Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Tech Mahindra

Good Q2, Maintain Buy

IT & ITeS	Sharekhan code: TECHM

Reco/View: Buy	↔	CMP: **Rs. 1,688**	Price Target: **Rs. 1,950**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↓	

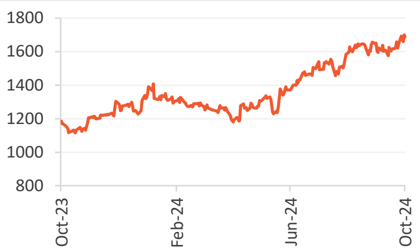
Company details

Market cap:	Rs. 1,65,145 cr
52-week high/low:	Rs.1,709/1,089
NSE volume: (No of shares)	23.3 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	63.57 cr

Shareholding (%)

Promoters	35.0
FII	23.7
DII	30.9
Others	10.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.1	9.6	43.1	42.3
Relative to Sensex	7.2	9.7	31.0	19.0

Sharekhan Research, Bloomberg

Summary

- Revenues stood at $1,589 million, up 0.7% q-o-q/ 1.2% y-o-y in CC terms, beating our estimates of $ 1,577 million.
- EBIT margin rose by ~110 bps q-o-q to 9.6%, beating our estimates of 9.0%.Net new deal win TCVs stood at $603 million, up 13% q-o-q.
- Margins are expected to steadily recover under Project Fortius, with the management prioritising margins over securing large deals
- We maintain Buy with a revised price target of Rs 1950 (valued at 26x Sep26E EPS). At CMP, the stock trades at 33/25.3/20x its FY25/26/27E EPS.

Q2FY25 revenues stood at $1,589 million, up 0.7% q-o-q/ 1.2% y-o-y, in constant currency terms, beating our estimates $1,577 million led by CME, Technology and BFSI vertical. Revenue in rupee terms stood at Rs. 13,313, up 2.4% q-o-q/ 3.5% y-o-y. EBIT margin expanded by ~110 bps q-o-q to 9.6%, beating our estimates of 9.0%. enabled by savings achieved under Project Fortius and supported by currency tailwinds. Adjusted Net profit stood at Rs. crore 1250 crore up 46.8%q-o-q/94.3% y-o-y aided by higher income from gain on sale of land. Net new TCV for the quarter stood at $603 million, up 13% q-o-q/ down 6% y-o-y. Net headcount rose by 6,653 taking the total headcount to 154,273. LTM attrition rose 100 bps q-o-q to 11. We believe the recovery for Tech Mahindra although gradual, is playing out under the guidance of new leadership and service line structure. We have introduced FY27 estimates and roll forward to Sep26E EPS. We maintain Buy with revised price target (PT) of Rs. 1950 (valued at 26x Sep26E EPS). At CMP, the stock trades at 33/25.3/20x its FY25/26/27E EPS.

Key positives

- Net headcount additions were 6,653 taking the total to 154,273.
- Net new deal wins TCVs stood at $603 million, up 13% q-o-q.
- Key communications vertical grew 2.8% q-o-q, after five consecutive quarters of decline.

Key negatives

- LTM attrition rose 100 bps q-o-q to 11%
- Manufacturing declined 4.2%q-o-q

Management Commentary

- Management has identified financial services as a focus vertical and aims to differentiate itself by leveraging its strengths in areas like insurance, asset and wealth management, payments, and core banking,
- The company is currently prioritising margins over large deals.
- Management sees weaknesses in the communications vertical, as its key telecom clients continue to prioritize cost savings and their spending on discretionary projects is constrained
- The manufacturing vertical is seeing softness as outlook on discretionary spending in this vertical continues to be conservative along with softness in auto.
- The management reiterated that this year could be volatile as they are in the turnaround phase.
- The company has onboard 2000 freshers during the quarter and aims to onboard more than 6000 for the year.

