

Tech Mahindra (TECHM)

HOLD

Turnaround in progress

Summary

Tech Mahindra (TechM) reported 1.6% QoQ de-growth in Q4FY24 and was below our estimates. Going forward the company believes that Q4 was the lowest growth on YoY terms and expects growth to improve over the coming quarters. The company has laid down strategy till FY27E wherein the company aims to have a turnaround in FY25E, stabilize in FY26E and grow in line with peers by FY27E. Further, the company aims to achieve 15% margins by FY27E from 6% in FY24. The company will achieve the same by US\$250 mn annual cost savings (~4% of revenues) offset by 1.5% of investments. While we have factored in most of the growth and margin expectation, we believe execution is the key. Hence, we maintain our Hold rating with a target price of Rs 1,265 (18x FY26E EPS).

Key Highlights and Investment Rationale

- FY27E strategy of CEO:** The new CEO aims to achieve peer growth by FY27E. The CEO aims to achieve the same by creating SBU level focus on account mining, new accounts targeting and phasing of long tail accounts. Further, incentivizing sales team to achieve the same. The CEO also aims to tap large deals and focus on large accounts. The company has also created measures for tracking the progress like Growth in accounts > \$20M, Contribution from NA, Europe, prioritized pockets in APJ, Net new deal wins and Industry mix (where we believe focus will be higher on non teleco industries).
- 15% EBIT margin by FY27E:** The company aims to achieve 15% margins by FY27E vs 6% in FY24. The company aims to do the same by pyramid correction (consistent fresher hiring), synergy in portfolio companies, higher fixed price projects (as pyramid will help in driving efficiency) and pricing.

| TP | Rs1,265 | | | Key Stock Data | | | |
|----------------------------|----------|----------|----------|------------------------------------|----------|--|--|
| CMP | Rs1,190 | | | Bloomberg/Reuters TECHM IN/TEML.BO | | | |
| Potential upside/downside | 6% | | | | | | |
| Previous Rating | HOLD | | | | | | |
| Price Performance (%) | | | | | | | |
| | -1m | -3m | -12m | | | | |
| Absolute | (5.9) | (10.0) | 19.4 | | | | |
| Rel to Sensex | (8.0) | (15.1) | (4.2) | | | | |
| V/s Consensus | | | | Shareholding Pattern (%) | | | |
| EPS (Rs) | FY25E | FY26E | | | | | |
| IDBI Capital | 55 | 69 | | | | | |
| Consensus | 53 | 69 | | | | | |
| % difference | 4.2 | 0.3 | | | | | |
| Financial snapshot (Rs mn) | | | | | | | |
| Year | FY22 | FY23 | FY24 | FY25E | FY26E | | |
| Revenue | 4,46,460 | 5,32,902 | 5,19,955 | 5,28,046 | 5,70,135 | | |
| Change (yoY, %) | 18 | 19 | (2) | 2 | 8 | | |
| EBITDA | 80,200 | 80,286 | 49,646 | 71,154 | 91,516 | | |
| Change (yoY, %) | 17 | 0 | (38) | 43 | 29 | | |
| EBITDA Margin(%) | 18.0 | 15.1 | 9.5 | 13.5 | 16.1 | | |
| Adj.PAT | 55,661 | 50,681 | 26,666 | 48,296 | 60,726 | | |
| EPS (Rs) | 63 | 58 | 30 | 55 | 69 | | |
| Change (yoY, %) | 23.8 | (9.2) | (47.4) | 81 | 26 | | |
| PE(x) | 19 | 21 | 39 | 22 | 17 | | |
| Dividend Yield (%) | 3.8 | 4.2 | 3.4 | 4 | 5 | | |
| EV/EBITDA (x) | 12 | 12 | 20 | 14 | 11 | | |
| RoE (%) | 22 | 18 | 10 | 18 | 21 | | |
| RoCE (%) | 21 | 19 | 9 | 17 | 21 | | |

Source: IDBI Capital Research;

