

Results Miss Expectations; Outlook Remains Weak

Est. Vs. Actual for Q2FY24: Revenue – **MISS**; EBITDA Margin – **MISS**; PAT – **BEAT**; Deal Wins – **INLINE**

Changes in Estimates post Q2FY24

FY24E/FY25E: Revenue -1%/-1%; EBITDA Margins -1%/-1%; PAT -1%/-1%

Recommendation Rationale

- The outlook on Telecom and other verticals for the second half of the year remains uncertain. However, it continues to be healthy in the long term.
- TCV stood strong in Q2FY24 at \$640 Mn and was driven by high deal-wins in verticals such as Communication and Enterprise segments.
- The management is confident of gaining medium-term demand momentum on the backdrop of the deals it has won in the previous quarters. It also expects improvement on the margin front moving forward.

Sector Outlook: Cautiously positive

Company Outlook & Guidance: The demand scenario remains uncertain and may lead to lower revenue growth momentum in the near term.

Current Valuation: 16x FY25E P/E; Earlier Valuation: 16x FY25E

Current TP: 995/share (Earlier TP: Rs 995/share)

Recommendation: Given the uncertainty from the world's largest economies, we expect delays in decision-making on IT budgets. Keeping this in view, we recommend a **SELL** on the stocks.

Financial Performance

In Q2FY24, Tech Mahindra Ltd. (Tech M) reported revenue of Rs 12,869 Cr, down 2.2% on a QoQ basis. While it posted a de-growth of 5.9% on a YoY basis (in CC terms), it stood below our expectations. The company posted an operating profit of Rs 606 Cr, reporting a de-growth of 31.9% on a QoQ basis. The company's operating margins, too, stood below our expectations, declining by 210bps. This was largely led by higher SG&A expenses, an unfavourable currency mix, and one-time acquisition costs during the quarter. The company's net profit for Q2FY24 stood at Rs 505 Cr, registering a de-growth of 28.7% QoQ.

Outlook

From a long-term perspective, we believe Tech Mahindra is sorting out the client-specific engagement issues on the verticals front and the deal pipeline remains sturdy. However, rising concerns over the prospects of large economies along with prevailing supply-side constraints pose uncertainties over the company's short-term growth rates.

Valuation & Recommendation

We assign a 16x P/E multiple to its FY25E earnings of Rs 62.1/share to arrive at a TP of Rs 995/share, implying a downside of 13% from the CMP. Hence, we recommend a **SELL** on the stock.

Key Financials (Consolidated)

(Rs Cr)	Q2FY24	QoQ (%)	YoY (%)	Axis Est.	Variance
Net Sales	12,864	-2%	-2%	13150	-2%
EBITDA	607	-47%	-47%	685	-11%
EBITDA Margin	4.7%	200 bps	(664) bps	5.21%	300 bps
Net Profit	494	-0	-61%	469	5%
EPS (Rs)	5.59	-29%	-62%	7.4	-24%

Source: Company, Axis Research

(CMP as of 25 October 2023)

CMP (Rs)	1,142
Upside /Downside (%)	(13%)
High/Low (Rs)	1320/983
Market cap (Cr)	1,11,380
Avg. daily vol. (6m)Shrs.	5,94,320
No. of shares (Cr)	22

Shareholding (%)

	Jun-22	Sep-22	Dec-22
Promoter	49.2	49.2	49.2
FII	16.0	9.2	10.8
MFs / UTI	12.6	11.8	11.4
Banks / FI	22.3	29.9	28.8
Others	49.2	49.2	49.2

Financial & Valuations

Y/E Mar (Rs Cr)	FY23E	FY24E	FY25E
Net Sales	53,290	56,488	63,831
EBITDA	8,029	16,833	22,255
Net Profit	4,831	5,749	6,842
EPS (Rs)	54.8	57.5	62.7
PER (x)	18.0	18.0	18.0
P/BV (x)	6.4	6.4	6.4
EV/EBITDA (x)	4.3	3.2	2.4
ROE (%)	26%	34%	35%

Change in Estimates (%)