Revision in estimates: We have revised our estimates to factor in Q2FY25 performance and introduced FY27E

Our Call

Valuation–Maintain Buy with revised PT of Rs. 1950: Tech M reported good quarter with beat on revenue and margin front. Margins are expected to steadily recover under Project Fortius, with management prioritizing margins over securing large deals. Net new deal wins are steadily improving along with second consecutive quarter of net-headcount additions. We believe the recovery for Tech Mahindra although gradual, is playing out under the guidance of new leadership and service line structure. We maintain Buy with a revised price target of Rs 1950 (valued at 26x Sep26E EPS). At CMP, the stock trades at 33/25.3/20x its FY25/26/27E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and recession in the US can moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY24	FY25E	FY26E	FY27E
Revenue	51,995.5	53,404.7	58,436.0	64,483.6
OPM (%)	9.5	13.1	15.7	17.8
Adjusted PAT	2,816.0	4,507.4	5,864.4	7,431.8
% YoY growth	-44.4	60.1	30.1	26.7
Adjusted EPS (Rs.)	32.0	51.2	66.6	84.5
P/E (x)	52.7	33.0	25.3	20.0
P/B (x)	5.5	5.1	4.6	4.1
EV/EBITDA (x)	31.6	21.6	16.1	12.5
RoNW (%)	8.6	16.2	19.3	22.0
RoCE (%)	12.1	18.8	22.4	25.9

Source: Company; Sharekhan estimates

Key result highlights

- **Revenue growth:** TechM reported revenues stood at $1,589 million, up 0.7% q-o-q/1.2% y-o-y in CC, beating our estimates of our estimates $1,577 million, led by CME, Technology and BFSI vertical. Revenue in rupee terms stood at Rs. 13,313, up 2.4% q-o-q/ 3.5% y-o-y. IT services revenue grew 2.3% q-o-q while BPO segment revenues grew 2.9% q-o-q.
- **Margins:** EBIT margin expanded by ~115 bps q-o-q to 9.6 %, beating our estimates of 9.0% with nearly 40 bps contributed by forex movement, and the balance 70 bps owing to operating efficiencies and savings under Project Fortius.
- **Verticals-wise performance:** Communications, Technology, BFSI, Retail, and Others grew 2.8%/5.6%/2.6%/4.6% and 10.2% q-o-q respectively. Manufacturing and Healthcare & Lifesciences declined 4.2%/2.1% q-o-q.
- **Geography-wise performance:** Europe and RoW grew 4.5%/4.9% q-o-q respectively. While Americas declined 0.6% q-o-q.
- **Deal wins:** Net new TCV for the quarter stood at $603 million, up 13% q-o-q/ down 6% y-o-y. The company achieved strategic wins in the communications space, along with an expansion of its BFSI portfolio and onboarding of two new logos, one each from the US and Europe.
- **Attrition and utilisation:** Net headcount increased by 6,653 taking the total headcount to 154,273. LTM attrition rose 100 bps q-o-q to 11% while Utilisation was flat q-o-q at 86%.
- **Client metrics:** Revenue from Top 5, Top 10 and Top 20 clients improved by 1.9%/1.9% and 4.6% respectively. On a sequential basis, the company added 1 client in $50 million+ and 4 clients in $ 5 million+ category while $10 million+ category saw a decline of 4 clients respectively. Number of active clients improved by 13 q-o-q to 1178.
- **Cash generation:** Free Cash Flow (FCF) stood at $157 million, up 48% q-o-q with FCF to net income ratio at 106%. Cash and Cash equivalent stood at Rs 6566 crore versus Rs 8055.2 crore in Q1FY25.

