

CMP: ₹ 1,695

Target: ₹ 2,000 (18%)

Target Period: 12 months

BUY

October 21, 2024

## Strong quarter boosted by operational efficiencies...

**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.

**Q2FY25 Performance:** Tech M in Q2FY25 reported a revenue of US\$1,589, up 1.9% QoQ/2.2% YoY. In CC terms the revenue was up 0.7% QoQ /1.2% YoY. The EBIT margins saw healthy expansion of 110 bps QoQ to 9.6%. The PAT stood at ₹1,250 crore, up 46% QoQ, also aided by higher other income.

### Investment Rationale

- **Turnaround Phase on track aided by margin gains:** Company believes H2FY25 is expected to be better as the foundation for a turnaround has been established. During Q2, EBIT margin improved (for 3<sup>rd</sup> consecutive quarter) by 110 bps QoQ to 9.6% aided by a 40-bps boost from forex gains and 70 bps from operational efficiencies under Project Fortius. **Further, ~150 bps of margins would be invested for long-term investments which is a step in a right direct towards growth, amid the aspirational 15% EBIT margins by FY27.**
- **Robust growth across segments, barring Manufacturing:** The management stated that the demand environment remains unchanged and discretionary spending is constrained. **Telecom grew 2.8% despite client focus on cost savings & budget constraints. BFSI grew 2.4% and saw opportunities in existing accounts and quality new logo additions.** However, the manufacturing segment faced challenges from weakness in the automotive segment, particularly in the Americas and de-grew 4% QoQ. **Sustained momentum in key accounts and consistent margin performance will be monitorable ahead for future growth.**
- **Steady progress for long term metrics and transformation focus:** It indicated that **accounts over US\$20 mn are experiencing accelerated growth (1.5x overall growth) aided by the Turbocharge program**, while the company is working on building its large deal capabilities and reducing the percentage of subcontracting revenue while investing in new talent and training to expand margins. Furthermore, the management is prioritising margins over large deals. On Gen AI transformation, ~1/3rd of the IT workforce use GitHub Co-pilot and utilise AWS and Google as part of the organizational transformation.

### Rating and Target Price

- TECHM continues to take all the right steps under its 3-year roadmap for topline and bottom-line growth. **We introduce our FY27 estimates and believe that company's US\$ revenue will grow at CAGR of 6.7% between FY24-27E but operating profit growth is likely to outpace with EBIT margin improving from 6.1% in FY24 to 14.5% in FY27E, implying a CAGR of 43.6% over FY24-27E.**
- We retain our **BUY** rating on the stock. We, now, **value it at a target price of ₹ 2,000 at 25x P/E on FY27E EPS.**

### Key Financial Summary

(₹ crore)	FY22	FY23	FY24	5 Years CAGR (FY19-24)	FY25E	FY26E	FY27E	3 years CAGR (FY24-27E)
Net sales	44,646	53,290	51,996	8.4	53,885	58,788	64,343	7.4
EBIT	6,500	6,072	3,147	-9.6	5,071	7,912	9,330	43.6
EBIT Margin (%)	14.6	11.4	6.1		9.4	13.5	14.5	
Net Profit	5,566	4,831	2,358	-11.3	4,119	6,003	7,078	44.3
EPS (₹)	63.1	54.8	26.7		46.5	67.9	80.3	
P/E	26.9	31.0	63.6		36.4	25.0	21.1	
RoNW (%)	20.7	17.3	8.8		15.1	21.3	22.4	
RoCE (%)	22.5	20.5	12.6		18.2	25.1	26.8	

Source: Company, ICICI Direct Research

## Tech Mahindra

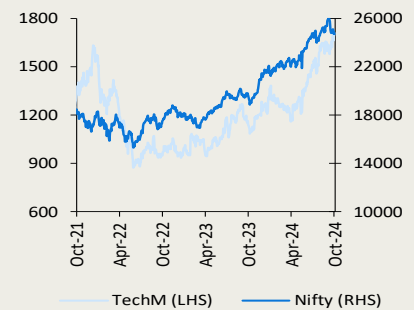
### Particulars

Particular	Amount
Market Cap (₹ Crore)	1,50,356
Total Debt (₹ Crore)	1,531
Cash & Inv. (₹ Crore)	7,515
EV (₹ Crore)	1,44,372
52 week H/L	1761 / 1098
Equity capital	441
Face value (₹)	5