Devang Bhatt

devang.bhatt@idbicapital.com

+91-22-4069 1846

Con-call Highlights

Management stated FY25E growth to be volatile, however, on YoY basis the company will see improvement in coming quarters of FY25E(compare to Q4FY24 YoY growth). The company aspires that FY27E will be the year which will see growth in line with peers and have laid down the new strategies as follows:

- Focus on increasing visibility and clients in geos like Americas, Europe & prioritize more in ROW countries by prioritising sales investments and enhancing client services.
- Focusing on existing verticals:
 - Company aims to grow in Telco vertical by investing in non-terrestrial networks and 6G network, building an AI ecosystem and strengthening hyper-scalers & SaaS partnership.
 - In Manufacturing, growth would be driven by integration of service offerings (IT, engineering services and BPS) for innovation & efficiency, Next gen offerings (Gen AI, micro factories, localisation and cyber-security) and enhancing core domain capabilities.
 - Management aims to capitalise on their differentiation and drive growth on the back of new offerings (Market DaaS, Lending PaaS, Payments utility, ESG Offering, IaaS, Digital engineering), building capability, targeting on high potential sub-verticals (wealth & asset management, core banking, payments) and focusing on tier1 & 2 client acquisitions.
 - Additionally, with the verticals, management has key focus on growing capabilities in AI by reskilling the employee base, infusion of AI & automation in all deals and building the start-up partner ecosystem.
- Focus on Service lines like Next gen services, Cloud & infrastructure services, engineering services and digital enterprise application.
- Company will be saving \$250mn average per year till FY27 and invest 1.5% margin in capability apart from the other investments. Management has guided EBIT margin to be at 15% by FY27 v/s 6.1% in FY24. To achieve this company has highlighted below points:
 - Focusing on pyramid rationalisation by reducing in average resource cost and hiring fresher's.

- Focus on high margin services.
- By optimising G&A cost and sub-con cost
- Revenue for the quarter stood at \$1,548 mn which de-grew by 1.6% QoQ & de-grew 7.2% YoY in reported terms. This was majorly led by decline in communication vertical. EBIT margin is at 7.4% which grew by 200bps v/s last quarter.
- In terms of geowise, Americas degrew by 3.6% QoQ while Europe was flat and Row was up 1.0% QoQ. Among, verticals comms was down 2.8% QoQ, Retail was down 9.4% QoQ and others down 1.4% QoQ while BFSI was up 3.5% QoQ and Technology was flat QoQ.
- New deal win stood at US\$500 mn up 31% QoQ and down 15% YoY.

Exhibit 1: Financial snapshot

(Rs mn)

| Year-end: March | Q4FY24 | Q3FY24 | QoQ (%) | Q4FY23 | YoY (%) |
|-----------------------------|-----------------|-----------------|--------------|-----------------|---------------|
| Revenues (US\$ mn) | 1,548 | 1,573 | (1.6) | 1,668 | (7.2) |
| Revenues | 1,28,713 | 1,31,013 | (1.8) | 1,37,182 | (6.2) |
| COGS | 93,941 | 99,648 | (5.7) | 97,484 | (3.6) |
| Gross profit | 34,772 | 31,365 | 10.9 | 39,698 | (12.4) |
| SG&A | 20,694 | 19,900 | 4.0 | 19,493 | 6.2 |
| EBITDA | 14,078 | 11,465 | 22.8 | 20,205 | (30.3) |
| Depreciation & amortization | 4,614 | 4,434 | 4.1 | 4,902 | (5.9) |
| EBIT | 9,464 | 7,031 | 34.6 | 15,303 | (38.2) |
| Other income | 3,150 | -290 | (1,186.2) | 2,121 | 48.5 |
| PBT | 12,614 | 6,741 | 87.1 | 17,424 | (27.6) |
| Tax | 2,949 | 1,551 | 90.1 | 3,999 | (26.3) |
| Minority interest | 32 | -85 | n.m. | -123 | n.m. |
| Adjusted net profit | 9,697 | 5,105 | 90.0 | 13,302 | (27.1) |
| Exceptional items | 3,087 | 0 | n.m. | 2,126 | n.m. |
| Reported net profit | 6,610 | 5,105 | 29.5 | 11,176 | (40.9) |
| Reported EPS (Rs.) | 7.5 | 5.8 | 29.9 | 12.6 | (40.7) |
| Diluted EPS (Rs) | 11.0 | 5.8 | 90.6 | 15.0 | (26.9) |
| <hr/> | | | | | |
| As % of net revenue | | | | | |
| Gross profit | 27.0 | 23.9 | | | 28.9 |
| SG&A | 16.1 | 15.2 | | | 14.2 |
| EBITDA | 10.9 | 8.8 | | | 14.7 |
| EBIT | 7.4 | 5.4 | | | 11.2 |
| Reported net profit | 5.1 | 3.9 | | | 8.1 |
| Tax rate | 23.4 | 23.0 | | | 23.0 |

