

NOT RATED**TECH MAHINDRA**

| IT Services

| 19 October 2024

Beats modest expectations; Steady move toward FY27 targets

- A beat on revenue, margins and TCV against low expectations. Steadily moving to achieve its FY27 targets. Momentum to continue in 2H.
- First growth quarter (QoQ) for Telecom in six. Not clear if the worst is over. Manufacturing (auto heavy) under pressure, just like for peers.
- Industry matching growth in FY26 a challenge though EBIT margins on the right trajectory to hit 15% in FY27. Will initiate coverage soon.

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Revenue, EBIT margin and order inflow better than low expectations: Tech Mahindra (TML) Delivered 0.7% against flat growth expectation in CC QoQ terms. EBIT margin saw a 110-bps improvement versus about 40 that we expected. ~US\$600mn new TCV is higher than the US\$500mn that the street was working with. Communication vertical grew 2.7% QoQ in USD terms, a first in 6 quarters. But not sure that is sustainable going forward. Except Manufacturing (auto heavy) declined by 4% QoQ and healthcare and life sciences (1.8%) all other verticals grew. 110bps improvement in EBIT margin was driven 70bps by Project Fortius (cost containment program) and 40bps by currency. Looks like value-based pricing and offshore shift were key levers that delivered in the quarter within Project Fortius.

Demand is indicated to be very similar to previous quarters: Said incrementally it is a bit weaker in Auto. In BFSI the CEO says things have not changed materially. This is at odds with what we are hearing from its peers.

Expect margin improvement to be more measured in 2H: Project Fortius involved 150bps investment in FY25 and 75bps in FY26. CFO talked about 2H being slightly heavier on investment compared to 1H. So, while TML is indicating margin improvement QoQ, we think it will be very gradual. Plus, TML has not indicated when and how much the compensation will increase by if at all in FY25.

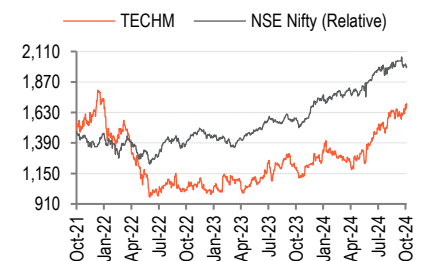
New deal TCV at its highest in the last 4 quarters: With TML currently focused on margins than on growth and not bidding for low margin projects where there is little visibility on back-ended margin improvement, the improvement in net new TCV has been steady. TML is now talking about a new band of US\$600-800mn per quarter going forward.

Value based pricing effort: TML's effort is to improve margins through better price realization and optimized skill utilization within the diamond-shaped organization while still integrating fresh talent. There is a focus on realizing full value from existing contracts and implementing disciplined governance in fixed-price programs, which include automation initiatives.

Ticker/Price	TECHM IN/Rs 1,688
Market cap	US\$ 17.8bn
Free float	65%
3M ADV	US\$ 42.4mn
52wk high/low	Rs 1,710/Rs 1,098
Promoter/FPI/DII	35%/24%/31%

Source: NSE | Price as of 18 Oct 2024

Stock performance



Source: NSE



New deal win TCV for the quarter was US\$603mn, with highlights including strategic wins in the communications space and along with the onboarding of two BFSI new logos, one each from the U.S. and Europe

Progress on towards hitting FY27 goals:

The transformation was to be on three pillars of growth, margins and organizational transformation. On growth - accounts with revenues greater than US\$20mn have grown 1.5 x pace of rest of the company. This is due to investment in dedicated client and delivery partners for top accounts.

From margins perspective, TML is working on both short term and long-term measures. On the short term, there is a reduction in Subcon costs. From a longer-term perspective, it's focus on the pyramid and value-based pricing.

In terms of organization there is a focus on simplifying, clarifying, innovating and driving performance management. One-third of TML's IT services workforce is Gen AI trained using GitHub Copilot, which TML thinks is ahead of its peer groups. It is also seeing the percentage of Gen AI infused deals go up every quarter.

BFSI positivity tempered

TML stated that the BFSI sector is experiencing slightly elevated spending levels compared to a year ago, though the concentration of clients means that downturns in individual clients can significantly impact overall performance. TML says that this vertical remains vulnerable to furlough pressures, like manufacturing. While there is a slight improvement in sentiment, it is not substantial.

Communication sector still faces pressure

Rate cuts are anticipated to provide relief to telecom clients burdened with heavy debt, potentially enabling increased tech spending. Recent QoQ growth in the communications segment driven particularly by the Asia-Pacific and Europe clients indicates some stabilization, although challenges remain in the U.S. market

Weakness among the top five clients, predominantly telecom, is attributed to significant budget pressures resulting from high interest rates. Despite this, there is confidence in regaining market share and maintaining competitive positioning. TML talked about its unique capabilities across IT services, network services and BPS in Telecom space.

Other points

Other income totaled US\$62mn, including a gain on the sale of land amounting to ~US\$54mn.

