

22nd Oct 2008**BUY**

Price	Target Price
Rs 415	Rs 613

Sensex	10,683
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Price Performance

(%)	1M	3M	6M	12M
Absolute	(45)	(44)	(58)	(72)
Rel. to Sensex	(25)	(26)	(31)	(52)

Source: Capitaline

Stock Details

Sector	IT Services
Reuters	TEML.BO
Bloomberg	TECHM@IN
Equity Capital(Rs mn)	1217
Face Value(Rs)	10
52 Week H/L	1,305/336
Market Cap(Rs bn//US\$ mn)	45/919
Daily Avg Volume (No of shares)	120261
Daily Avg Turnover (US\$)	1.7

Shareholding Pattern (%)

(30 th Sep'08)	
Promoters	83.3
FII/NRI	2.3
Institutions	2.0
Private Corp.	2.0
Public	10.4

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Margin expansion continues to surprise**Q2FY09 Result Highlights**

Tech Mahindra reported revenues of US\$ 270mn flat QoQ, Rs 11.6 bn (+4.3% QoQ, 29.8% YoY), slightly below expectations. However for a 2nd quarter in a row operating **margins expansion surprised positively by ~230 bps to 28%** (V/s our expectations of ~190 bps decline as we had built in transition costs related to new deals) helped by gross margin expansion of ~210 bps and tight control on SGA costs (**SGA expenses down by 12 bps QoQ**). Net profits at Rs 2355 mn (-9% QoQ, +29.5% YoY) came in lower than estimates driven by high forex losses at Rs 320 mn during the quarter. Net hiring during the quarter was below par at 766. Revenues from top client ex BTGS deal declined by ~11.2% sequentially on reported numbers (**we estimate that top client revenues adjusted for US\$/GBP movement declined by ~2% sequentially V/s management comments of revenues being flat at constant currency, for working see section below**).

BTGS deal ramps up to US\$ 32 mn during Q2FY09; core BT declines by ~8% adjusted for forex movements

Company management during the investor call indicated that the revenues from the BTGS deal during the quarter were at US\$ 32 mn, in line with our expectations. Though revenues from top client declined by ~11% sequentially on reported US\$ revenues and company maintained that revenues from the top clients were flat in constant currency terms, we reckon that revenues from top client were down ~2% QoQ while revenues from core BT business were down ~8% sequentially.

	Q1FY09	Q2FY09
Top client revenues(in US\$ mn)	171.3	161.9
QoQ change		-5.5%
Avg GBP/US\$ rate	1.97	1.90
Top client revenues (in GBP mn)	87.0	85.2
QoQ change		-2.0%
Core BT revenues(in US\$ mn)	146.3	129.9
QoQ change		-11.2%
Avg GBP/US\$ rate	1.97	1.90
Core BT revenues (in GBP mn)	74.3	68.4
QoQ change		-7.9%

Source: Company, Emkay Research

Tech M management during the investor call indicated that growth within core BT business was challenging on account of overall cuts in BT's core business IT spend, however company continues to gain market share within existing business on account of preferred vendor relationship that it enjoys. Further the company also indicated that the scope of business on the US\$ 700 mn contract signed with BT during Q1FY09 could be increased to ~US\$1 bn soon.

(in US\$ mn)	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09
Quarterly Revenues	211	221	245	258	272	270
QoQ growth, %	6.7%	4.7%	11.1%	5.1%	5.5%	-0.8%
Top client revenues	135.0	143.5	149.6	167.6	171.3	161.9
QoQ growth, %	1.9%	6.3%	4.2%	12.0%	2.2%	2.2%
Top 5 client revenues	179.3	189.9	201.1	214.0	228.4	221.2
QoQ growth, %	9.2%	5.9%	5.9%	6.4%	6.7%	-3.1%
Top 10 client revenues	189.8	196.5	215.8	229.4	244.7	240.1
QoQ growth, %	7.9%	3.5%	9.8%	6.3%	6.7%	-1.9%