Source: Company; IDBI Capital Research

Exhibit 2: Actual vs. estimates

| Year to March | Q4FY24 | Q4FY24E | Variance (%) |
|--------------------------|----------|----------|--------------|
| Revenue (US\$ mn) | 1,548 | 1,561 | -0.8% |
| Revenue (Rs mn) | 1,28,713 | 1,29,600 | -0.7% |
| EBIT (Rs mn) | 9,464 | 9,122 | 3.8% |
| EBIT margin (%) | 7.4% | 7.0% | 31 bps |
| Recurring PAT (Rs mn) | 9,697 | 7,590 | 27.8% |
| Recurring PAT margin (%) | 7.53% | 5.86% | 168bps |
| Recurring EPS (Rs) | 11.0 | 8.6 | 28.2% |

Source: Company, IDBI Capital Research

Exhibit 3: Earnings Revision

| Year-end: March | FY25E | | | FY26E | | |
|-------------------|-------|-------|-----------|-------|--------|----------|
| | New | Old | Chg (%) | New | Old | Chg (%) |
| Revenue (US\$ mn) | 6,362 | 6600 | -3.6% | 6,869 | 7264 | -5.4% |
| Revenue (Rs bn) | 528.0 | 548 | -3.6% | 570.1 | 602.9 | -5.4% |
| EBIT margin (%) | 10.0% | 12.0% | (195) bps | 12.5% | 13.40% | (94) bps |
| EPS (Rs/sh) | 54.7 | 60 | -8.8% | 68.8 | 73.2 | -6.0% |