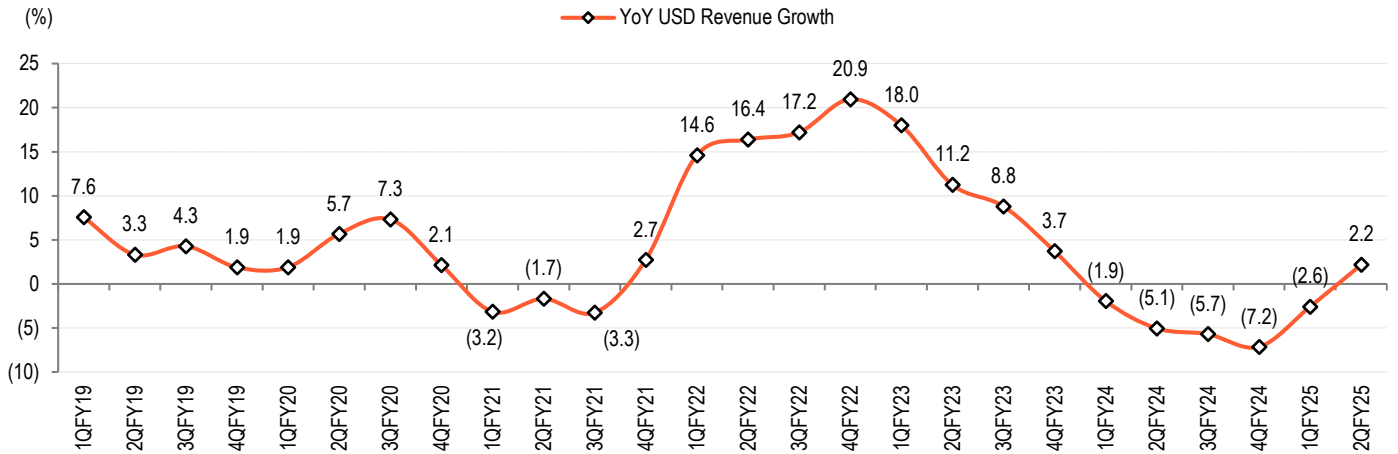
Added 6650 net employees QoQ with 2000 being freshers. Likely due to high utilization and probably decent demand.

Fig 1 – Quarterly results: Comparison of actuals with estimates

Y/E March (Rs mn)	2QFY24	1QFY25	2QFY25	YoY (%)	QoQ (%)	2QFY25E	Dev (%)
Net Sales (US\$ mn)	1,555	1,559	1,589	2.2	1.9	1,572	1.1
Net Sales	1,28,639	1,30,055	1,33,132	3.5	2.4	1,31,748	1.1
Direct Cost	99,752	95,532	95,957	(3.8)	0.4	96,487	(0.5)
Gross Margin	28,887	34,523	37,175	28.7	7.7	35,261	5.4
% of Sales	22.5	26.5	27.9			26.8	
SG&A	18,164	18,878	19,673	8.3	4.2	18,878	4.2
% of Sales	14.1	14.5	14.8			14.3	
EBITDA	10,723	15,645	17,502	63.2	11.9	16,383	6.8
EBITDA Margin (%)	8.3	12.0	13.1			12.4	
Depreciation & Amortisation	4,657	4,622	4,698	0.9	1.6	4,645	1.1
EBIT	6066	11,023	12804	111.1	16.2	11,737	9.1
EBIT Margin (%)	4.7	8.5	9.6			8.9	
Interest	975	715	890	(8.7)	24.5	715	24.5
Other Income	2,642	1,447	5,215	97.4	260.4	2,449	113.0
Amortisation of goodwill	1,495	0	0			0	
PBT	6,238	11,755	17,129	174.6	45.7	13,471	27.2
Exceptional Item (as Reported)	(85)	26	6			0	
Provision for Tax	1,100	3,133	4,560	314.5	45.5	3,583	27.3
Effective Tax Rate	17.6	26.7	26.6			26.6	
Minority share in Profit / Loss	(114)	(133)	(74)	(35.1)	(44.4)	(100)	(26.0)
PAT (Reported)	4,939	8,515	12,501	153.1	46.8	9,789	27.7
NPM (%)	3.8	6.5	9.4			7.4	

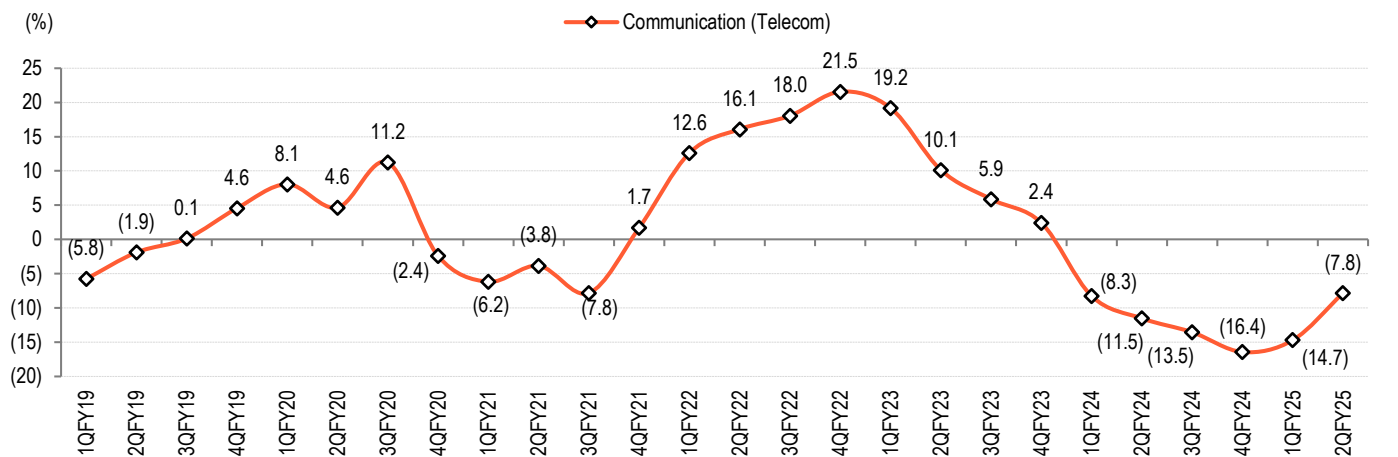
Source: Company, BOBCAPS Research

Fig 2 – YoY USD Revenue growth for Enterprise side – in the positive territory after several quarters.



