.1
Cash EPS	33.6	43.1	43.0	54.9	61.6	59.2	61.5	65.4
Book Value	127.1	164.3	185.0	211.8	230.1	235.6	284.3	312.9
DPS	6.0	12.0	9.0	14.0	14.0	15.0	20.0	15.0
Payout %	22.2	34.8	28.2	32.8	28.7	32.7	45.7	32.6
Valuation (x)								
P/E	31.2	24.5	26.7	20.1	17.6	18.7	19.7	18.7
Cash P/E	25.8	20.1	20.2	15.8	14.1	14.7	14.1	13.3
EV/EBITDA	19.7	17.1	17.4	15.2	10.8	12.9	10.9	9.6
EV/Sales	3.6	2.8	2.5	2.3	2.0	2.0	1.7	1.5
Price/Book Value	6.8	5.3	4.7	4.1	3.8	3.7	3.0	2.8
Dividend Yield (%)	0.7	1.4	1.0	1.6	1.6	1.7	2.3	1.7
Profitability Ratios (%)								
RoE	24.5	22.8	18.3	21.5	21.2	18.5	15.4	14.7
RoCE	19.7	17.2	13.4	14.2	18.5	13.1	12.0	12.3
ROIC	26.6	23.2	19.0	21.3	33.3	20.1	21.4	24.6
Turnover Ratios								
Debtors (Days)	113	110	98	107	104	115	97	96
Fixed Asset Turnover (x)	5.6	6.2	4.3	3.9	4.7	4.1	4.3	5.2
Leverage Ratio								
Debt/Equity Ratio(x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Cash Flow Statement

(INR b)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
CF from Operations	43	50	46	57	71	71	72	77
Change in Working Capital	-9	-5	5	17	11	-22	9	-1
Other adjustments	-11	-13	-11	-11	-13	-12	-12	-13
Net Operating CF	24	32	41	63	69	38	69	63
Net Purchase of FA	-11	-9	-8	-21	-6	-30	-15	-11
Free Cash Flow	13	23	33	42	63	7	54	52
Net Purchase of Invest.	-10	2	-23	0	0	0	0	0
Net Cash from Invest.	-21	-7	-31	-21	-6	-30	-15	-11
Inc./ (Dec) in Equity	1	0	0	0	0	0	0	0
Proceeds from LTB/STB	-3	0	-4	9	-10	24	-14	-7
Dividend Payments	-2	-6	-12	-14	-15	-15	-20	-15
Cash Flow from Fin.	-5	-6	-16	-6	-24	9	-35	-22
Net Cash Flow	-2	20	-6	36	39	17	19	30
Opening Cash Balance	39	40	60	55	91	130	146	165
Add: Net Cash	-2	20	-6	36	39	17	19	30
Add: Other Adjustments	2	0	0	0	0	0	0	0
Closing Cash Balance	40	60	55	91	130	146	165	195

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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