

CMP: ₹ 1,535

Target: ₹ 1,780 (16%)

Target Period: 12 months

BUY

July 26, 2024

Margin expansion led turnaround begins...

About the stock: Tech Mahindra (TechM) has over 1.47 lakh+ employees across 90 countries serving 1000+ clients in the Telecom, BFSI, manufacturing & retail sectors.

Q1FY25 Performance: TechM in Q1FY25 reported revenue of US\$ 1,559 mn (₹13,005 crore), up 0.7% QoQ both in US\$ and CC terms while it was down 2.6% YoY in US\$ terms/ 1.2% YoY in CC terms. The EBIT margins saw healthy expansion of 110 bps QoQ to 8.5%.

Investment Rationale

- On track to achieve its stated goals for FY27, led by margin expansion:** The MD & CEO Mohit Joshi reiterated the company's three-year roadmap for topline & bottom-line growth through providing "scale at speed". Even amidst a challenging demand environment where discretionary spend continues to remain muted, the management remains confident of achieving its stated goals. During Q1, EBIT margin improved by 110 bps QoQ to 8.5% aided by operational efficiencies & savings from Project Fortius and moderation of subcontracting costs which were offset by headwinds from decline in revenue in Comviva (-50 bps, due to seasonality in communications vertical) and higher visa costs.
- Broad based Deal wins; Investing in the future of GenAI:** The company during the quarter won TCV of US\$ 534 mn, up 6.8% QoQ and 48.7% YoY, which were largely broad based. It launched "TechM VerifAI" platform which provides solution for validating and verifying AI outcomes. The company has deployed more than 100 AI/GenAI solutions and offerings and enabled 25,000+ employees on AI led pair programming.
- Laser focus on strategic areas:** Management reiterated their focus on the strategic areas such as – mining of the existing portfolios i.e., scaling large accounts, client logo additions, solution development in areas of strength such as core banking, wealth & asset management, insurance & payments & to fully integrate the capabilities of our portfolio companies. Coupled with its Project Fortius and Turbocharge Program, it is set to achieve its goals in a gradual yet steady way.

Rating and Target Price

- TECHM continues to remain well positioned amongst its peers to achieve both revenue and earnings growth. **We believe that company's US\$ revenue will grow at CAGR of 6.4% between FY24-26E but operating profit growth is likely to outpace with EBIT margin to improve from 6.1% in FY24 to 13.4% in FY26E. Consequently, PAT to grow at CAGR of 60.4% over FY24-26E.**
- We retain our **BUY** rating on the stock. However, **we revise our valuation and value it at a target price of ₹ 1,780 at 26x P/E on FY26E EPS vs 25x earlier.**

Tech Mahindra

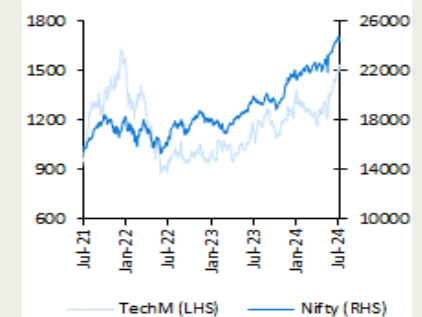
Particulars

Particular	Amount
Market Cap (₹ Crore)	1,36,163
Total Debt (₹ Crore)	1,531
Cash & Inv. (₹ Crore)	7,515
EV (₹ Crore)	1,30,179
52 week H/L	1547 / 1082
Equity capital	441
Face value (₹)	5

Shareholding pattern

	Sep-23	Dec-23	Mar-24	Jun-24
Promoters	35	35	35	35
FII	26	25	24	23
DII	27	29	30	31
Public	12	11	11	11

Price Chart



Key risks

- Lower than expected growth in margins;
- Lower than anticipated synergies from portfolio companies

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Key Financial Summary

(₹ crore)	FY22	FY23	FY24	5 Years CAGR (FY19-24)	FY25E	FY26E	2 years CAGR (FY24-26E)
Net sales	44,646	53,290	51,996	8.4	53,642	59,646	7.1
EBITDA	8,020	8,029	4,965	-4.8	6,877	9,912	41.3
EBIT Margin (%)	18.0	11.4	6.1		9.3	13.4	
Net Profit	5,566	4,831	2,358	-11.3	3,749	6,069	60.4
EPS (₹)	63.1	54.8	26.7		42.4	68.6	
P/E	24.3	28.0	57.6		36.2	22.4	
RoNW (%)	20.7	17.3	8.8		13.8	21.6	
RoCE (%)	22.5	20.5	12.6		16.7	25.4	