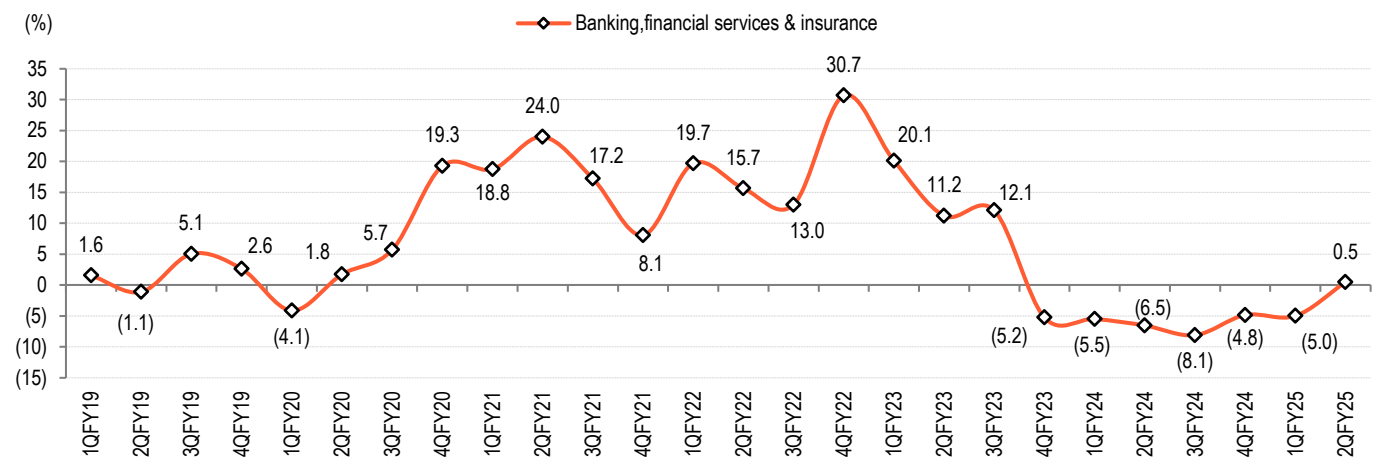
Source: Company, BOBCAPS Research

Fig 3 – YoY USD Revenue growth for communications vertical. Still down YoY though growth seen QoQ



