Tech Mahindra Ltd – MP

CMP Rs744, Target Rs758

Sector: Software	
Sensex:	15,127
CMP (Rs):	744
Target price (Rs):	758
Upside (%):	1.9
52 Week h/l (Rs):	828/204
Market cap (Rscr) :	9.059
6m Avg vol ('000Nos):	861
No of o/s shares (mn):	122
FV (Rs):	10
Bloomberg code:	TECHM IB
Reuters code:	TEML.BO
BSE code:	532755
NSE code:	TECHM

Prices as on 09 Jun, 2009

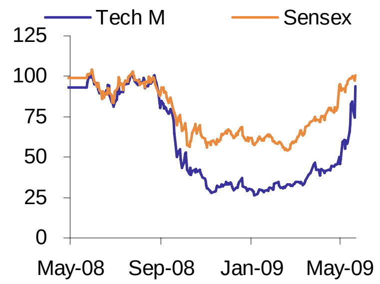
Shareholding pattern

March' 09	(%)
Promoters	83.3
Institutions	5.0
Non promoter corp hold	2.0
Public & others	9.7

Performance rel. to sensex

(%)	1m	3m	1yr
Tech M	83.5	97.4	(5.9)
Infosys	(8.4)	(34.2)	(5.7)
TCS	(3.4)	(16.4)	(14.4)
Wipro	(8.1)	20.4	(12.6)

Share price trend



Satyam finally made public the financial information it provided to the selected bidders during the bid process to finalize a strategic investor in April 2009. The revenue run-rate and profitability disclosed by the company was significantly ahead of market estimates. The OPM at 9% and 17.5% in the stressed months of January and February 2009 was far better than 2-3% margin indicated in Mr.Raju's confession letter.

Tech Mahindra stock has had a dream run over the past three months during which it nearly trebled. No doubt that disclosure of Satyam's better-than-expected financials should re-rate Tech M; valuations have already converged significantly towards larger peers in recent months. After adding Satyam's estimated contribution (Rs21) to the FY11 EPS, Tech M trades near its fair value of Rs758 (based on 12x FY11 P/E). We rate the stock as Market Performer.

Financial information disclosed included the following

A) P&L for Q3 FY09 and January and February 2009

Particulars	Stand-alone			Consolidated
Period (Rs mn)	Q3 FY09	Jan'09	Feb'09	Q3 FY09
Sales	22,940	6,810	6,760	24,144
Expenditure	(19,300)	(6,200)	(5,580)	(20,585)
Operating profit	3,640	610	1,180	3,559
OPM (%)	15.9	9.0	17.5	14.7
Interest	(80)	(20)	(40)	(148)
Other income	(880)	(340)	(390)	(872)
Depreciation	(660)	(210)	(210)	(739)
PBT	2,020	40	540	1,799
Tax	(210)	0	(20)	(199)
ETR (%)	10.4	-	3.7	11.1
PAT	1,810	40	520	1,601
NPM (%)	7.9	0.6	7.7	6.6
Exceptionals	0	0	0	0
Minority Interest	0	0	0	0
APAT	1,810	40	520	1,601
No of shares (in mn)	674.0	674.0	674.0	674.0
EPS Annualized (Rs)	10.7	0.7	9.3	9.5
Revenues (US$mn)	488	145	144	514
Rev Annualized (US$mn)	1,952	1,739	1,726	2,055
Net Profit (US$mn)	39	1	11	34
Cost Components				
(Rs mn)				
Employee Exp	15,090	5,040	4,560	16,152
SG&A	4,210	1,160	1,020	4,434
Total Expenditure	19,300	6,200	5,580	20,585
(as a % to sales)				
Employee Exp	65.8	74.0	67.5	66.9
SG&A	18.4	17.0	15.1	18.4
Total	84.1	91.0	82.5	85.3

Source: Company, India Infoline Research

B) Key balance sheet and business information of the stand-alone company

1) Cash balance of Rs3.7bn as at March 31, 2009.
2) Forward/option contracts outstanding as of March 31, 2009 at US$164mn with estimated M-T-M losses at Rs1.1bn. M-T-M losses paid out in January to March 2009 at Rs1.5bn.
3) Account receivable outstanding as at end-February 2009 stood at Rs19.1bn; of which, receivables worth Rs5.9bn were overdue.
4) Commitments and contingencies as on March 31, 2009 stood at Rs18bn.
5) Net block and Investments as at March 31, 2009 at Rs4.2bn and Rs6.3bn respectively.
6) Unacknowledged claims of Rs12.3bn.
7) 41,622 employees as at March 28, 2009.

C) US$400-500mn revenue loss between January-March 2009

1) 23 customers have terminated Masters Service Agreements (MSA) with the company. These clients accounted for US$70mn (14%) revenues in Q3 FY09.
2) 19 customers have completely withdrawn business (MSAs intact though). These clients accounted for US$22mn (5%) revenues in Q3 FY09.
3) 24 customers have withdrawn purchase orders of value US$91mn spread over the next 12 months.