### Shareholding pattern

	Dec-23	Mar-24	Jun-24	Sep-24
Promoters	35	35	35	35
FII	25	24	23	24
DII	29	30	31	31
Public	11	11	11	10

### Price Chart



### Key risks

- Continued weakness in Top 5 clients which are telecom heavy;
- Lower than expected margin expansion under Project Fortius

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## Performance highlights and Outlook

- **Revenue Performance:** The company in Q2FY25 reported a revenue of US\$ 15,89, up 1.9% QoQ, 2.2% YoY. In CC terms the revenue was up 0.7% QoQ and 1.2% YoY. In rupee terms the revenue stood at ₹ 13,313 crore, up 2.4% QoQ and 3.5% YoY.
- **Other Income:** The company recorded other income of ₹521 crore, which included sale of land of approximately ~₹450 crore. Company also informed that a one-time revenue of €22 mn (~₹200 crore) recorded in Q3FY24 from their product specific revenues, won't repeat in Q3FY25.
- **Margin Performance:** EBIT margin of the company **improved by 110 bps QoQ to 9.6% for the third consecutive quarter aided by a 40-bps boost from forex gains and 70 bps from operational efficiencies under Project Fortius.**
- **Geography performance:** Geography wise barring America (51.1% of the mix) which de-grew by 0.7%, both Europe (24% of mix) **and ROW (24.9% of mix) was up by 4.6% and 5% QoQ respectively. The America's region is seeing some pressure right now and is expected to see a turnaround in FY26.**
- **Segment performance:** Segment wise on a QoQ basis all the segments grew barring Manufacturing (17.2% of the mix) and Healthcare & Lifesciences (7.4% of mix) which declined by 4% and 1.8% respectively. Others (4% of the mix), Hi-Tech & Media (14.3% of the mix), Retail transport & logistics (7.9% of the mix), Communications (33.4% of the mix) and BFSI (15.8% of the mix), grew by 7.8%, 5.7%, 5.6%, 2.7% and 2.4% respectively.
  - **Communication Segment:** This segment grew **2.8% QoQ (after 5 consecutive quarters) on the back of stabilization and growth in the APAC and Europe communications portfolio. However, US continues to remain stressed and is expected to improve next year.**
  - **Telecom:** The company's **top 5 client base is concentrated by Telecom clients as seven out of the top ten telcos (in the world) are TechM's clients. Telecom clients are facing budget pressures due to high interest rates** and are expected to benefit going ahead from the Fed rate cuts.
  - **BFSI Segment:** The management mentioned that **they're seeing a slight sentimental shift in the customer behaviour in this segment and onboarded 2 new logos in the segment form US and Europe.**
  - **Manufacturing Segment:** This segment saw a **soft quarter as the outlook for discretionary spending for manufacturing continues to be conservative coupled with softness in the auto sector.**
- **Deal Wins:** The company during the quarter won a TCV of US\$ 603 mn, up 13% QoQ, down 6% YoY. In the quarter, the company has witnessed strategic wins in the communication space coupled with its expansion in the BFSI portfolio, where it won 2 new logos from US and Europe respectively.
- **Headcount & Attrition:** The total headcount increased by 6,653 and stood at 1,54,273, with 25,000+ employees now enabled on AI-led pair programming, up from 15,000 in Q1. It also plans to onboard 6,000 freshers in FY25, with 2,000 onboarded so far. The attrition for the quarter stood at 10.6%, up 50 bps QoQ and down 80 bps YoY. **The company is yet to decide on the wage hikes.**
- **AI/GenAI:** With 1/3rd of the IT workforce using GitHub Co-pilot and utilizing AWS and Google as part of the organizational transformation the company now has 25,000+ employees enabled on AI-led pair

programming, up from 15,000 in Q1. Moreover, percentage of GenAI infused deals is growing with every passing quarter.