Source: Company, Emkay Research

In Rs mn	Q2FY09	Q1FY09	QoQ(%)	Q2FY08	YoY (%)
Net sales	11648	11164	4.3%	8976	29.8%
Total Income	11,648	11,164		8,976	
Operating expenses	8387	8295		7004	
EBITDA	3,261	2,869	13.7%	1,972	65.4%
Margins (%)	28.00	25.70		22.0	
Depreciation	267	258		193	
EBIT	2,994	2,611	14.7%	1,779	68.3%
Margins (%)	25.7	23.4		19.8	
Interest Paid	0	2		25	
Other income	-320	261		249	
Pre-tax profit	2,674	2,870		2,003	
Tax provided	321	283		187	
Profit after tax	3,027	2,585		1,818	
Emkay Net profit	2,355	2,583	-8.8%	1,818	29.5%
EPS, Rs	18.0	19.7		13.9	

Source: Company, Emkay Research

Margins improve to 28%, highest in the co's history

Tech Mahindra surprised us positively on operating margins for the 2nd quarter in a row, reporting EBITDA margins of 28%, up ~230 bps sequentially, highest in the company's reporting history. Though the company's progress on margin expansion is commendable over the past 2 quarters (with help from currency depreciation as well), we were perplexed by the extent of margin expansion (we expecting margins to decline driven by transition costs on the large deal concluded with BT during Q1FY09) as company's offshore onsite revenue mix at 40:60 remained unchanged at Q1FY09 as well as company reported ~500 bps decline in utilization rates to 69%. We note that the company's quarterly margin profile has been erratic in the past and thus **do not rule out the possibility of a negative surprise on the margin front over the next 2-3 quarters when transition costs related to the US\$ 700 mn deal are incurred.**

	Q1FY07	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09
OPM's	22.3%	25.4%	26.92%	25.36%	22.1%	22.0%	21.94%	21.8%	25.7%	28.0%
Utilisation	74%	69%	67%	67%	67%	63%	69%	73%	74%	69%
Onsite Rev	34%	38%	40%	41%	43%	45%	44%	42%	40%	40%

Source: Company, Emkay Research

Further we are surprised by the extent of tight control on SGA expenses over the past 2 quarters as we believe that new client acquisition should remain a key focus area for company management in order to diversify co's revenue profile over the next few years.

Higher than expected forex losses cause lower than expected profits

Tech Mahindra incurred Rs 320 mn of forex losses during the quarter impacting net profits (adjusted for one off tax write back of Rs 673 mn) at Rs 2355 mn. Tech M management indicated that it had forex losses of ~US\$ 26 mn sitting on the Balance Sheet at the end of September'08 quarter and expects to book ~US\$ 2-3 mn of these losses during H2FY09. Further the company has US\$/INR hedges of US\$ 800 mn and GBP/US\$ of 300 mn at the end of Q2FY09.

Cut estimates to build in slower US\$ revenue growth; Maintain 'BUY'

We have cut our FY09/FY10 US\$ revenue estimates by ~4%/10% to build in macro weakness, reset our currency assumptions and build in higher operating margins/cost control. We now expect Tech Mahindra to report earnings of Rs 76.7 and Rs 84.7 in FY09 and FY10 (V/s Rs 76.5 and Rs 83.7 earlier).

We maintain BUY with a revised price target of Rs 613 based on 8x FY10 adjusted earnings of Rs 76.7 (adjusted for upfront payment made for large deals).

(All fig in Rs mn except EPS)	FY09E			FY10E		
	Old	New	% change	Old	New	% change
Revenues(US\$ mn)	1,157	1,112	-3.9	1,424	1,283	-9.9
Revenues	48,650	48,194	-0.9	59,033	57,734	-2.2
EBITDA	11,598	12,506	7.8	13,291	13,846	4.2
Net profits	10,021	10,044	0.2	10,962	11,093	1.2
EPS	76.5	76.7	0.2	83.7	84.7	1.2

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