On the other hand, company has won new business orders worth US$380mn in the above-mentioned period mainly from existing clients.

The above disclosed financial information has to be read in conjunction with following caveats

1) The revealed financial information is not compliant with either Indian GAAP or US GAAP.
2) The information has not been audited, reviewed or verified independently.
3) It has been prepared by the company using the data collected through its internal MIS, books of accounts and is based on certain management estimations, assumptions and approximations.

Disclosed revenue run-rate and margins significantly ahead of market assumptions

We were pleasantly surprised by the respectable revenue run-rate and healthy profitability levels of Satyam even in the stressed months of January and February 2009. It has to be noted that Q4 FY09 has been an extremely difficult period for software companies - admitted by managements of various companies and also reflected in their Q4 FY09 results. Despite the unfavorable macro environment and the unfortunate scandal that affected client's confidence in the company, Satyam's revenue-rate in January and February 2009 stood at US$1.7bn+ pa, reflecting only a modest deceleration on sequential basis. Bigger surprise came at the operating profitability front with the stand-alone company reporting a margin of 9% and 17.5% for the months of January and February respectively. The annualized net profit for the month of February at ~Rs6.2bn was also significantly ahead of our expectations.

Majority of the analyst were expecting Satyam's revenues and operating margin in FY10 in the range of US$1.2-1.4bn and 3-8% respectively based on the little information that was available before this disclosure. The margin estimates were mainly influenced by Mr.Raju's confession letter that had indicated that company was earning an abysmal operating margin of ~3%.

Satyam to add significantly to Tech M's EPS FY11 onwards

With the help of the above useful financial information, we broadly estimated Satyam's P&L for FY10 and FY11. We expect the company to clock revenues of ~US$1.3bn at 11% OPM in FY10. The revenue estimate is lower than the January-February run-rate as we factor the client attrition/revenue losses disclosed. This along with pervasive pricing pressures across industry and adverse currency movements would impact OPM in the year. In FY11, we have assumed 5% growth in revenues and material expansion in margin driven by aggressive cost cutting and absence of macro headwinds. Based on 51% ownership, Satyam is likely to add Rs21 to Tech M's EPS.

Broad financial projections for Satyam

Period (Rs mn)	FY10E	FY11E
Sales	59,800	62,790
Expenditure	(53,222)	(52,744)
Operating profit	6,578	10,046
OPM (%)	11.0	16.0
Interest	(480)	(480)
Other income	(2,000)	0
Depreciation	(2,520)	(2,646)
PBT	1,578	6,920
Tax	0	(1,488)
ETR (%)	-	21.5
PAT	1,578	5,433
NPM (%)	2.6	8.7
Contribution to Tech M EPS	**6.2**	**21.2**

Source: Company, India Infoline Research

Unprecedented run-up over the past three months captures most positives; Rate MP

Tech Mahindra share price has had a dream run over the past three months during which it nearly trebled. No doubt that disclosure of Satyam's better-than-expected financials should re-rate Tech M; valuations have already converged significantly towards larger peers in recent months. After adding Satyam's estimated contribution (Rs21) to the FY11 EPS, Tech M trades near its fair value of Rs758 (based on 12x FY11 P/E). We rate the stock as Market Performer.

Financial summary of Tech M (excluding Satyam consolidation)

Y/e 31 Mar (Rs m)	FY08	FY09	FY10E	FY11E
Revenues	37,661	44,647	42,794	46,103
yoy growth (%)	28.6	18.5	(4.1)	7.7
Operating profit	8,258	11,902	10,057	10,373
OPM (%)	21.9	26.7	23.5	22.5
Pre-exceptional PAT	7,701	9,223	6,047	5,477
Reported PAT	3,300	10,146	6,047	5,477
yoy growth (%)	171.6	207.5	(40.4)	(9.4)
EPS (Rs)	63.4	70.7	46.4	42.0
P/E (x)	11.7	10.5	16.0	17.7
Price/Book (x)	7.1	5.0	3.9	3.3
EV/EBITDA (x)	10.8	7.7	11.5	10.7
Debt/Equity (x)	-	-	0.9	0.7
RoE (%)	70.1	57.2	27.3	20.3
RoCE (%)	36.6	69.8	27.2	19.2

Source: Company, India Infoline Research

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

India Infoline Ltd. One India Bull Center, Jupiter Mill Compound, 841, Senapati Bapat Marg, Nr, Elphinstone Road, Lower Parel (W), Mumbai 400 013.

For Research related queries, write to: Amar Ambani at amar@indiainfoline.com or research@indiainfoline.com
For Sales and Account related information, write to customer care: info@5pmail.com or call on 91-22 4007 1000