- Outlook:** The demand environment remains largely unchanged. Q3 will likely see furloughs, along with the usual trend of being a seasonally weak quarter. Moving forward the Fed rate cuts are expected to reduce debt loads for telecom players which is a positive sign for the company. **The short-term margin levers include – reducing subcon costs and pricing focus while long term lever is investments made for infusion and training of fresh graduate trainees.**
- Dividend:** The company declared an interim dividend of ₹15 per share.

**Exhibit 1: Quarter Performance**

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
Revenue (₹ crore)	13,313	12,864	3.5	13,006	2.4	Revenue grew by 0.7% QoQ / declined by 1.2% YoY in CC terms
Employee expenses	9,596	9,975	(3.8)	9,553	0.4	
Gross Margin	3,718	2,889	28.7	3,452	7.7	
Gross margin (%)	27.9	22.5	547 bps	26.5	138 bps	
SG&A expenses	1,967	1,816	8.3	1,888	4.2	
EBITDA	1,750	1,072	63.2	1,565	11.9	
EBITDA Margin (%)	13.1	8	482 bps	12.0	112 bps	
Dep. & amort.	469.8	465.7	0.9	462.2	1.6	
EBIT	1,280	607	111.1	1,102	16.2	
EBIT Margin (%)	9.6	5	490 bps	8.5	114 bps	EBIT margin improved (for 3rd consecutive quarter) by 110 bps QoQ to 9.6% aided by a 40-bps boost from forex gains and 70 bps from operational efficiencies under Project Fortius.
Other income (less int.)	433	167	159.4	73	490.8	
PBT	1,713	773	121.5	1,176	45.7	
Tax paid	456	110	314.5	313	45.5	
PAT	1,250	494	153.1	851	46.8	
Adjusted PAT	1,250	494	153.1	851	46.8	

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 2: Profit and loss statement					₹ crore
(Year-end March)	FY24	FY25E	FY26E	FY27E	
<b>Net sales</b>	<b>51,996</b>	<b>53,885</b>	<b>58,788</b>	<b>64,343</b>	
Growth (%)	(2)	4	9	9	
COGS (empl. exp.)	39,115	39,342	41,822	45,297	
Gross profit	12,881	14,543	16,965	19,045	
S,G&A expenses	7,916	7,575	7,172	7,657	
Total Operating Exp.	47,031	46,917	48,995	52,954	
<b>EBITDA</b>	<b>4,965</b>	<b>6,968</b>	<b>9,793</b>	<b>11,389</b>	
Growth (%)	(38)	40	41	16	
Depreciation	1,817	1,897	1,881	2,059	
Interest	392	361	360	360	
Other Income	917	925	598	665	
PBT	3,672	5,636	8,150	9,635	
Total Tax	828	1,478	2,103	2,513	
Exceptional item	-	-	-	-	
<b>PAT</b>	<b>2,358</b>	<b>4,119</b>	<b>6,003</b>	<b>7,078</b>	
Growth (%)	(51)	75	46	18	
EPS (₹)	26.7	46.5	67.9	80.3	