Y/E Mar	FY24E	FY25E
Sales	-1%	-1%
EBITDA	-1%	-1%
PAT	-1%	-1%

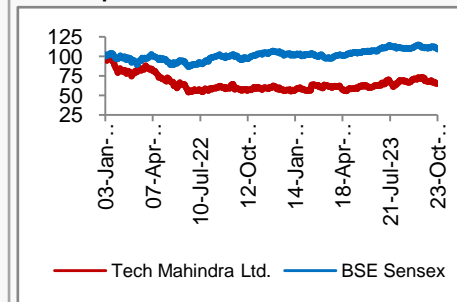
ESG disclosure Score**

Environmental Disclosure	70.8
Social Disclosure Score	48.5
Governance Disclosure	87.4
Total ESG Disclosure	68.9
Sector Average	46.0

Source: Bloomberg, Scale: 0.1-100

**Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

Relative performance



Source: ACE Equity, Axis Securities

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Key Highlights

- **Strength in the medium-term demand continues:** Both US and Europe regions are facing uncertainties in terms of automation spend and H1FY24 is likely to remain tepid. However, one can see a pickup in demand in FY25 due to increasing engagement with the clients. With the macro environment stabilizing, the company expects a pick-up in decision-making at the clients' end.
- **Broad-based vertical growth:** On the vertical front, the Communications, Media & Entertainment verticals delivered a de-growth of 4.9% QoQ, and Manufacturing grew by 2.2% QoQ. Technology remained tepid at 0.5% growth QoQ while BFSI verticals reported a de-growth of 3.0% QoQ. Retail Transport & Logistics grew by 0.7% QoQ. The majority of verticals witnessed tepid growth but are likely to report sustainable long-term growth backed by a strong deal pipeline in the near term. The management is positive about a strong recovery in the majority of verticals and believes the company to expand its margins with growing volume in the second half of the year. However, the first half of the FY24 is likely to remain tepid.
- **Better geographical performance:** On the geographical front, while North America (53% of revenue) declined by 0.7% QoQ, Europe (24.0% of revenue) de-grew by 6.8% QoQ, and RoW (23% of revenue) business de-grew by 6.4% QoQ (in the CC terms).

Key Risks to our Estimates and TP

- The demand environment is uncertain because of the potential threat of recession from the world's largest economies.
- The rising subcontracting cost and cross-currency headwinds may impact the company's operating margins negatively.

Segment Details

	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24
1 Million dollar +	502	524	549	562	574	582	580	568
5 Million dollar +	173	174	176	184	185	186	190	186
10 Million dollar +	96	97	104	108	109	112	115	114
20 Million dollar +	50	54	60	63	65	65	62	61
\$50 Million dollar +	22	23	23	23	24	24	26	26

Source: Company, Axis Research

	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24
Revenue- top 5 clients (%)	22.7%	22.0%	21.0%	19.0%	18.0%	16.8%	17.4%	16.6%
Revenue- top 10 clients (%)	31.4%	31.0%	30.0%	28.0%	27.0%	26.5%	27.3%	27.1%
Revenue- top 20 clients (%)	42.4%	43.0%	41.0%	43.0%	4.0%	40.0%	39.4%	39.5%

Employee Details

Segment Details	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24
Software professional	81,115	85,830	88,030	86,776	84,874	83,789	81,521	81,200
BPO Professional	56,297	57,315	61,392	68,388	63,568	60,102	58,079	60,985
Sales and Support	7,655	8,028	8,613	8,748	8,626	8,509	8,697	8,419
Number of Employees	1,45,067	1,51,173	1,58,035	1,63,912	1,57,068	1,52,400	1,48,297	1,50,604
Utilization (In %)	86%	83%	83%	85%	86%	86%	88%	86.1%

Source: Company, Axis Research

Revenue by Industry (%)

	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24
Communication, Media and Entertainment	40.9%	40.6%	40.4%	39.7%	39.8%	40.1%	37.8%	37.0%
Manufacturing	15.8%	14.9%	15.3%	16.0%	15.7%	15.9%	16.9%	17.8%
Technology	8.4%	9.3%	9.7%	10.1%	10.3%	10.3%	10.7%	11.0%
BFSI	15.4%	17.4%	16.7%	16.8%	15.9%	15.9%	16.1%	16.1%
Retail, Transport and Logistics	8.5%	7.6%	7.9%	8.1%	8.5%	7.6%	7.9%	8.2%
Others	9.0%	10.2%	10.0%	9.8%	9.9%	10.2%	10.6%	10.0%

Source: Company, Axis Research

Revenue by Geography

	Q3FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
America	48.5%	48.3%	49.6%	50.8%	49.7%	49.6%	51.4%	53.3%
Europe	25.5%	26.4%	25.5%	24.5%	24.4%	25.3%	24.6%	23.6%
Rest of the World	26.6%	25.3%	24.9%	24.7%	25.9%	25.1%	24.0%	23.2%