Source: Company, ICICI Direct Research

Performance highlights and Outlook

- **Revenue Performance:** TechM in Q1FY25 reported revenue of US\$ 1,559 mn, up 0.7% QoQ both in US\$ and CC terms while it was down 2.6% YoY in US\$ terms/ 1.2% YoY in CC terms. In rupee terms the revenue came at ₹ 13,005 crore, up 1% QoQ and down 1.2% YoY.
- **Margin Performance:** EBIT margin improved by 110 bps QoQ to 8.5% aided by operational efficiencies & savings from Project Fortius and moderation of subcontracting costs which were offset by headwinds from decline in revenue in Comviva (-50 bps, due to seasonality in communications vertical) and higher visa costs.
- **Geography performance:** Geography wise in CC terms, North America (52.4% of mix) grew by 3.9% QoQ while Europe (23.4% of mix) and ROW (24.2% of the mix) declined by 2.6% and 2.5% QoQ respectively.
- **Segment performance:** Segment wise on a QoQ basis Healthcare & Lifesciences (7.7% of mix), Retail transport & logistics (7.7% of mix), Manufacturing (18.3% of mix), BFSI (15.7% of mix) and Hi-tech & Media (13.8% of mix) grew by 8%, 5.2%, 2.5%, 0.7% and 0.5% respectively while Others (3.8% of mix) and its largest vertical Communications (33.1% of mix) declined by 5.1% & 1.9% QoQ respectively.
 - **BFSI Segment:** BFSI is seeing some new opportunities with addition of new logos in it. In the US, there is **traction across the asset & wealth management, cards & payments, risk & compliance and insurance while investment banking and lending business saw some softness**. The company's BFSI portfolio is relatively small but has an advantage of deriving synergies from their already existing portfolio.
- **AI/GenAI:** TechM launched "TechM VerifAI" platform which provides a unique solution to the industry for validating and verifying AI outcomes which have recently gained increased importance. The platform enables companies to move from pilots to enterprise level adoption of AI. Other than this the company has **deployed more than 100 AI/GenAI solutions & offerings** across AI Ops, computer vision, workplace automation and more. Now, TechM has **25,000+ employees enabled on AI led pair programming vs 15,000 in the previous quarter**. Its indigenous language LLM "Project Indus" is not expected to generate any revenues and is utilised primarily for tech demonstration purposes demonstrating the company's capabilities in building a LLM from scratch.
- **Deal Wins:** The company during the quarter won TCV of US\$ 534 mn, up 6.8% QoQ and 48.7% YoY. The deal wins for the quarter are broad-based and are from the focused prioritised market of US, Europe and selected pockets of APG.
- **Headcount & Attrition:** The company added 2,165 employees during the quarter taking the total headcount to 147,620 employees. The LTM attrition stood at 10%, flat QoQ/ down ~300 bps YoY.
- **Outlook:** The management expects FY25 to be better than FY24. However, Communication vertical would continue to be soft due to industry headwinds. On the margins front, employee pyramid continues to be a key margin lever for the medium to long term.

Exhibit 1: Quarter Performance

	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)	Comments
Revenue (₹ crore)	13,006	13,159	(1.2)	12,871	1.0	Revenue grew by 0.7% QoQ / declined by 1.2% YoY in CC terms
Employee expenses	9,553	9,781	(2.3)	9,394	1.7	
Gross Margin	3,452	3,379	2.2	3,477	(0.7)	
Gross margin (%)	26.5	25.7	87 bps	27.0	-47 bps	
SG&A expenses	1,888	2,041	(7.5)	2,069	(8.8)	
EBITDA	1,565	1,338	16.9	1,408	11.1	
EBITDA Margin (%)	12.0	10	187 bps	10.9	109 bps	
Dep. & amort.	462.2	446.6	3.5	461.4	0.2	
EBIT	1,102	891	23.7	946	16.5	
EBIT Margin (%)	8.5	7	170 bps	7.4	112 bps	EBIT margin improved by 110 bps QoQ aided by operational efficiencies & savings from Project Fortius and moderation of subcon costs which were offset by headwinds from decline in revenue in Comviva (-50 bps, due to seasonality in communications vertical) and higher visa costs.
Other income (less int.)	73	72	1.7	315	(76.8)	
PBT	1,176	963	22.0	1,261	(6.8)	
Tax paid	313	268	17.1	295	6.2	
PAT	851	693	23.0	661	28.8	
Adjusted PAT	851	693	23.0	661	28.8	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Net sales	53,290	51,996	53,642	59,646
Growth (%)	19	(2)	3	11
COGS (empl. exp.)	38,120	39,115	39,691	42,576
Gross profit	15,170	12,881	13,951	17,069
S,G&A expenses	7,142	7,916	7,074	7,157
Total Operating Exp.	45,261	47,031	46,764	49,734
EBITDA	8,029	4,965	6,877	9,912
Growth (%)	0	(38)	39	44
Depreciation	1,957	1,817	1,884	1,909
Interest	326	392	372	360
Other Income	965	917	503	595
PBT	6,711	3,672	5,125	8,238
Total Tax	1,589	828	1,332	2,126
Exceptional item	-	-	-	-
PAT	4,831	2,358	3,749	6,069
Growth (%)	(13)	(51)	59	62
EPS (₹)	54.8	26.7	42.4	68.6

