

Morgan Stanley India Company
Private Limited+

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Stock Rating
Equal-weight

Industry View
Cautious

Tech Mahindra Limited

Recovery remains elusive; Dec08 results disappoint

Quick Comment: Despite having signed some of the largest deals in the industry over last two years, TechM (TM) reported a decline in rupee revenues. BT has recently issued a fresh warning for its global services business and we believe TM's revenues from its top clients could continue to lag for a while. Moreover, mid-sized vendors like TM are likely to face further delays in signing new business in a tough macro economic environment in our view. In the absence of any near-term triggers, we maintain our EW rating on the stock.

Dec08 results: Revenues of Rs11.3bn (-2.8% QoQ, +16.7% YoY) and net profit excluding extra-ordinary items of Rs2.2bn (-5.3% QoQ, +11.7% YoY) was below our expectations. Gross margins for Telecom service provider segment (87% of revenues and 88% of EBIT) improved to 42.7% (+160bps QoQ) whereas TEM (Equip manufacturer) and BPO reported margins of 25.7% (-40bps QoQ,) and 48.8% (-790bps QoQ). BT now accounts for 57% of revenues and reported second consecutive QoQ revenue decline.

Will large deals deliver? Tech Mahindra's revenue growth has not matched the high investor expectations set by announcement of deals worth over US\$2bn (US\$1.4bn at current GBP/USD rates) between Dec06-Jul08. These deals were won from BT and have since seen multiple time and execution delays. The largest deal (US\$1bn for 5 years) Barcelona has achieved a revenue run-rate of US\$35m per quarter after almost two years. In addition, the overall revenues from BT, despite the large deals, continues to decline in absolute terms.

Valuation: The stock has de-rated severely over the last 12m and is currently trading at 3x FY10e EPS with cash of US\$110m. In our view, lack of transparency, upfront payments to BT to win deals and mgmt inability to translate deal wins into revenues could lead to further corrosion of the stock price over the coming quarters.

Key Ratios and Statistics

Reuters: **TEML.BO** Bloomberg: **TECHM IN**

India Software

Price target	Rs290.00
Shr price, close (Jan 23, 2009)	Rs210.15
52-Week Range	Rs990.00-210.15
Sh out, dil, curr (mn)	131
Mkt cap, curr (mn)	Rs27,472
EV, curr (mn)	Rs26,274
Avg daily trading volume (mn)	Rs39

Fiscal Year ending	03/08	03/09e	03/10e	03/11e
ModelWare EPS (Rs)	58.90	74.54	72.07	72.13
Prior ModelWare EPS (Rs)	-	75.05	72.27	73.49
Consensus EPS (Rs)§	57.27	77.45	76.88	75.54
Revenue, net (Rs mn)	37,661	45,693	47,016	52,625
EBITDA (Rs mn)	8,257	12,489	11,341	12,232
ModelWare net inc (Rs mn)	7,700	9,767	9,588	9,740
P/E	12.0	2.8	2.9	2.9
P/BV	7.4	1.3	0.9	0.7
RNOA (%)	86.9	88.9	70.5	66.1
ROE (%)	83.8	77.7	44.5	32.3
EV/EBITDA	11.0	1.5	0.9	0.3
Div yld (%)	0.8	2.9	3.3	3.8
FCF yld ratio (%)	(0.2)	34.1	30.8	30.8
Leverage (EOP) (%)	(10.4)	(42.8)	(55.9)	(63.0)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

e = Morgan Stanley Research estimates

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Exhibit 1

Tech Mahindra: Dec08 Income Statement (Rs m, %)

Year to March 31st	Dec-07	Sep-08	Dec-08	QoQ	YoY	Comments
Revenue	9,704	11,648	11,322	-2.8%	16.7%	Lower working days, currency fluctuations impacted revenues
Cost of Services	6,144	6,867	6,572	-4.3%	7.0%	Reported revenues from BT declined for second consecutive quarter
Gross Profit	3,560	4,781	4,750	-0.6%	33.4%	
<i>Gross Margins (%)</i>	36.7	41.0	42.0	91 bps	527 bps	
SG&A	1,431	1,520	1,570	3.3%	9.7%	
EBIDTA	2,129	3,261	3,180	-2.5%	49.4%	
<i>EBIDTA Margins (%)</i>	21.9	28.0	28.1	9 bps	615 bps	
Depreciation	206	267	286	7.1%	38.8%	
Operating Profit	1,923	2,994	2,894	-3.3%	50.5%	Ramp up in large deals announced could impact margins
<i>Operating Margins (%)</i>	19.8	25.7	25.6	-14 bps	574 bps	
Other Income	300	(320)	(397)	24.1%	-232.3%	Includes int income of US\$0.6m; MTM Fx loss of US\$9m
Interest	16	-	-	NM	NM	
PBT	2,207	2,674	2,497	-6.6%	13.1%	
Tax	213	321	269	-16.2%	26.3%	
<i>Tax rate (%)</i>	9.7	12.0	10.8	-123 bps	112 bps	
PAT	1,994	2,353	2,228	-5.3%	11.7%	
Minority Interest	1	1	1	0.0%	0.0%	
Profit after minority int	1,995	2,354	2,229	-5.3%	11.7%	
Extraord (Tax write back)	-	673	-	NM	NM	
PAT after extra-ord items	1,995	3,027	2,229	-26.4%	11.7%	
EPS, Basic (Rs)	16.5	24.9	18.3	-26.5%	11.3%	
EPS, Diluted (Rs)	15.2	23.2	17.2	-26.2%	12.5%	