Source: Company; IDBI Capital Research

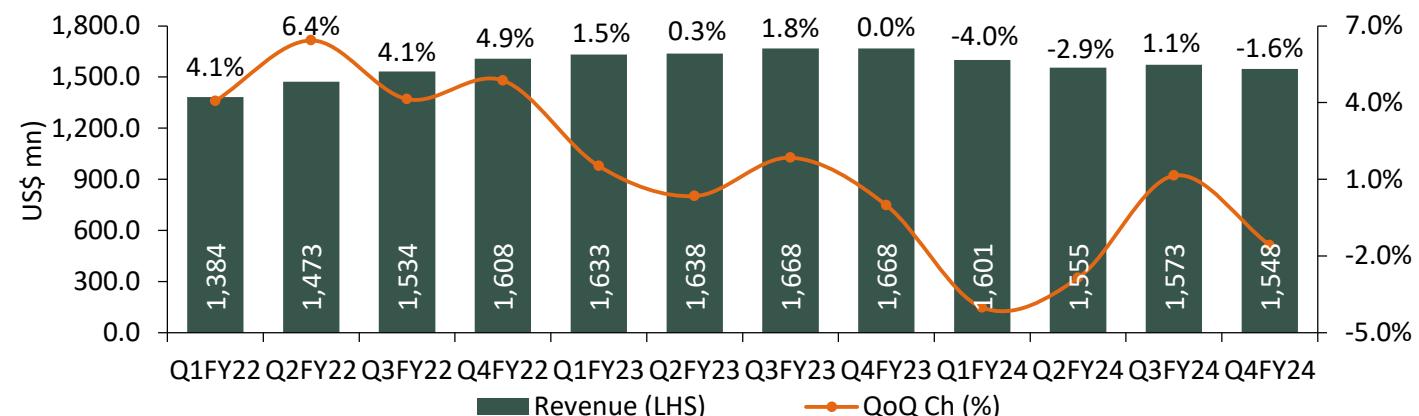
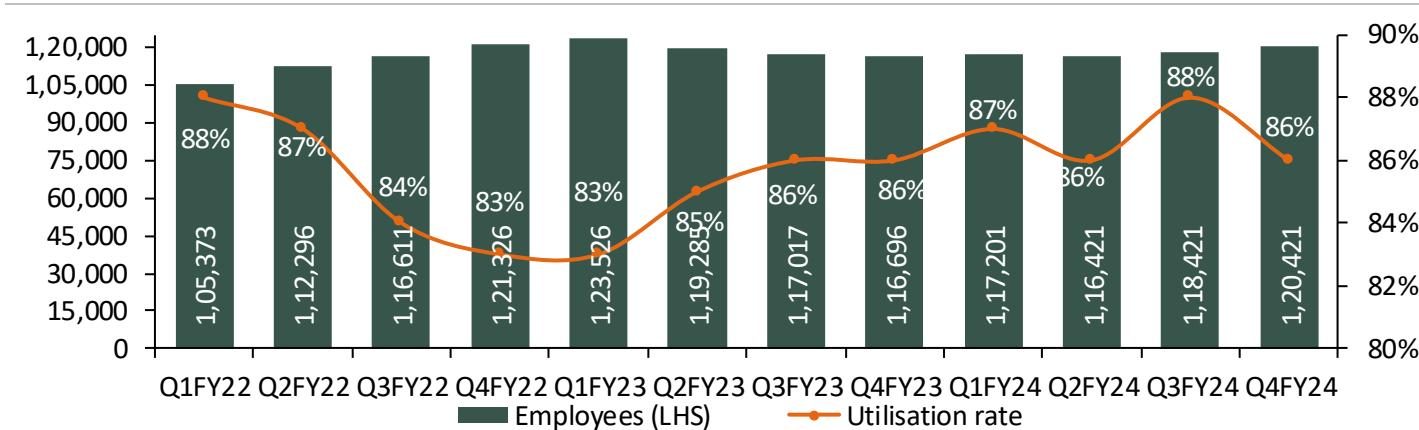
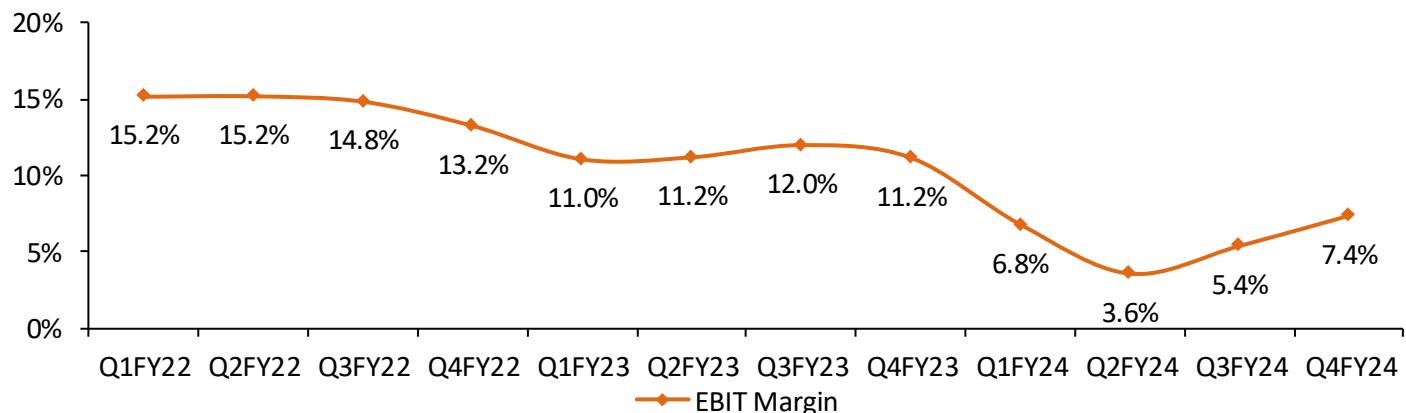
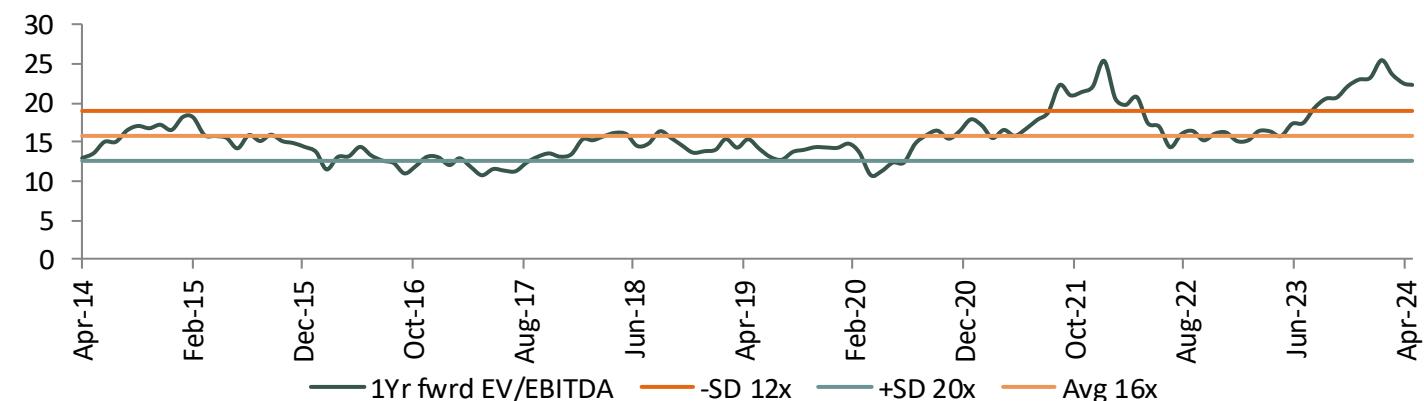
Exhibit 4: Q4FY24 revenue growth was below our estimates

