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Tech Mahindra on growth path

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Tech Mahindra, India's fifth-largest information and technology (IT) services company, has shown steady growth in its share prices. Currently, the price is around ₹632 as compared to ₹376 last July. Analysts say it is a correction since the company's focus over the past year has been on driving profitability with more intellectual property (IP)-led revenues, which have been making a positive impact on its operating profit margins.

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"When they bought Lightbridge Communications Corporation (LCC), it resulted in a margin collapse. From there, its price to earnings (PE) ratio dropped to push it to become a 10-PE stock, making it cheaper than some of the mid-caps at that point. When the margin curved off, after two years, the stocks have recovered, rising to 14 PE," said Madhu Babu, research analyst at equity analyst firm Prabhudas Lilladher. At the same time, the drag from the LCC and Comviva businesses is expected to have stabilised.

IP-led revenues have continued to positively impact its operating profit margins. Analysts said if the company continued with headcount reduction and showed positive improvement in LCC and Comviva, it would see steady margin growth.

"Tech Mahindra's telecom business has bottomed out. Telecom recovery could be a trigger for the stock to go up," said Harit Shah, research analyst, Reliance Securities.

With margins showing steady improvement, the fourth quarter of 2017-18 might bring a certain margin expansion, he added. The shift in the wage hike cycle means that wage hikes will not impact the next quarter. "While manufacturing and banking, financial services and insurance (BFSI) remain key growth drivers for its enterprise business, lower drag from Comviva and LCC will support growth and margins expansion in the telecom vertical," said IIFL.

While the management seems confident about enterprise revenues due to the number of deals, analysts caution against expecting too much from the BFSI outputs. Its BFSI scale is smaller than its large-cap peers. It would be unfair to expect revenues on the scale of peers from this vertical, analysts added.

"We are no longer reporting LCC revenues separately as it is fully owned now. We have decided to keep Comviva as a separate company," said CP Gurnani, Tech Mahindra managing director and chief executive officer.

IIFL said it was expecting a 120 bps (basis points) operating profit expansion over the next two years. It added that while customers have started discussing 5G, it hasn't really reflected in the company's capex guidance and is expected to play out in 2019. With LCC showing signs of profitability, it would give the company better numbers in 2018 than 2017, analysts said.