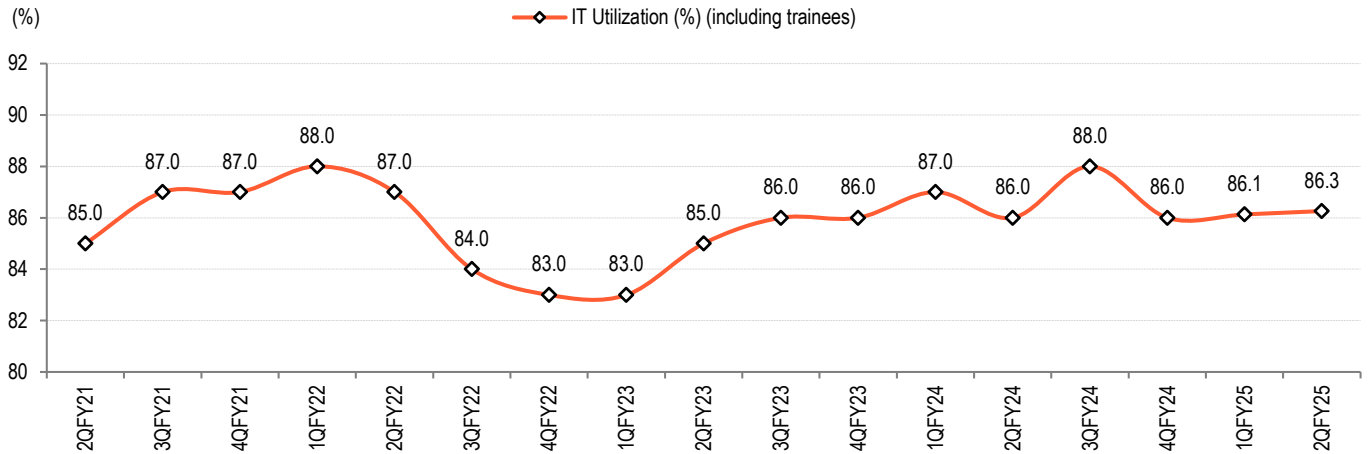
Source: Company, BOBCAPS Research

Fig 4 – YoY USD Revenue growth in the BFSI vertical



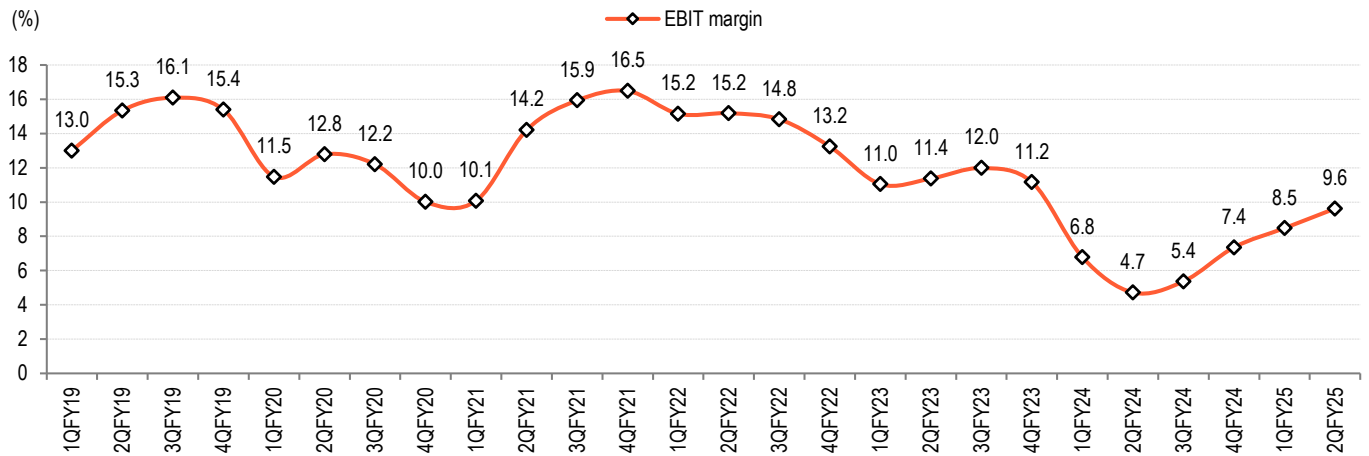
Source: Company, BOBCAPS Research

Fig 5 – Utilization rates QoQ



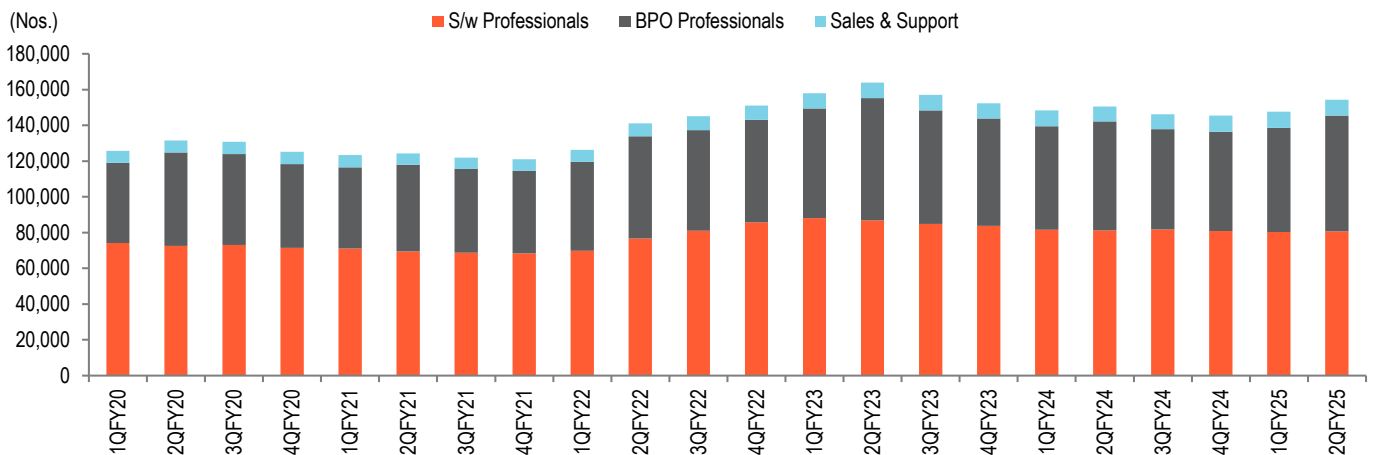
Source: Company, BOBCAPS Research

Fig 6 – EBIT Margin (%) steadily improving



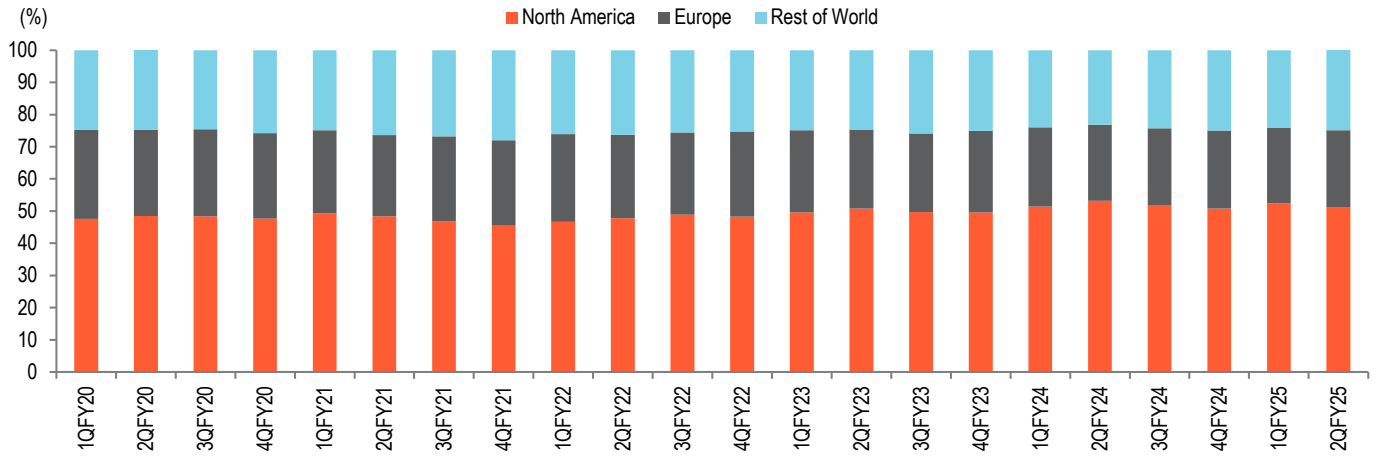
Source: Company, BOBCAPS Research

Fig 7 – Total Headcount trend QoQ. A solid addition in the quarter



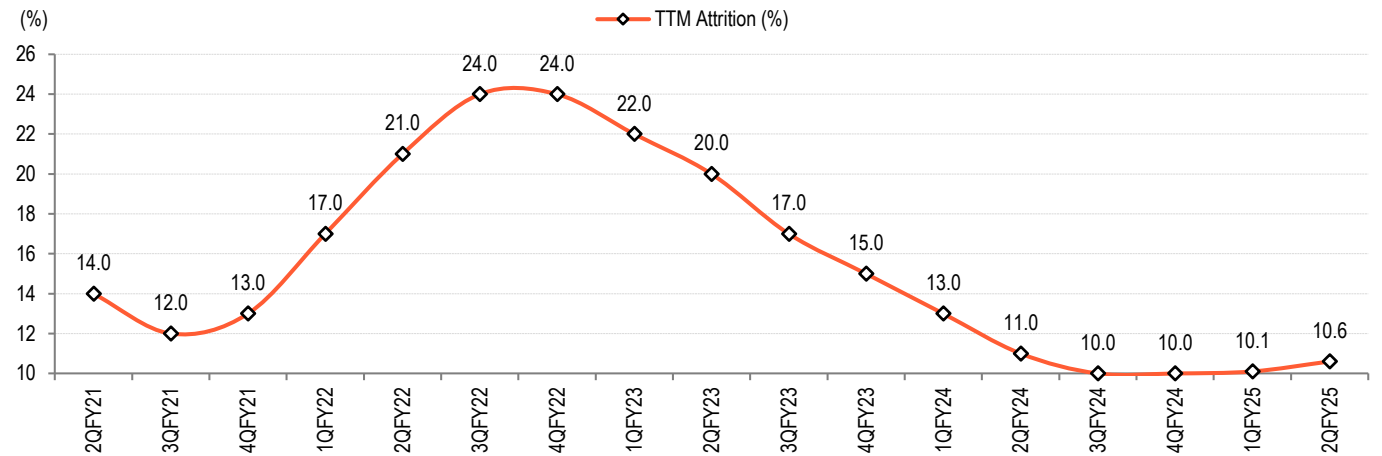
Source: Company, BOBCAPS Research

Fig 8 – Revenue contribution in terms of Geographies



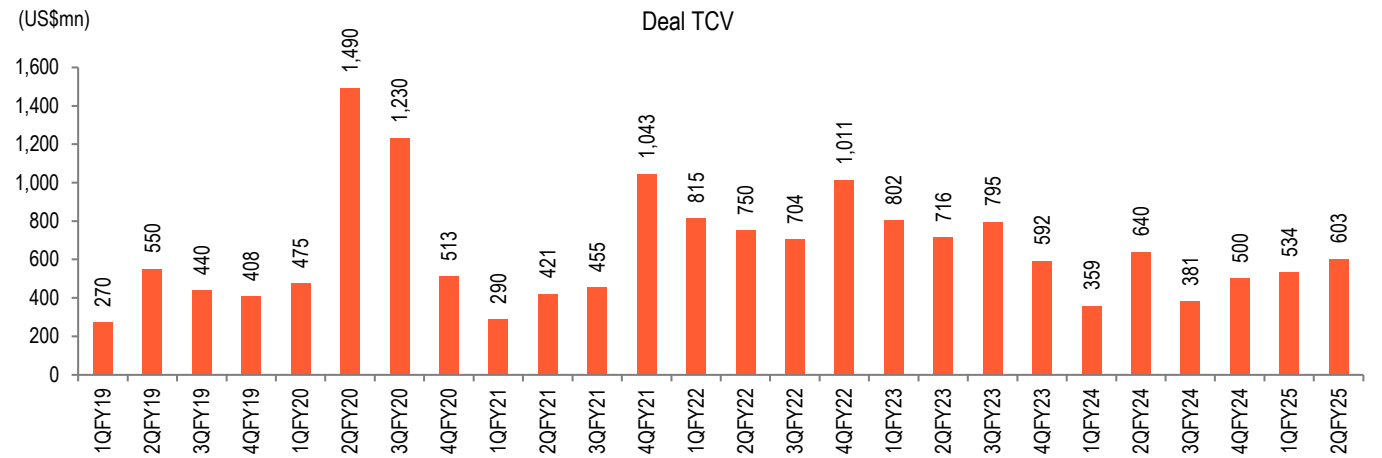
Source: Company, BOBCAPS Research

Fig 9 – Attrition Rate trend QoQ. Small uptick



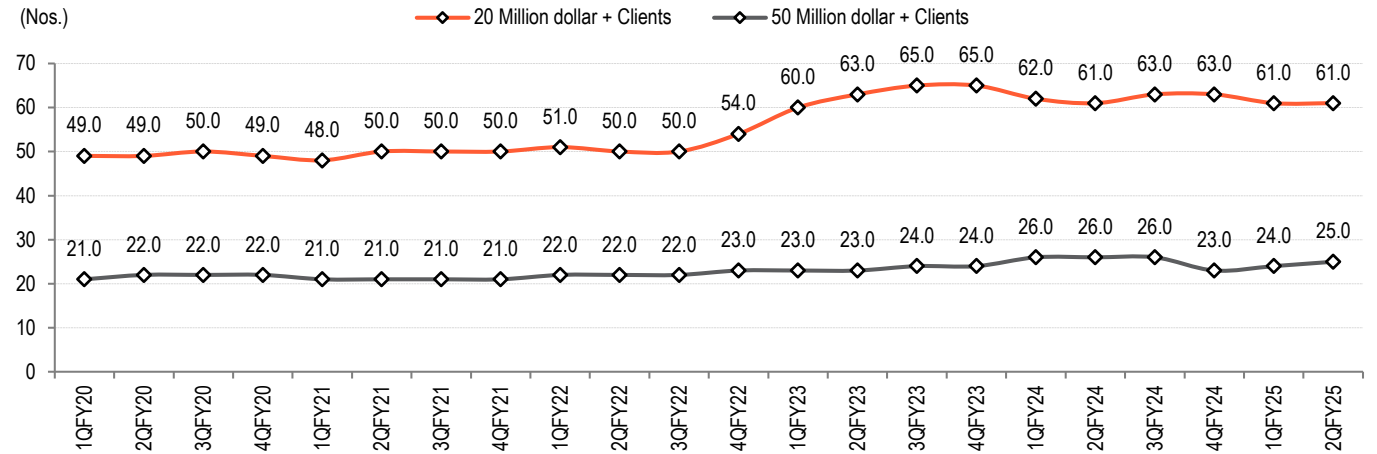
Source: Company, BOBCAPS Research

Fig 10 – TCV trend QoQ. On a rising trend



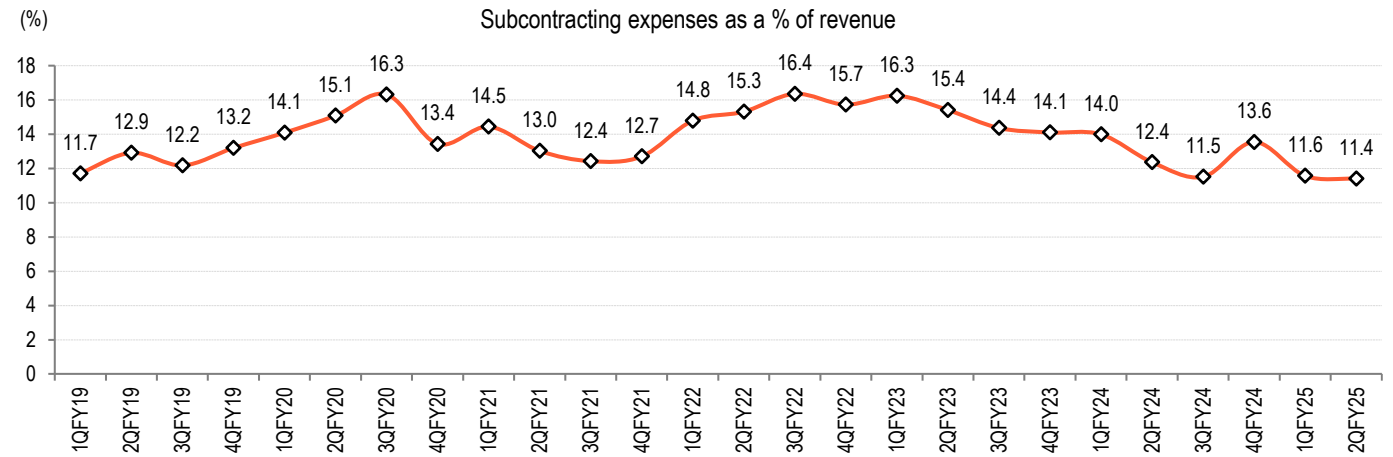
Source: Company, BOBCAPS Research

Fig 11 – Number of clients: >US\$20mn and >US\$50mn bucket



Source: Company, BOBCAPS Research

Fig 12 – Subcontracting costs as % of revenue



Source: Company, BOBCAPS Research

Fig 13 – Quarterly Snapshot

Year to 31 March (Rs mn)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
INR/US\$	77.7	80.0	82.3	82.3	82.2	82.7	83.3	83.1	83.4	83.8
US\$ Revenue (US\$ mn)	1633	1638	1668	1668	1601	1555	1573	1548	1559	1589
INR Revenue	1,27,079	1,31,295	1,37,346	1,37,182	1,31,590	1,28,639	1,31,013	1,28,713	1,30,055	1,33,132