Results (Consolidated) Rs cr

Particulars	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)
Revenues In USD (mn)	**1,588.7**	**1,555.2**	**2.2**	**1,559.0**	**1.9**
Revenues In INR	**13,313.2**	**12,863.9**	**3.5**	**13,005.5**	**2.4**
Cost of Services	9,595.7	9,975.2	-3.8	9,553.2	0.4
Gross profit	**3,717.5**	**2,888.7**	**28.7**	**3,452.3**	**7.7**
SG&A	1,967.3	1,816.4	8.3	1,887.8	4.2
EBITDA	**1,750.2**	**1,072.3**	**63.2**	**1,564.5**	**11.9**
Depreciation	469.8	465.7	0.9	462.2	1.6
EBIT	**1,280.4**	**606.6**	**111.1**	**1,102.3**	**16.2**
Other Income	521.5	264.2	97.4	144.7	260.4
PBT	**1,712.9**	**773.3**	**121.5**	**1,175.5**	**45.7**
Provision for taxes	456.0	110.0	314.5	313.3	45.5
Adjusted net profit	**1,250.1**	**643.4**	**94.3**	**851.5**	**46.8**
Non Recurring / Exceptional Items	0.0	-149.5	-	0.0	-
Reported net profit	**1,250.1**	**493.9**	**153.1**	**851.5**	**46.8**
EPS (Rs) Excl Treasury Shares	14.1	5.6	153.1	9.6	46.9
Margin (%)			**BPS**		**BPS**
EBITDA Margins	13.1	8.3	481	12.0	112
EBIT Margin	9.6	4.7	490	8.5	114
PAT Margin	9.4	5.0	439	6.5	284
Tax rate	26.6	14.2	1,240	26.7	-3