Source: Company, Axis Research

Results Review
(Rs Cr)

In Cr	Q2FY24	Q1FY24	Q2FY23	% change (YoY)	% change (QoQ)
Total Revenue	12,864	13,159	13,130	-2%	-2%
Total Cost of Sales	9,975	9,781	9,461		
Gross Profit	2,889	3,379	3,669	-21%	-14%
Margin (%)	22%	26%	28%	-549	-322
SGA	1,816	2,041	1,684		
EBITDA	1,072	2,021	1,984	-46%	-47%
Margin (%)	8%	15%	15%	-677	-702
Depreciation	466	447	492		
Operating profit	607	891	1,492		
Margin (%)	5%	7%	11%	-664.47	
Other Income	264	192	290		
Interest Expenses	98	147	79		
Pre Tax Profit	615	971	1,664		
Tax	110	268	365		
ETR (%)	18%	28%	22%	-405	-967
Net Profit After Taxes	505	704	1,299	-61%	-28%
Non Controlling Interest	11	11	14		
Net Income After Extraordinary Items	494	693	1,285	-62%	-29%
Margin (%)	4%	5%	10%	-595	-142
EPS	5.59	7.84	14.58	-62%	-29%

Source: Company, Axis Securities

Financials (consolidated)

Profit & Loss

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Net sales	44,646	53,290	54,356	61,422
Growth, %	19%	19%	2%	13%
Other income	1,112	965	1,750	1,947
Total income	4,576	5,426	5,611	6,337
Employee expenses	29,243	38,120	24,206	23,640
Other Operating expenses	7,383	9,588	10,661	11,529
EBITDA (Core)	8,020	8,029	16,833	22,255
Growth, %	12%	0%	110%	32%
Margin, %	18%	18%	18%	18%
Depreciation	1,623	1,957	1,697	1,829
EBIT	6,397	6,072	15,136	20,426
Growth, %	22%	-5%	149%	35%
Margin, %	14%	11%	28%	33%
Interest paid	104	95	95	95
Pre-tax profit	7,452	6,445	16,790	22,278
Tax provided	2,009	1,588	4,421	5,508
Profit after tax	5,630	4,857	12,369	16,771
Net Profit	5,137	4,831	5,749	6,842
Growth, %	18%	-6%	19%	19%
Net Profit (adjusted)	5,137	4,831	5,749	6,842

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Cash & bank	2,848	7,299	16,816	31,286
Debtors	9,225	10,647	12,268	13,578
Other current assets	6,590	6,590	6,590	6,590
Total current assets	25,689	31,570	42,392	57,693
Net fixed assets	431	431	431	431
CWIP	276	276	276	276
Other Non current assets	752	752	752	752
Deffered tax assets	609	609	609	609
Total Non Current Assets	207	207	207	207
Total assets	36,613	42,100	52,357	66,932
Creditors	2,971	3,247	3,406	3,482
Provisions	395	395	395	395
Total current liabilities	9,939	10,215	10,374	10,450
Other liabilities	42	42	42	42
Paid-up capital	433	433	433	433
Reserves & surplus	25,718	30,930	41,028	55,527
Shareholders' equity	2,615	3,136	4,146	5,596
Total equity & liabilities	36,613	42,100	52,357	66,932

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Pre-tax profit	7,507	10,831	16,790	22,278
Depreciation	1,267	1,580	1,697	1,829
Chg in working capital	-1,750	-1,430	-1,305	-831
Total tax paid	2,009	3,349	4,421	5,508
Cash flow from operating activities	6,853	10,900	17,157	23,292
Capital expenditure	673	777	896	991
Cash flow from investing activities	-673	-777	-896	-991
Free cash flow	6,853	10,900	17,157	23,292
Dividend (incl. tax)	2,323	2,323	2,323	2,323
Cash flow from financing activities	-42	24	24	24
Net chg in cash	1,805	4,450	9,517	14,469