Gross Margin	35,917	36,681	39,409	39,698	33,785	28,887	31,365	34,772	34,523	37,175
SGA	17,116	16,840	17,969	19,493	20,405	18,164	19,900	20,694	18,878	19,673
EBITDA	18,801	19,841	21,440	20,205	13,380	10,723	11,465	14,078	15,645	17,502
Depreciation	4,767	4,917	4,981	4,902	4,466	4,657	4,434	4,614	4,622	4,698
EBIT	14,034	14,924	16,459	15,303	8,914	6,066	7,031	9,464	11,023	12,804
Other income (net)	1,221	2,902	2,472	3,055	1,917	2,642	875	3,735	1,447	5,215
PBT	14,855	16,639	17,712	15,248	9,712	6,153	6,789	9,591	11,781	17,135
Tax	3,380	3,647	4,859	3,999	2,676	1,100	1,551	2,949	3,133	4,560
Minority Share in profit/Loss	(159)	(138)	113	(73)	(111)	(114)	(133)	(32)	(133)	(74)
Exceptional Item	3	(153)	(90)	(50)	78	(85)	48	64	26	6
PAT	11,316	12,854	12,966	11,176	6,925	4,939	5,105	6,610	8,515	12,501
YoY Growth (%)										
US\$ Revenue	18.0	11.2	8.8	3.7	(1.9)	(5.1)	(5.7)	(7.2)	(2.6)	2.2
INR Revenue	24.6	20.7	19.9	13.2	3.5	(2.0)	(4.6)	(6.2)	(1.2)	3.5
Gross Profit	11.2	6.4	14.5	11.6	(5.9)	(21.2)	(20.4)	(12.4)	2.2	28.7
EBITDA	0.2	(0.6)	4.1	(3.3)	(28.8)	(46.0)	(46.5)	(30.3)	16.9	63.2
EBIT	(9.2)	(9.7)	(3.1)	(4.6)	(36.5)	(59.4)	(57.3)	(38.2)	23.7	111.1
Net Profit	(16.4)	(4.0)	(5.3)	(25.8)	(38.8)	(61.6)	(60.6)	(40.9)	23.0	153.1
QoQ Growth (%)										
US\$ Revenue	1.5	0.3	1.8	0.0	(4.0)	(2.8)	1.1	(1.6)	0.7	1.9
INR Revenue	4.9	3.3	4.6	(0.1)	(4.1)	(2.2)	1.8	(1.8)	1.0	2.4
EBITDA	(10.0)	5.5	8.1	(5.8)	(33.8)	(19.9)	6.9	22.8	11.1	11.9
EBIT	(12.5)	6.3	10.3	(7.0)	(41.7)	(31.9)	15.9	34.6	16.5	16.2