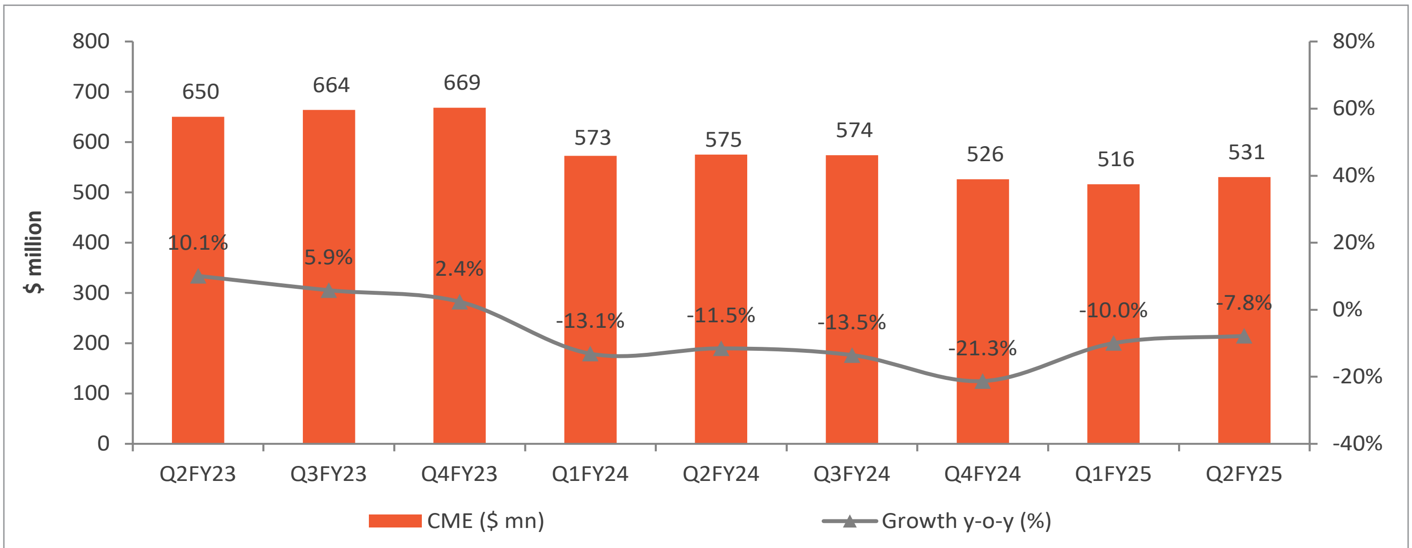
Source: Company, Sharekhan Research

Revenue mix: Geographies, industry verticals, and other operating metrics Rs cr

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%) q-o-q	$ Growth (%) y-o-y
Revenues ($ mn)	1,589	100	1.9	2.2
Geographic mix				
America	812	51.1	-0.6	-2.1
Europe	381	24.0	4.5	3.9
RoW	396	24.9	4.9	9.6
Industry verticals				
CME	531	33.4	2.8	-7.8
Manufacturing	273	17.2	-4.2	-1.3
Technology	227	14.3	5.6	32.8
BFSI	251	15.8	2.6	0.3
Retail, transpost and logistics	126	7.9	4.6	-1.6
Others	64	4.0	10.2	-59.1
Clients contribution				
Top 5	238	15.0	1.9	-9.9
Top 10	397	25.0	1.9	-5.4
Top 20	620	39.0	4.6	2.2
Revenue by services		(%)	q-o-q	y-o-y
IT	1,328	83.6	1.8	0.4
BPO	261	16.4	2.4	11.8