Source: Company; IDBI Capital Research
Exhibit 5: Utilisation rate decreased to 86%

Source: Company; IDBI Capital Research

Exhibit 6: EBIT Margin improved QoQ by 200bps



Source: Company; IDBI Capital Research

Exhibit 7: One-year forward PER trend



Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

| Year-end: March | FY21 | FY22 | FY23 | FY24E | FY25E | FY26E |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Net sales | 3,78,551 | 4,46,460 | 5,32,902 | 5,19,955 | 5,28,046 | 5,70,135 |
| <i>Change (yoY, %)</i> | 2.7 | 18 | 19 | (2) | 2 | 8 |
| Operating expenses | (3,10,080) | (3,66,261) | (4,52,616) | (4,70,309) | (4,56,892) | (4,78,619) |
| EBITDA | 68,471 | 80,200 | 80,286 | 49,646 | 71,154 | 91,516 |
| <i>Change (yoY, %)</i> | 19.6 | 17 | 0 | (38) | 43 | 29 |
| <i>Margin (%)</i> | 18.1 | 18.0 | 15.1 | 9.5 | 13.5 | 16.1 |
| Depreciation | (14,577) | (15,204) | (19,567) | (19,666) | (18,094) | (20,500) |
| EBIT | 53,894 | 64,996 | 60,719 | 29,980 | 53,060 | 71,017 |
| Interest paid | (1,740) | (1,626) | (3,256) | (3,922) | (2,340) | (2,340) |
| Other income | 7,871 | 11,123 | 9,650 | 9,169 | 13,200 | 11,600 |
| Pre-tax profit | 60,025 | 74,493 | 64,743 | 35,227 | 63,920 | 80,277 |
| Tax | (15,999) | (18,220) | (15,885) | (8,276) | (15,341) | (19,266) |
| <i>Effective tax rate (%)</i> | 26.7 | 24.5 | 24.5 | 23.5 | 24.0 | 24.0 |
| Minority Interest | 255.0 | (612.0) | (547.0) | (285.0) | (284.0) | (284.0) |
| Net profit | 43,774 | 55,661 | 48,311 | 26,666 | 48,296 | 60,726 |
| Exceptional items | - | - | (2,370) | - | - | - |
| Adjusted net profit | 44,788 | 55,661 | 50,681 | 26,666 | 48,296 | 60,726 |
| <i>Change (yoY, %)</i> | 5.4 | 24 | (9) | (47) | 81 | 26 |
| EPS | 51.2 | 63.4 | 57.6 | 30.3 | 54.9 | 69.0 |
| Dividend per sh | 45.0 | 45.0 | 50.0 | 40.0 | 45.0 | 55.0 |
| <i>Dividend Payout %</i> | 87.8 | 71.0 | 86.8 | 132 | 82 | 80 |

