

**NOT RATED****TECH MAHINDRA**

| IT Services

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**On track with its FY27 objectives**

- 1QFY25 was broadly along expected lines and the first positive but modest step in achieving its FY27 objectives
- 1QFY25 growth was driven by its manufacturing (2.4% in QoQ US\$ terms), retail CPG (5.2%), Healthcare & Life Sciences (7.9%) segments
- It did not indicate improvement in demand conditions in the last three months. We will be initiating coverage on the sector and stock soon

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**1QFY25 broadly in line:** TECHM's 1QFY25 was broadly along expected lines and the first positive but modest step in achieving its FY27 objectives: (1) growing revenue ahead of its peer average (2) delivering 15% EBIT margin and (3) ROCE>30%. Hence, the ~24% upmove since 1 June 2024 may be a bit overdone in the short term. TECHM does not think the demand environment has changed materially over the last three months, either generally or in the BFSI space.

**Comviva seasonality impacts modestly:** TECHM's 1QFY25 revenue was a tad below our estimate (0.7% growth in constant currency (CC) and USD terms while we were expecting 1%) while the EBIT margin was 60bps higher (see Figure 1). The reason for the US\$ number being higher than ours is because we had assumed a higher cross currency impact. 1Q is a seasonally weak quarter because of the absence/lower revenue booked on Comviva, TECHM's mobility solutions entity. However, the seasonal impact of Comviva has been reducing over time based on our understanding. About 50bps was the impact both on the revenue and the EBIT margin (QoQ) due to Comviva.

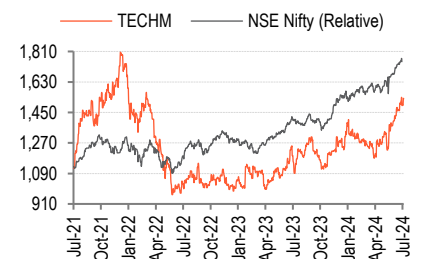
**Reiterates that FY25 will be better than FY24:** TECHM, which is in the very early stages of its three-year turnaround journey (as laid out three months ago), indicated it was happy with the progress. It reiterated in its results press conference the view that growth in FY25 will be better than FY24 (4.7% CC decline).

**Telecom growth still negative but less so compared to the past:** 1QFY25 growth was driven by its Manufacturing (2.4% in QoQ US\$ terms), Retail CPG (5.2%), and the Healthcare and Life Sciences (7.9%) segments. The Telecom segment remains stressed though the pain is lessening. While growth remains in negative territory YoY, the decline has moderated from teens to single digits.

**No improvement in BFSI or general demand:** TECHM stated that demand remains broadly like what it was three months ago but slightly better YoY. While BFSI, especially in the US, has done well for most players, TECHM did not see a material change in demand conditions here either.

Ticker/Price	TECHM IN/Rs 1,530
Market cap	US\$ 16.0bn
Free float	64%
3M ADV	US\$ 40.0mn
52wk high/low	Rs 1,548/Rs 1,082
Promoter/FPI/DII	36%/39%/25%

Source: NSE | Price as of 25 Jul 2024

**Stock performance**

Source: NSE



- On the positive side in BFSI, TML has been empaneled by a large Global bank as a preferred vendor. TML, however, stated that BFSI growth would be volatile in the foreseeable future
- When questioned about many of its peers winning large communication service provider contracts in the recent past, TECHM stated it has been choosy when bidding for them as it wants to prioritise margins over growth currently.
- EBIT margin improved by 110bps. The gains from project Fortius helped counter headwinds from the lack of Comviva revenue, higher visa costs, etc. There was a 200bps subcontractor cost compression QoQ which helped its gross margin. SGA contracted by 160bps QoQ. All these gains were countered by extra investments made by the company (as indicated at the start of the year and which will be gradually reduced over the next two years).
- Deal TCV (total contract value) was US\$ 534mn, which improved 6.8% QoQ. It is well diversified in terms of industry verticals and key regions.
- The segmental breakdown of numbers have been reorganised and some of the revenue numbers, which were based in the IT services segment, have been moved to Business Process Services (BPS). So, the segmental analysis from a growth and margin perspective may be misleading.
- TECHM stated that it has not decided on wage hikes and will look at it if required in 2HFY25 depending on the company's financial health.
- Just like in the case of Zensar it indicated that it has seen unusual furloughs in the Hi-Tech sector but that these are not very material now.
- On the AI/Gen AI side it made two announcements. One was Tech M Verify, which it claims is a robust validation and assurance framework for AI systems. TECHM believes it is the missing link that will help companies move from pilots and experimentation phases to enterprise level adoption of AI.
- It also announced the launch of project Indus which is the first and one of the only large language models for indigenous Indian languages. This is more a technology demonstrator and helps build TECHM's image amongst clients though monetisation directly may not be on the cards in the near term.
- TECHM does not expect pressure in its BPS business (which is contact centre heavy) due to Gen AI as it believes that it already has a lot of AI/Gen AI infused in it now. And the contact centre business constitutes ~5% of its total turnover currently.

**Fig 1 – Quarterly performance**

Y/E March (Rs mn)	1QFY24	4QFY24	1QFY25	YoY (%)	QoQ (%)	1QFY25E	Dev (%)
Net Sales (USD mn)	1,601	1,548	1,559	(3.3)	0.7	1,550	0.6
Net Sales	131,590	128,713	130,055	(2.2)	1.0	129,175	0.7
Direct Cost	97,805	93,941	95,532	(4.0)	1.7	93,694	2.0
Gross Margin	33,785	34,772	34,523	2.9	(0.7)	35,481	(2.7)
% of Sales	25.7	27.0	26.5	-	(1.7)	27.5	-
SG&A	20,405	20,694	18,878	1.4	(8.8)	20,694	(8.8)
% of Sales	15.5	16.1	14.5	-	(9.7)	16.0	-
<b>EBITDA</b>	<b>13,380</b>	<b>14,078</b>	<b>15,645</b>	<b>5.2</b>	<b>11.1</b>	<b>14,787</b>	<b>5.8</b>
EBITDA Margin (%)	10.2	10.9	12.0	-	10.0	11.4	-
Depreciation & Amortisation	4,466	4,614	4,622	3.3	0.2	4,645	(0.5)
<b>EBIT</b>	<b>8914</b>	<b>9,464</b>	<b>11023</b>	<b>6.2</b>	<b>16.5</b>	<b>10,142</b>	<b>8.7</b>
EBIT Margin (%)	6.8	7.4	8.5	-	15.3	7.9	-
Interest	1,197	585	715	(51.1)	22.2	424	68.7
Other Income	1,917	3,735	1,447	94.8	(61.3)	2,532	(42.8)
Amortisation of goodwill	0	3,087	-	-	-	-	-
<b>PBT</b>	<b>9,634</b>	<b>9,527</b>	<b>11,755</b>	<b>(1.1)</b>	<b>23.4</b>	<b>12,249</b>	<b>(4.0)</b>
Exceptional Item (as Reported)	78	64	26	-	-	-	-
Provision for Tax	2,676	2,949	3,133	10.2	6.2	3,001	4.4
Effective Tax Rate	27.8	31.0	26.7	-	-	24.5	-
Minority share in Profit / Loss	(111)	(32)	(133)	(71.2)	315.6	(100)	33.0
<b>PAT (Reported)</b>	<b>6,925</b>	<b>6,610</b>	<b>8,515</b>	<b>(4.5)</b>	<b>28.8</b>	<b>9,148</b>	<b>(6.9)</b>
NPM (%)	5.3	5.1	6.5	-	-	7.1	-

Source: Company, BOBCAPS Research

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