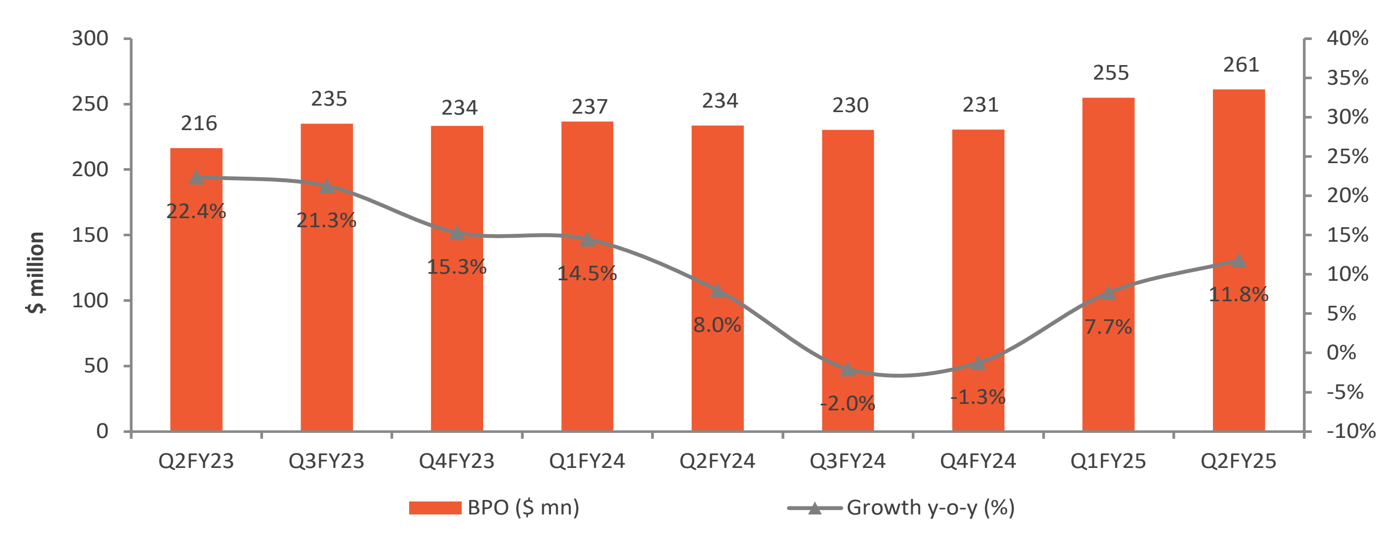
Source: Company, Sharekhan Research

CME vertical revenue growth trend



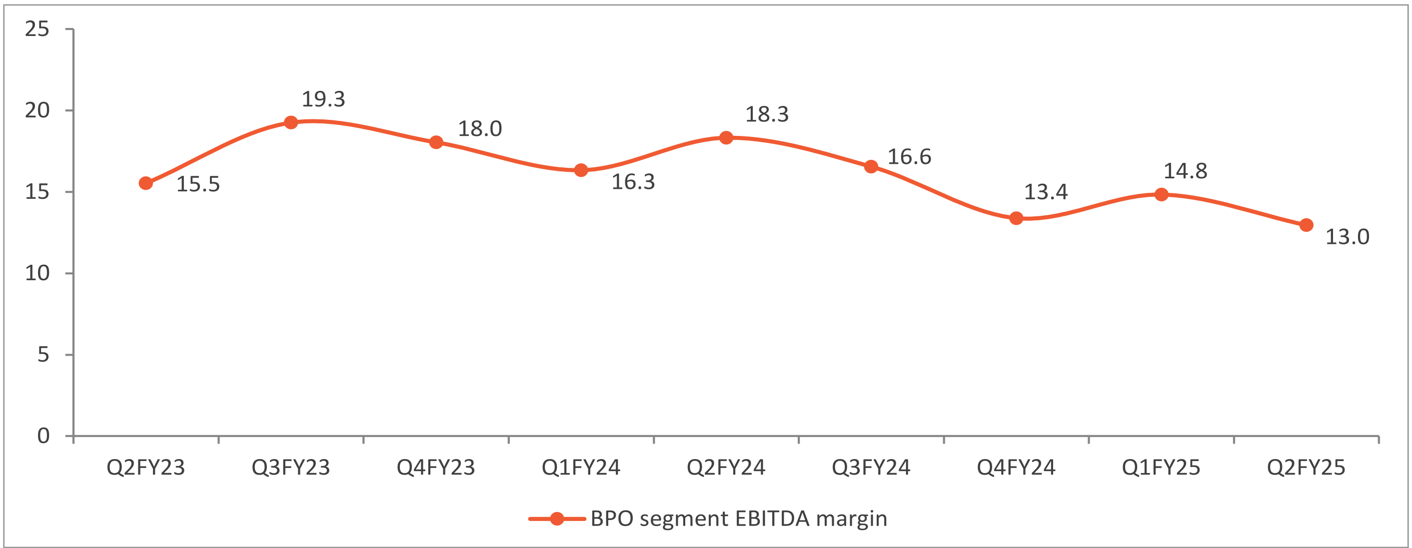
Source: Company, Sharekhan Research

BPO revenue growth trend



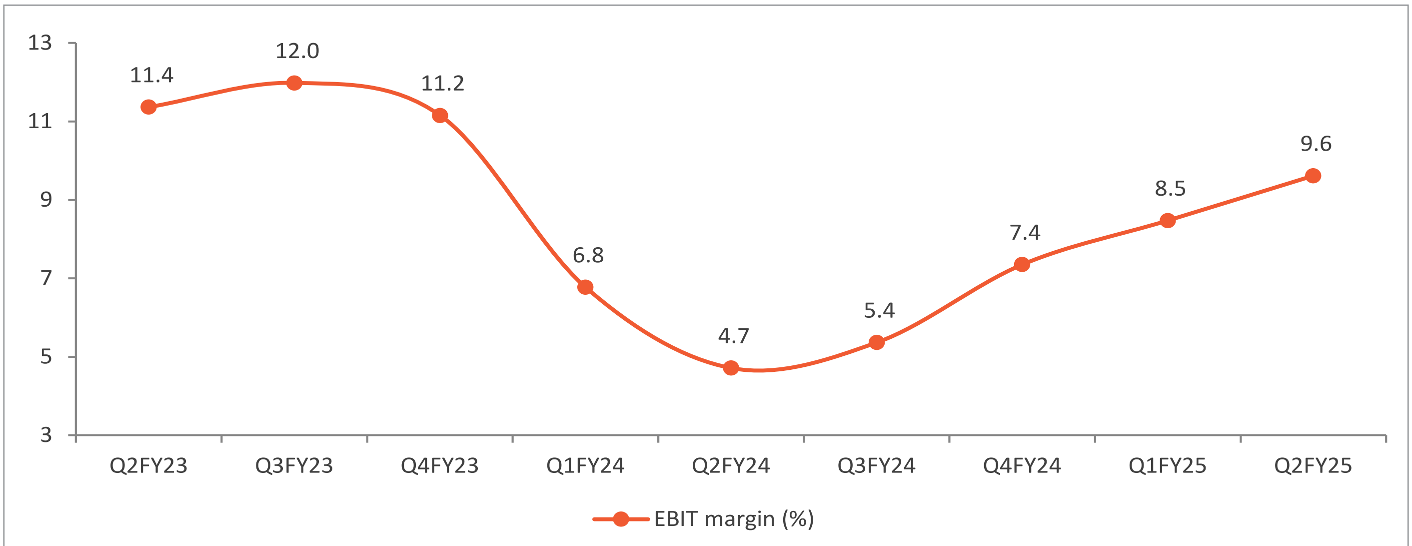
Source: Company, Sharekhan Research

BPO segment's EBITDA margin trend



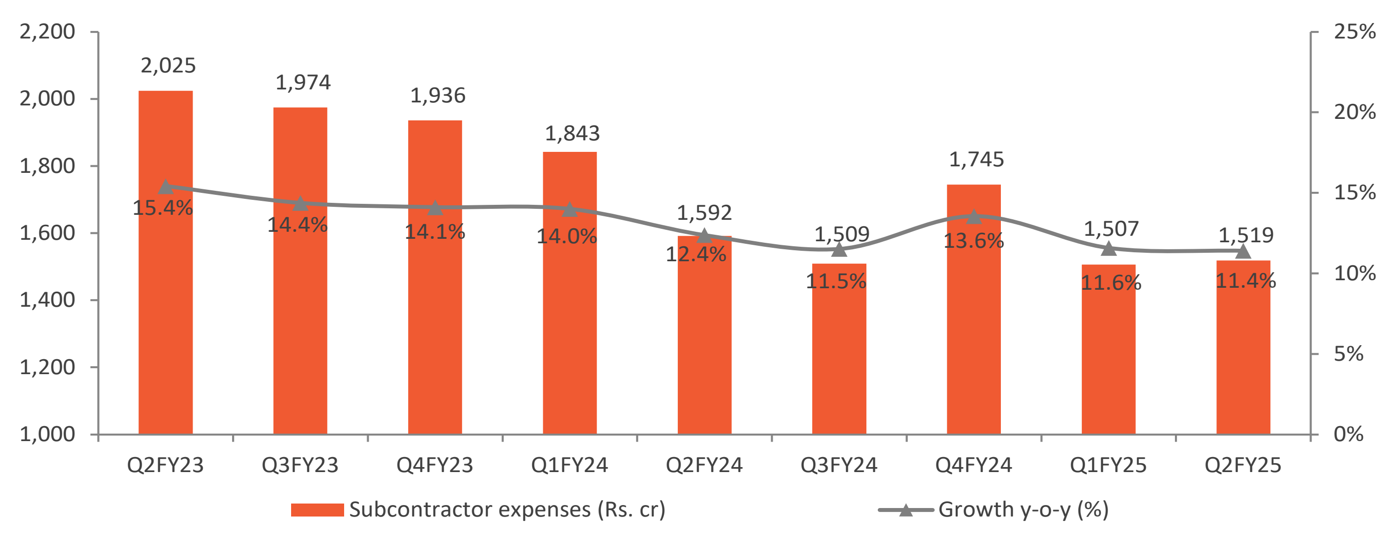