| Balance Sheet | | | | | | | (Rs mn) |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|---------|
| Year-end: March | FY21 | FY22 | FY23 | FY24E* | FY25E | FY26E | |
| Shareholders' funds | 2,48,650 | 2,68,857 | 2,79,245 | 2,70,711 | 2,79,407 | 2,91,733 | |
| Share capital | 4,370 | 4,388 | 4,400 | 4,400 | 4,400 | 4,400 | |
| Reserves & surplus | 2,44,280 | 2,64,469 | 2,74,845 | 2,66,311 | 2,75,007 | 2,87,333 | |
| Total Debt | 16,928 | 15,817 | 15,782 | 13,782 | 11,782 | 9,782 | |
| Other liabilities | 19,027 | 31,572 | 27,523 | 27,523 | 27,523 | 27,523 | |
| Curr Liab & prov | 1,07,619 | 1,22,955 | 1,31,020 | 1,51,869 | 1,51,280 | 1,62,261 | |
| Current liabilities | 71,051 | 93,494 | 96,998 | 1,02,010 | 1,00,646 | 1,07,591 | |
| Provisions | 36,568 | 29,461 | 34,022 | 49,859 | 50,635 | 54,670 | |
| Total liabilities | 1,43,574 | 1,70,344 | 1,74,325 | 1,93,174 | 1,90,585 | 1,99,566 | |
| Total equity & liabilities | 3,96,019 | 4,44,155 | 4,58,272 | 4,68,872 | 4,75,263 | 4,96,854 | |
| | | | | | | | |
| Net fixed assets | 80,405 | 1,39,318 | 1,38,792 | 1,34,126 | 1,31,032 | 1,25,532 | |
| Investments | 6,648 | 5,276 | 6,797 | 6,797 | 6,797 | 6,797 | |
| Other non-curr assets | 56,367 | 55,004 | 68,356 | 68,356 | 68,356 | 68,356 | |
| Current assets | 2,52,599 | 2,44,557 | 2,44,327 | 2,59,593 | 2,69,078 | 2,96,169 | |
| Inventories | 242 | 405 | 236 | 230 | 234 | 252 | |
| Sundry Debtors | 90,317 | 1,19,334 | 1,28,816 | 1,39,604 | 1,41,777 | 1,53,077 | |
| Cash and Bank | 1,24,971 | 84,104 | 70,379 | 74,993 | 81,606 | 93,754 | |
| Loans and advances | 29,331 | 33,964 | 39,897 | 39,887 | 40,508 | 43,736 | |
| Total assets | 3,96,019 | 4,44,155 | 4,58,272 | 4,68,872 | 4,75,263 | 4,96,854 | |