Source: Company, Axis Securities

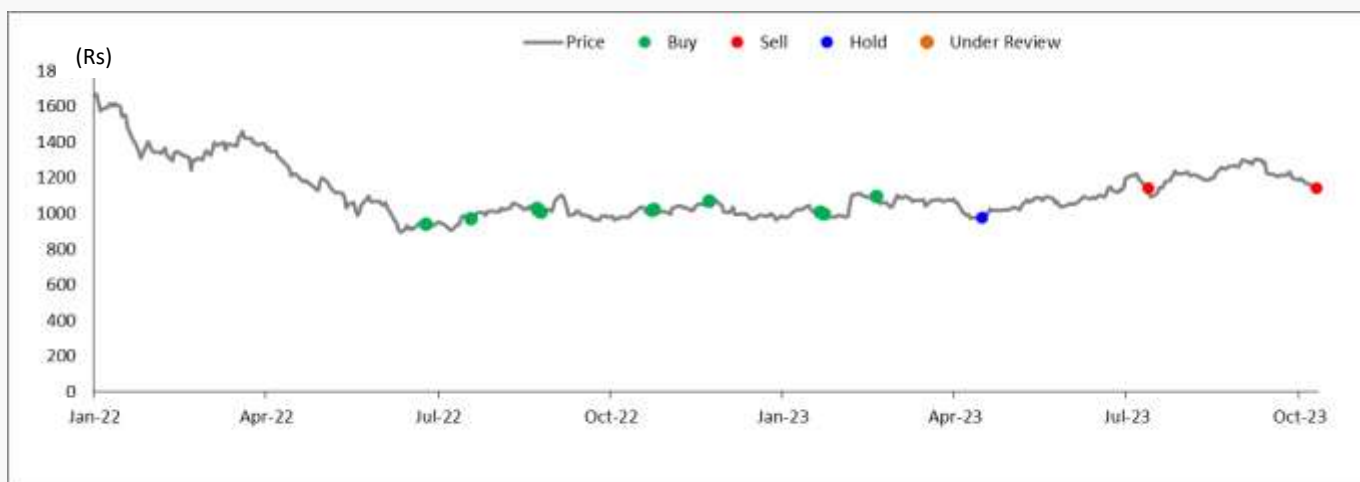
Ratio Analysis

(%)

Y/E March	FY22A	FY23E	FY24E	FY25E
Per Share data	63.3	54.8	57.0	62.1
EPS (INR)	24%	-13%	4%	9%
Growth, %	297.2	356.4	471.1	635.9
Book NAV/share (INR)	46	46	46	46
FDEPS (INR)	77.5	103.6	160.4	211.9
CEPS (INR)	42.8	42.8	42.8	42.8
CFPS (INR)	24	24	24	24
DPS (INR)				
Return ratios	15%	18%	24%	25%
Return on assets (%)	23%	26%	34%	35%
Return on equity (%)	21%	24%	30%	30%
Return on capital employed (%)				
Turnover ratios	74.2	65.0	65.0	65.0
Asset turnover (x)	74.2	65.0	65.0	65.0
Sales/Total assets (x)	102.4	102.4	102.4	102.4
Receivables Days	5.0	4.7	2.7	1.3
Cash conversion cycle				
Liquidity ratios	2.5	3.0	3.9	5.3
Current ratio (x)	1.6	2.0	2.8	4.1
Quick Ratio	0	0	0	0
Net debt/Equity (%)	1	1	1	1
Leverage Ratio				
Valuation	20.0	18.0	18.0	18.0
PER (x)	5.1	4.3	3.2	2.4
Price/Book (x)	2.8	2.8	2.8	2.8
EV/Net sales (x)	6.4	6.4	6.4	6.4
EV/EBITDA (x)	4.4	4.4	4.4	4.4
Dividend Yield	63.3	54.8	57.0	62.1

Source: Company, Axis Securities

Tech Mahindra Price Chart and Recommendation History



Date	Reco	TP	Research
01-Jul-22	BUY	1,700	Top Picks
25-Jul-22	BUY	1,200	Result Update
25-Jul-22	BUY	1,200	Result Update
30-Aug-22	BUY	1,350	Event Update
01-Sep-22	BUY	1,200	Top Picks
01-Oct-22	BUY	1,200	Top Picks
02-Nov-22	BUY	1,200	Result Update
01-Nov-22	BUY	1,200	Result Update
01-Dec-22	BUY	1,300	Top Picks
01-Jan-23	BUY	1,300	Top Picks
31-Jan-23	BUY	1,200	Result Update
01-Feb-23	BUY	1,200	Top Picks
01-Mar-23	BUY	1,300	Top Picks
01-Apr-23	BUY	1,300	Top Picks
28-Apr-23	HOLD	1,050	Result Update
27-Jul-23	SELL	995	Result Update
26-Oct-23	SELL	995	Result Update

Source: Axis Securities

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