Source: Company, Sharekhan Research

Tech M's EBIT margin trend



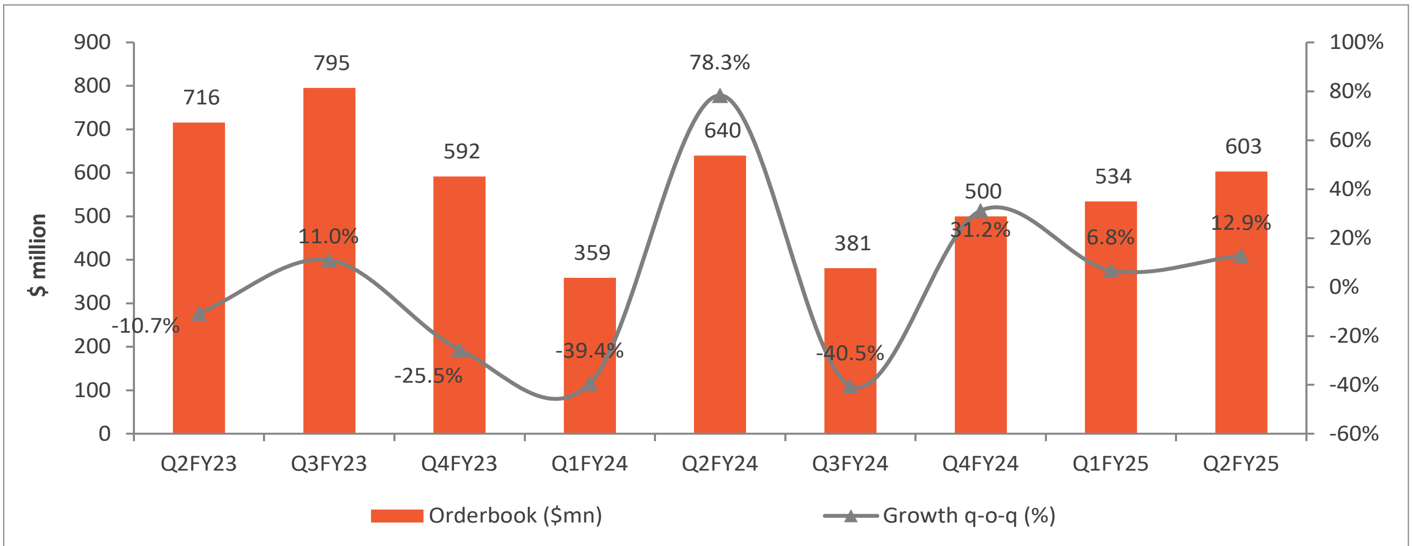
Source: Company, Sharekhan Research

Subcontractor expense (Rs. crore) and as a % of revenues



Source: Company, Sharekhan Research

New deal win TCV trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Macro