*Figures are estimated, awaiting annual report

| Cash Flow Statement | | | | | | | (Rs mn) |
|--------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|---------|
| Year-end: March | FY21 | FY22 | FY23 | FY24E* | FY25E | FY26E | |
| Pre-tax profit | 60,025 | 74,493 | 64,743 | 35,227 | 63,920 | 80,277 | |
| Depreciation | 14,577 | 15,204 | 19,567 | 19,666 | 18,094 | 20,500 | |
| Tax paid | (16,284) | (13,487) | (21,950) | (8,276) | (15,341) | (19,266) | |
| Chg in working capital | (11,266) | (18,477) | (7,181) | 10,076 | (3,385) | (3,567) | |
| Other operating activities | 58,648 | 14,183 | (3,520) | 121 | (76) | (395) | |
| Cash flow from operations (a) | 1,05,700 | 71,916 | 51,659 | 56,814 | 63,213 | 77,548 | |
| Capital expenditure | (18,935) | (74,117) | (19,041) | (15,000) | (15,000) | (15,000) | |
| Chg in investments | (2,844) | 1,372 | (1,521) | - | - | - | |
| Other investing activities | - | - | - | - | - | - | |
| Cash flow from investing (b) | (21,779) | (72,745) | (20,562) | (15,000) | (15,000) | (15,000) | |
| Equity raised/(repaid) | 11 | 18 | 12 | - | - | - | |
| Debt raised/(repaid) | (7,354) | (1,111) | (35) | (2,000) | (2,000) | (2,000) | |
| Dividend (incl. tax) | (39,330) | (39,492) | (44,000) | (35,200) | (39,600) | (48,400) | |
| Chg in minorities | 117 | 547 | (799) | - | - | - | |
| Other financing activities | - | - | - | - | - | - | |
| Cash flow from financing (c) | (46,556) | (40,038) | (44,822) | (37,200) | (41,600) | (50,400) | |
| Net chg in cash (a+b+c) | 37,365 | (40,867) | (13,725) | 4,614 | 6,613 | 12,148 | |

*Figures are estimated, awaiting annual report

Financial Ratios

| Year-end: March | FY21 | FY22 | FY23 | FY24 | FY25E | FY26E |
|--|-------|------|------|------|-------|-------|
| Book Value (Rs) | 284.5 | 306 | 317 | 308 | 318 | 332 |
| Adj EPS (Rs) | 51.2 | 63.4 | 57.6 | 30.3 | 54.9 | 69.0 |
| Adj EPS growth (%) | 5.1 | 24 | -9 | -47 | 81 | 26 |
| EBITDA margin (%) | 18.1 | 18.0 | 15.1 | 9.5 | 13.5 | 16.1 |
| Pre-tax margin (%) | 15.9 | 16.7 | 12.1 | 6.8 | 12.1 | 14.1 |
| Net Debt/Equity (x) | -0.4 | -0.3 | -0.2 | -0.2 | -0.2 | -0.3 |
| ROCE (%) | 19.4 | 21 | 19 | 9 | 17 | 21 |
| ROE (%) | 19.2 | 22 | 18 | 10 | 18 | 21 |
| DuPont Analysis | | | | | | |
| Asset turnover (x) | 1.0 | 1.1 | 1.2 | 1.1 | 1.1 | 1.1 |
| Leverage factor (x) | 1.6 | 1.6 | 1.6 | 1.7 | 1.7 | 1.7 |
| Net margin (%) | 11.8 | 12.5 | 9.5 | 5.1 | 9.1 | 10.7 |
| Working Capital & Liquidity ratio | | | | | | |
| Inventory days | 0 | 0 | 0 | 0 | 0 | 0 |
| Receivable days | 87 | 98 | 88 | 98 | 98 | 98 |
| Payable days | 33 | 41 | 35 | 34 | 34 | 34 |

Valuations

| Year-end: March | FY21 | FY22 | FY23 | FY24 | FY25E | FY26E |
|----------------------|------|------|------|------|-------|-------|
| PER (x) | 23 | 19 | 21 | 39 | 22 | 17 |
| Price/Book value (x) | 4.2 | 3.9 | 3.8 | 3.9 | 3.7 | 3.6 |
| EV/Net sales (x) | 2 | 2 | 2 | 2 | 2 | 2 |
| EV/EBITDA (x) | 14 | 12 | 12 | 20 | 14 | 11 |
| Dividend Yield (%) | 3.8 | 3.8 | 4.2 | 3.4 | 3.8 | 4.6 |

Source: Company; IDBI Capital Research



Notes

Dealing

(91-22) 6836 1111

dealing@idbic平.资本.com

Key to Ratings Stocks:**BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

6th Floor, IDBI Tower, WTC Complex, Cuffe Parade, Colaba, Mumbai – 400 005. Phones: (91-22) 4069 1700; Fax: (91-22) 2215 1787; Email: info@idbic平.资本.com

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