Net Profit	(24.8)	13.6	0.9	(13.8)	(38.0)	(28.7)	3.4	29.5	28.8	46.8
Margins (%)										
Gross Margin	28.3	27.9	28.7	28.9	25.7	22.5	23.9	27.0	26.5	27.9
EBITDA	14.8	15.1	15.6	14.7	10.2	8.3	8.8	10.9	12.0	13.1
EBIT	11.0	11.4	12.0	11.2	6.8	4.7	5.4	7.4	8.5	9.6
PAT	8.9	9.8	9.4	8.1	5.3	3.8	3.9	5.1	6.5	9.4
SGA	13.5	12.8	13.1	14.2	15.5	14.1	15.2	16.1	14.5	14.8

Source: Company, BOBCAPS Research

Fig 14 – Key Metrics

Key Metrics	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
P and L (Rs mn)										
Revenue	1,27,079	1,31,295	1,37,346	1,37,182	1,31,590	1,28,639	1,31,013	1,28,713	1,30,055	1,33,132
EBITDA	18,801	19,841	21,440	20,205	13,380	10,723	11,465	14,078	15,645	17,502
PAT	11,316	12,854	12,966	11,176	6,925	4,939	5,105	6,610	8,515	12,501
Vertical Mix (%)										
Communication (Telecom)	40.4	39.7	39.8	40.1	37.8	37.0	36.5	36.1	33.1	33.4
Manufacturing	15.3	16.0	15.7	15.9	16.9	17.8	18.1	18.2	18.3	17.2
Technology, media & entertainment	9.7	10.1	10.3	10.3	10.7	11.0	10.5	10.7	13.8	14.3
Banking, financial services & insurance	16.7	16.3	15.9	15.9	16.1	16.1	15.5	16.3	15.7	15.8
Retail, transport & logistics	7.9	8.1	8.5	7.6	7.1	8.2	8.6	7.3	7.7	7.9
Others	10.0	9.8	9.9	10.2	4.0	10.0	10.8	4.0	3.8	4.0
Geographical Mix (%)										
North America	49.6	50.8	49.7	49.6	51.4	53.3	51.9	50.8	52.4	51.1
Europe	25.5	24.5	24.4	25.3	24.6	23.6	23.8	24.2	23.4	24.0
Rest of World	24.9	24.7	25.9	25.1	24.0	23.2	24.3	25.0	24.2	24.9
IT Headcount Mix (%)										
Onsite	27.2	27.3	27.5	27.3	26.9	26.6	26.1	25.2	24.6	23.7
