EQUITY RESEARCH **Jun 18, 2007**

INITIATING COVERAGE

Tech Mahindra Limited — Buy

Nurturing Partnership

Tech Mahindra, a joint venture between M&M and British Telecom, is a leading player, providing end-to-end IT solutions to the telecom industry. With the largest deal in the history of the Indian IT industry, worth USD 1 billion from British Telecom won by Tech Mahindra in 3Q'07, the revenues are expected to grow at a CAGR of 48% from FY07-FY09E. The continuous growth of the telecom industry, coupled with the company's increasing client base will lead to further growth in revenues. To meet the growing needs of the business Tech Mahindra is recruiting aggressively, mainly from campuses, which will help to drive down personnel expenses.

Share Data

Market Cap	Rs. 176.33 bn
Price	1454.6
BSE Sensex	14084.14
Reuters	TEML.BO
Bloomberg	TECHM IN
Avg. Volume (52 Week)	0.68 mn
52-Week High/Low	Rs. 2049.8/520.6
Shares Outstanding	121.22 mn

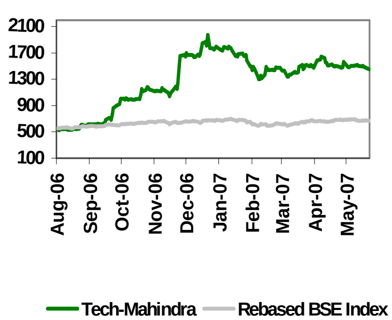
Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	72.6	102.3
+/- (%)	29.3%	40.9%
PER (x)	20.7x	14.7x
EV/ Sales (x)	4.0x	2.7x
EV/ EBITDA (x)	16.5x	11.2x

Shareholding Pattern (%)

Promoters	84
FIIs	2
Institutions	2
Public & Others	13

Relative Performance



Key Figures

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY07-09E)
Net Sales	9,456	12,427	29,290	44,228	64,130	48.0%
EBITDA	1,357	2,839	7,365	10,615	15,712	46.1%
Net Profit	1,031	2,530	6,464	8,806	13,024	41.9%
Margins(%)						
EBITDA	14.2%	22.2%	25.1%	24.0%	24.5%	
NPM	10.8%	19.8%	22.0%	19.9%	20.3%	
Per Share Data (Rs.)						
Normalized EPS	10.1	24.3	56.2	72.6	102.3	35.0%
PER (x)	148.2x	61.7x	26.7x	20.7x	14.7x	

- Driven by the growth in revenues from BT (British Telecom), we expect revenues to grow from Rs. 29,290 million in FY07 to Rs. 64,130 million in FY09E reflecting a CAGR of 48%.
- EBITDA and net profit margins are expected to fall by 110bps and 210bps respectively in FY08E due to the initial costs in BTGS deal but will improve in FY09E.
- At the current price of Rs. 1,454.6, the stock trades at a forward PE of 20.7x estimated FY08E earnings and at 14.7x estimated FY09E earnings. Based on the target P/E multiple of 24x, we believe that the stock is under valued. We initiate coverage with a buy with a target price of Rs. 1,743 over the next twelve months.

Investment Rationale

BTGS deal will give a boost to revenues

BTGS deal is expected to extend beyond USD 1 bn

In December, 2006, Tech Mahindra won the British Telecom (BT) outsourcing deal worth USD 1 billion. The initial work to start the deal is nearly complete and work is expected to commence in the 2nd half of 2007 which will result in the revenue growth.

It is also expected that the offshore outsourcing activities being done by BT could result in the BT Global Services (BTGS) deal extending beyond USD 1 billion thereby leading to further growth in revenues.

Increased recruitment for growing business needs

Campus recruitments to trim down personnel expenses

In FY07, a total of 9,256 new employees were hired to meet the growing needs of the company. The increased recruitment shows the confidence of the management in the future prospects of the company. Besides that, the company is reducing lateral hiring by making more campus recruitments as hiring from campus is more cost efficient. After the training period of the new employees in the 1st half of FY08, the employee utilization rate is expected to increase.

Increased IT spending in telecom sector to unfold more opportunities

IT spending by telecom sector is expected to increase to 38.5% of the total cost base by 2009 (from about 31% in 2005). Tech Mahindra is a leader in this high growth domain and is consequently well poised to exploit the opportunities that will unfold as a result of this trend.

Client addition reduces risk

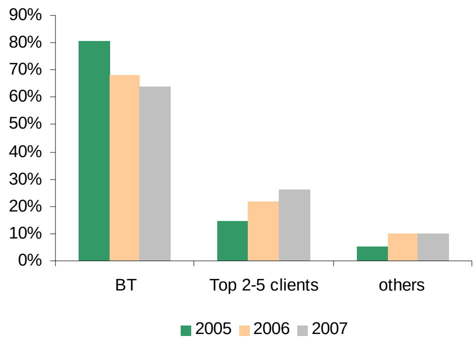
Added 21 clients in FY07

For the past few years, Tech Mahindra has maintained the trend of continuous client addition to its portfolio. Its clients include British Telecom, Alcatel, O2, Hutchison, Motorola and many other tier-1 players in the telecom industry. In FY07, the company added 21 new clients and in the current quarter, five new clients have been added to the portfolio. This regular client addition leads to an improved portfolio of customers resulting in reduced risk.

Service diversification through alliances, joint-ventures and acquisitions

Tech-Mahindra is entering into various alliances and joint ventures with a view of diversifying the services offered by the company. These efforts include a joint venture in partnership with Motorola known as CanvasM to deliver targeted solutions in the form of Value Added Services and an acquisition of iPolicy Networks, a network security product company. These will lead to less dependence on one service for the revenues.

Key Risks



Client concentration

Tech Mahindra's major portion of revenue i.e. nearly 70% comes from the single customer, British Telecom. Besides that, top 10 customers contribute 90% of the total revenues. Any effect on revenues from these customers can have an impact on the total revenues of the company thereby having an impact on our rating.

Dependence on single vertical

Tech Mahindra's revenues come from the services and solutions provided to the telecom sector and there is no diversification to other sectors, which makes its performance highly dependant on the performance of telecom sector. A slow down in the telecom sector can have a negative impact on the revenues of the company.

Outlook

Keeping in view the increased spending by telecom companies for software and IT services; there are ample opportunities for growth in the revenues of Tech Mahindra.

We expect the revenues to grow at a CAGR of 48% over FY07-FY09E driven by the recent BTGS deal coupled with the high growth prospects.

At the current price of Rs. 1,454.6, we believe that the stock is undervalued and we initiate coverage with a buy with a target price of Rs. 1,743.

COMPANY BACKGROUND

Leader in providing IT solutions to telecom sector

Tech Mahindra Limited, formerly known as Mahindra British Telecom, is a joint venture between Mahindra & Mahindra and British Telecommunications. The company provides a wide variety of services ranging from IT strategy and consulting to system integration, design, application development and product engineering to Telecom service providers and telecom equipment manufacturers.

Founded in 1986, Tech Mahindra is headquartered at Pune, and has multiple offshore development centres across 6 cities in India and 1 in UK. Tech Mahindra caters to the American, European and Asia-Pacific markets with its key customers including British Telecom, AT&T and Alcatel.

In 2007, Tech Mahindra was ranked as one of the top ten leaders in the global outsourcing service provider domain by International Association of Outsourcing Professionals (IAOP).

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