headwinds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25 aided by lower base and easing sectoral headwinds. Though the IT sector has already outperformed the Nifty last year, we expect overall outperformance in CY24 as well-driven by receding headwinds and better earnings visibility.

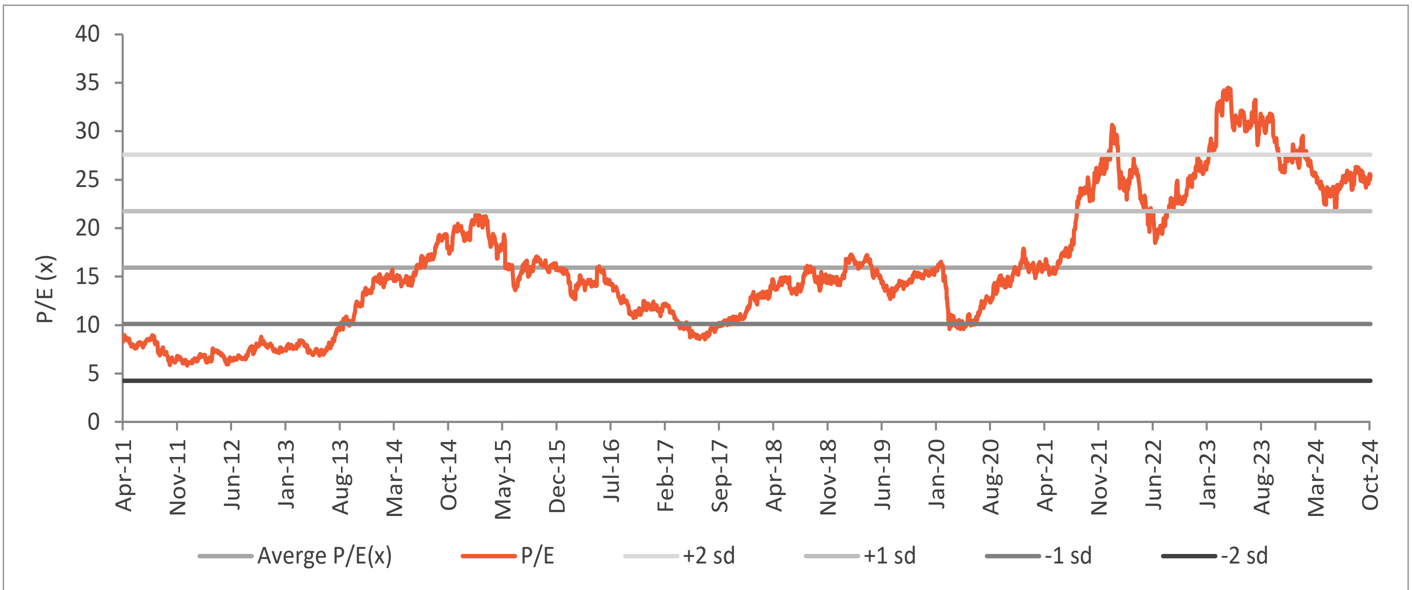
■ Company outlook - Turnaround plan promising