Offshore	72.8	72.7	72.5	72.7	73.1	73.4	73.9	74.8	75.4	76.3
IT Utilization (%) (including trainees)	83.0	85.0	86.0	86.0	87.0	86.0	88.0	86.0	86.1	86.3
Clients Concentration (%)										
Top 5 Clients	21.0	19.0	18.0	17.0	17.0	17.0	16.0	16.0	15.5	15.1
Top 10 Clients	30.0	28.0	27.0	26.0	27.0	27.0	26.0	26.0	25.1	24.9
Top 20 Clients	41.0	40.0	40.0	40.0	39.0	39.0	39.0	39.0	38.4	38.6
Number of Client										
1 USD mn +	549	562	574	582	580	568	558	553	545	545
5 USD mn +	176	184	185	186	190	186	185	190	191	195
10 USD mn +	104	108	109	112	115	114	118	114	113	109
20 USD mn +	60	63	65	65	62	61	63	63	61	61
50 USD mn +	23	23	24	24	26	26	26	23	24	25
Employees	1,58,035	1,63,912	1,57,068	1,52,400	1,48,297	1,50,604	1,46,250	1,45,455	1,47,620	1,54,273
Net employee added	6,862	5,877	(6,844)	(4,668)	(4,103)	2,307	(4,354)	(795)	2,165	6,653
TTM Attrition (%)	22	20	17	15	13	11	10	10	10	11
Financial Metrics (US\$ mn)										
Revenue	1,633	1,638	1,668	1,668	1,601	1,555	1,573	1,548	1,559	1,589
EBITDA	239	246	260	245	163	129	138	169	188	209
EBIT	177	184	200	186	108	73	84	114	132	153
PAT	145	162	157	137	85	62	62	79	103	150
Per Capita (Annualised) – US\$										
Revenue	41,320	39,975	42,486	43,769	43,176	41,306	43,022	42,575	42,241	41,192
EBITDA	6,042	5,991	6,626	6,441	4,388	3,437	3,766	4,653	5,082	5,414
EBIT	4,488	4,493	5,086	4,877	2,924	1,942	2,311	3,127	3,581	3,961
PAT	3,665	3,963	3,998	3,601	2,279	1,644	1,707	2,172	2,800	3,888
Per capita operating cost	36,832	35,482	37,400	38,892	40,252	39,364	40,711	39,449	38,661	37,232