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement					₹ crore
(Year-end March)	FY24	FY25E	FY26E	FY27E	
Profit before Tax	3,672	5,636	8,150	9,635	
Add: Depreciation	1,817	1,897	1,881	2,059	
(Inc)/dec in Current Assets	1,596	(573)	(1,497)	(1,696)	
Inc/(dec) in CL and Provisions	(297)	407	1,055	1,195	
Taxes paid	(1,247)	(1,478)	(2,103)	(2,513)	
<b>CF from operating activities</b>	<b>6,376</b>	<b>5,216</b>	<b>7,248</b>	<b>8,375</b>	
(Inc)/dec in Investments	(599)	-	-	-	
(Inc)/dec in Fixed Assets	(738)	(820)	(894)	(979)	
Others	153	1,033	598	665	
<b>CF from investing activities</b>	<b>(1,314)</b>	<b>213</b>	<b>(297)</b>	<b>(314)</b>	
Issue/(Buy back) of Equity	24	-	-	-	
Inc/(dec) in loan funds	(69)	-	-	-	
Dividend paid & dividend tax	(3,917)	(3,501)	(5,103)	(3,732)	
Inc/(dec) in debentures	-	-	-	-	
Finance charges	(351)	(361)	(360)	(360)	
<b>CF from financing activities</b>	<b>(4,767)</b>	<b>(4,211)</b>	<b>(5,813)</b>	<b>(4,442)</b>	
Net Cash flow	296	1,218	1,139	3,620	
Cash by acquisition	-	-	-	-	
Opening Cash	4,255	4,736	5,953	7,092	
<b>Cash carried to B/S</b>	<b>4,736</b>	<b>5,953</b>	<b>7,092</b>	<b>10,712</b>	

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet					₹ crore
(Year-end March)	FY24	FY25E	FY26E	FY27E	
<b>Liabilities</b>					
Equity Capital	441	441	441	441	
Reserve and Surplus	26,228	26,846	27,746	31,093	
Total Shareholders funds	26,669	27,287	28,188	31,534	
Minority Interest	477	520	564	608	
Total Debt	1,531	1,531	1,531	1,531	
Other long term liabilities	3,558	3,558	3,558	3,558	
<b>Total Liabilities</b>	<b>32,236</b>	<b>32,896</b>	<b>33,840</b>	<b>37,231</b>	
<b>Assets</b>					
Net Block	3,518	2,791	2,154	1,424	
Capital WIP	101	101	101	101	
Investments	3,238	3,241	3,241	3,241	
Deferred tax assets	1,440	1,440	1,440	1,440	
Goodwill on consolidation	7,511	7,511	7,511	7,511	
Debtors	11,402	11,816	12,891	14,109	
Loans and Advances	-	-	-	-	
Other non-current assets	4,064	4,060	4,060	4,061	
Cash	4,736	5,953	7,092	10,712	
Other current assets	4,472	4,634	5,056	5,534	
Total Current Assets	23,426	25,221	27,856	33,172	
Trade payables	3,785	3,923	4,280	4,684	
Current liabilities	6,266	6,493	7,084	7,753	
Provisions	1,137	1,179	1,286	1,407	
Total Current Liabilities	11,188	11,595	12,650	13,845	
Net Current Assets	12,238	13,626	15,207	19,327	
<b>Application of Funds</b>	<b>32,236</b>	<b>32,896</b>	<b>33,840</b>	<b>37,231</b>	

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios				
(Year-end March)	FY24	FY25E	FY26E	FY27E
<b>Per share data (₹)</b>				
EPS	26.7	46.5	67.9	80.3
BV	300.7	307.6	317.8	355.5
DPS	40	39	58	-
Cash Per Share	53.4	67.1	80.0	120.8
<b>Operating Ratios (%)</b>				
EBIT Margin	6.1	9.4	13.5	14.5
PAT Margin	4.5	7.6	10.2	11.0
<b>Return Ratios (%)</b>				
RoE	8.8	15.1	21.3	22.4
RoCE	12.6	18.2	25.1	26.8
RoIC	12.8	21.1	33.1	39.5
<b>Valuation Ratios (x)</b>				
P/E	63.6	36.4	25.0	21.1
EV / EBITDA	29.1	20.5	14.5	12.2
EV / Net Sales	2.8	2.7	2.4	2.2
Market Cap / Sales	2.9	2.8	2.6	2.3
Price to Book Value	5.6	5.5	5.3	4.8
<b>Solvency Ratios</b>				
Debt/EBITDA	0.3	0.2	0.2	0.1
Debt / Equity	0.1	0.1	0.1	0.0
Current Ratio	1.4	1.4	1.4	1.4
Quick Ratio	1.4	1.4	1.4	1.4

Source: Company, ICICI Direct Research

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Sell: <-15%



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