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Profit before Tax	6,711	3,672	5,125	8,238
Add: Depreciation	1,957	1,817	1,884	1,909
(Inc)/dec in Current Assets	(2,158)	1,596	(499)	(1,834)
Inc/(dec) in CL and Provisions	312	(297)	354	1,292
Taxes paid	(1,993)	(1,247)	(1,332)	(2,126)
CF from operating activities	5,572	6,376	5,394	7,245
(Inc)/dec in Investments	530	(599)	-	-
(Inc)/dec in Fixed Assets	(969)	(738)	(816)	(907)
Others	145	153	510	595
CF from investing activities	(279)	(1,314)	(306)	(312)
Issue/(Buy back) of Equity	44	24	-	-
Inc/(dec) in loan funds	(159)	(69)	-	-
Dividend paid & dividend tax	(4,263)	(3,917)	(3,187)	(5,159)
Inc/(dec) in debentures	-	-	-	-
Finance charges	(257)	(351)	(372)	(360)
CF from financing activities	(5,078)	(4,767)	(3,908)	(5,869)
Net Cash flow	215	296	1,180	1,064
Cash by acquisition	-	-	-	-
Opening Cash	3,975	4,255	4,736	5,915
Cash carried to B/S	4,255	4,736	5,915	6,979

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Liabilities				
Equity Capital	440	441	441	441
Reserve and Surplus	27,485	26,228	26,790	27,701
Total Shareholders funds	27,925	26,669	27,232	28,142
Minority Interest	470	477	524	568
Total Debt	1,578	1,531	1,531	1,531
Other long term liabilities	4,309	3,558	3,558	3,558
Total Liabilities	34,282	32,236	32,844	33,798
Assets				
Net Block	3,959	3,518	2,800	2,149
Capital WIP	84	101	101	101
Investments	3,388	3,238	3,240	3,240
Deferred tax assets	1,297	1,440	1,440	1,440
Goodwill on consolidation	7,666	7,511	7,511	7,511
Debtors	12,883	11,402	11,763	13,079
Loans and Advances	-	-	-	-
Other non-current assets	4,767	4,064	4,060	4,060
Cash	4,255	4,736	5,915	6,979
Other current assets	4,490	4,472	4,613	5,130
Total Current Assets	24,434	23,426	25,108	28,005
Trade payables	4,385	3,785	3,905	4,342
Current liabilities	6,856	6,266	6,464	7,187
Provisions	631	1,137	1,173	1,305
Total Current Liabilities	11,872	11,188	11,542	12,834
Net Current Assets	12,562	12,238	13,566	15,171
Application of Funds	34,282	32,236	32,844	33,798

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E
Per share data (₹)				
EPS	54.8	26.7	42.4	68.6
BV	286.7	300.7	307.0	317.3
DPS	50	40	36	58
Cash Per Share	43.7	53.4	66.7	78.7
Operating Ratios (%)				
EBIT Margin	11.4	6.1	9.3	13.4
PAT Margin	9.1	4.5	7.0	10.2
Return Ratios (%)				
RoE	17.3	8.8	13.8	21.6
RoCE	20.5	12.6	16.7	25.4
RoIC	22.4	12.8	20.8	33.4
Valuation Ratios (x)				
P/E	28.0	57.6	36.2	22.4
EV / EBITDA	16.3	26.2	18.8	12.9
EV / Net Sales	2.5	2.5	2.4	2.1
Market Cap / Sales	2.6	2.6	2.5	2.3
Price to Book Value	5.4	5.1	5.0	4.8
Solvency Ratios				
Debt/EBITDA	0.2	0.3	0.2	0.2
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	1.5	1.4	1.4	1.4
Quick Ratio	1.5	1.4	1.4	1.4

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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