Source: Company, BOBCAPS Research

Fig 15 – QoQ and YoY growth of various parameters (USD terms)

	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
QoQ Growth										
Total Company	1.5	0.3	1.9	(0.1)	(11.1)	4.9	1.1	(1.8)	0.9	1.9
By Geography (%)										
North America	4.2	2.8	(0.4)	(0.2)	(0.5)	0.7	(1.4)	(3.7)	3.9	(0.7)
Europe	(1.9)	(3.6)	1.4	3.6	(6.7)	(7.0)	2.2	0.1	(2.6)	4.5
Rest of World	(0.1)	(0.5)	6.8	(3.1)	(8.2)	(6.1)	5.9	1.3	(2.7)	5.0
By Industry (%)										
Communications, Media and Entertainment	1.0	(1.4)	2.1	0.7	(9.5)	(4.9)	(0.2)	(2.7)	(7.6)	2.7
Manufacturing	4.2	4.9	(0.1)	1.2	2.0	2.0	3.1	(1.0)	1.1	(4.0)
Technology	5.9	4.5	3.9	(0.0)	(0.3)	(0.1)	(3.5)	0.3	29.7	5.7
Banking, financial services & insurance	(2.6)	(2.1)	(0.7)	(0.0)	(2.8)	(3.1)	(2.3)	3.5	(3.0)	2.4
Retail, transport & logistics	5.5	2.9	6.9	(10.6)	(10.3)	12.2	6.1	(16.5)	5.5	5.6
Others	(0.5)	(1.7)	2.9	3.0	(62.4)	142.9	9.2	(63.5)	(4.6)	7.8
By Client classification (%)										
Top 5 Clients	(3.1)	(9.2)	(3.5)	(5.6)	(4.0)	(2.8)	(4.8)	(1.6)	(2.5)	(0.4)
Top 10 Clients	(1.8)	(6.3)	(1.8)	(3.7)	(0.3)	(2.8)	(2.6)	(1.6)	(2.8)	1.0
Top 20 Clients	(3.2)	(2.1)	1.8	(0.0)	(6.4)	(2.8)	1.1	(1.6)	(0.9)	2.5
YoY Growth										
Total Company	18.0	11.2	8.8	3.7	(1.9)	(5.1)	(5.7)	(7.2)	(2.6)	2.2
By Geography (%)										
North America	25.3	18.2	10.6	6.5	1.6	(0.5)	(1.5)	(4.9)	(0.7)	(2.0)
Europe	10.6	5.2	4.1	(0.6)	(5.4)	(8.7)	(8.0)	(11.2)	(7.3)	4.2
Rest of World	12.6	4.5	10.1	2.9	(5.5)	(10.8)	(11.5)	(7.5)	(2.0)	9.6
By Industry (%)										
Communications, Media and Entertainment	19.2	10.1	5.9	2.4	(8.3)	(11.5)	(13.5)	(16.4)	(14.7)	(7.8)
Manufacturing	9.4	11.2	8.0	10.7	8.3	5.3	8.7	6.3	5.3	(0.9)
Technology	30.1	24.8	32.8	14.9	8.2	3.4	(3.9)	(3.6)	25.4	32.7
Banking, financial services & insurance	20.1	11.2	12.1	(5.2)	(5.5)	(6.5)	(8.1)	(4.8)	(5.0)	0.5
Retail, transport & logistics	21.1	15.5	8.5	3.7	(11.9)	(3.9)	(4.6)	(10.8)	4.9	(1.2)
Others	11.3	0.9	(1.1)	3.7	(60.8)	(3.1)	2.9	(63.6)	(7.7)	(59.0)
By Client Classification (%)										
Top 5 Clients	12.1	(3.9)	(13.6)	(19.9)	(20.6)	(15.1)	(16.2)	(12.6)	(11.3)	(9.0)
Top 10 Clients	14.2	0.5	(6.5)	(13.0)	(11.8)	(8.5)	(9.2)	(7.2)	(9.5)	(5.9)
Top 20 Clients	12.0	3.5	2.7	(3.5)	(6.7)	(7.4)	(8.1)	(9.5)	(4.1)	1.2

Source: Company, BOBCAPS Research

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Note: Recommendation structure changed with effect from 21 June 2021

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