TechM is well-placed to capture 5G-related spending from TSPs and OEMs, given its early investments in network capabilities through LCC, investments in IPs, platforms, and investments/partnerships to develop an ecosystem. We remain positive on the company, considering strong demand in the telecom vertical, a strategic focus on digital acquisitions, steady pace of deal intake and a continuous focus on diversifying the business. Improvement in execution led by efficient capital allocation is expected to augur well for the company. The management expects FY25 to be better than FY24. The company aims at achieving topline growth above peers in FY27 with EBIT margin exceeding 15%. We believe the strategic initiatives would lead from turnaround to steady incremental gains for Tech M over FY25-27E.

■ Valuation - Maintain Buy with revised PT of Rs. 1950

Tech M reported good quarter with beat on revenue and margin front. Margins are expected to steadily recover under Project Fortius, with management prioritizing margins over securing large deals. Net new deal wins are steadily improving along with second consecutive quarter of net-headcount additions. We believe the recovery for Tech Mahindra although gradual, is playing out under the guidance of new leadership and service line structure. We maintain Buy with a revised price target of Rs 1950 (valued at 26x Sep26E EPS). At CMP, the stock trades at 33/25.3/20x its FY25/26/27E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

The company has been providing end-to-end services to telecom OEMs and service providers. Over the years, the company has acquired Comviva Technologies, LCC, and Hutchison Global Services to fill gaps in its service offerings in the telecom space. Notably, post the acquisition of Satyam, TechM entered the enterprise solutions space and became the fifth-largest Indian IT player. The company has now diversified its exposure to other verticals such as BFSI and manufacturing. TechM offers a bouquet of services including IT outsourcing services, consulting, next-generation solutions, application outsourcing, network services, infrastructure management services, integrated engineering solutions, business process outsourcing, platform solutions, and mobile value-added services.

Investment theme

TechM is one of the leading players in providing end-to-end services and solutions to telecom OEMs and major global service providers in the communication space (contributes more than 40% to its total revenue). Historically, this has helped the company whenever there is any uptick in technology spends, led by adoption of new technology. As the pace of spending from the roll-out of 5G network is likely to accelerate across the globe, TechM is well positioned to capitalise on the 5G opportunity across networks and IT services, given its investments in network capabilities, IPs, platforms, and partnerships. This has enabled the company to compete with large peers by striving for large deals in the enterprise segment.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements. 2)The contagion effect of banking crisis, macro headwinds and recession can moderate the pace of technology spending.

Additional Data

Key management personnel

Mr. Anand Mahindra	Chairman
Mohit Joshi	Managing Director and Chief Executive Officer
Rohit Anand	Chief Financial Officer
Manish Vyas	President, Communications, Media &Entertainment Business
Vivek Agarwal	President – BFSI, HLS and Corporate Development

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	10.41
2	TML BENEFIT TRUST	9.64
3	SBI Funds Management Ltd	3.77
4	Vanguard Group Inc/The	2.56
5	BlackRock Inc	2.46
6	First Sentier Investors ICVC	2.39
7	ICICI Prudential Asset Management	2.07
8	Mitsubishi UFJ Financial Group Inc	1.94
9	HDFC Asset Management Co Ltd	1.54
10	First Sentier Global Umbrella Fund	1.53

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/ weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN: - U99999MH1995PLC087498.

Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office Address - Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

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Compliance Officer: Ms. Binkle R. Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

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