Source: Company data, Morgan Stanley Research

Conference Call Key Takeaways:

1) Top client declined by -7.7% QoQ in rupee terms, 2) Total BT spend on transformational projects is likely to be GBP500m out of which management expects GBP350m would be incremental revenues to Tech Mahindra, 3) Out of 5500 campus offers for FY09e, only 2100 have joined and the balance has been deferred. For FY10e Tech Mahindra has given 1500 campus offers 4) Management indicated that decision making by clients has slowed down, 5) Capex of US\$150m over a 3-year period could be reduced in the current environment, 6) Hedge position of GBP265m at 1.98/US\$ and Fx gains of US\$2m in OCI, 6) Cash balance of US\$110m

Exhibit 2

Tech Mahindra: Summary of Original deals with BT and its current size at the prevailing exchange rates

Deal Summary	Original Contract Size (US\$m)	GBP/USD rate on deal date	Value of contract in GBP m	Current Rate (GBP/USD)	Value of contract in US\$m now
BT deal on Dec 20 2006	1,000	1.96	510	1.38	703
BT deal on Mar 17 2008	350	2.00	175	1.38	241
BT deal on July 21 2008	700	2.00	350	1.38	484

Source: Company data, Morgan Stanley Research

Exhibit 3

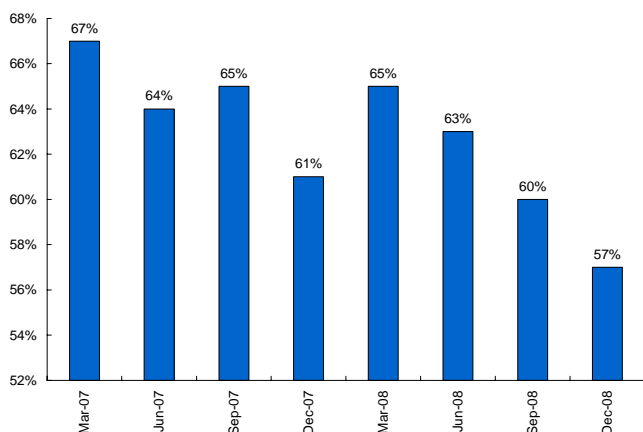
Tech Mahindra: Dec08 Operating Metrics

Year Ending 31 March	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
Geography (%)								
North America	19	19	19	20	20	22	23	26
Europe	76	74	75	70	75	72	69	65
Others	5	7	6	10	5	6	8	9
Client Conc (%)								
Top client's	67	64	65	61	65	63	60	57
Top 5 clients'	83	85	86	82	83	84	82	79
Top 10 clients'	89	90	89	88	89	90	89	87
Total Clients	83	87	96	105	107	110	110	110
Net Clients Added	5	4	9	9	2	3	0	0
>\$1 Million Customers	29	31	32	41	44	44	45	46
>\$5 Mn clients	8	9	12	12	13	12	14	14
>\$10 Mn clients	6	6	6	6	6	7	8	8
>\$20 Mn clients	3	3	3	3	3	4	4	4
>\$25 Mn clients	2	3	3	3	3	3	4	4
>\$50 Mn clients	2	2	2	2	2	2	2	2
Utilization Rates (%)								
Including Trainees	67	67	63	69	73	74	69	67
Staff								
Technical People	17,181	18,092	18,883	18,448	18,430	19,386	20,273	20,779
Sales & support people	813	1,035	1,026	1,003	1,009	1,101	1,128	1,123
BPO Professionals	1,755	2,019	3,191	3,704	3,445	3,882	3,734	3,527
Total Employees	19,749	21,146	23,100	23,155	22,884	24,369	25,135	25,429
Net addition	1,975	1,397	1,954	55	(271)	1,485	766	294
Delivery (%)								
Offshore	59	57	55	56	58	60	60	60
Onsite	41	43	45	44	42	40	40	40

Source: Company data, Morgan Stanley Research

Exhibit 4

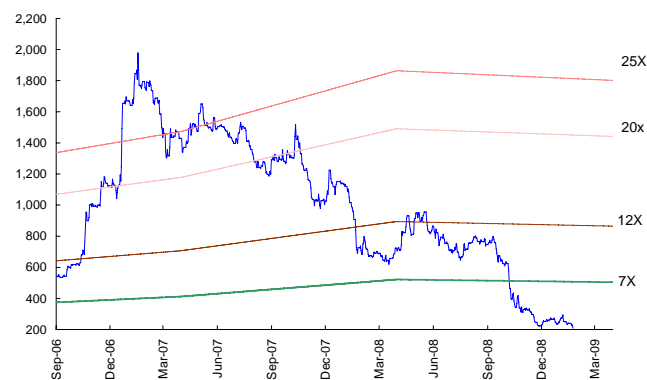
Tech Mahindra: Top client revenue share (%)



Source: Company data, Morgan Stanley Research

Exhibit 5

Tech Mahindra: 1-year Forward P/E Band Chart

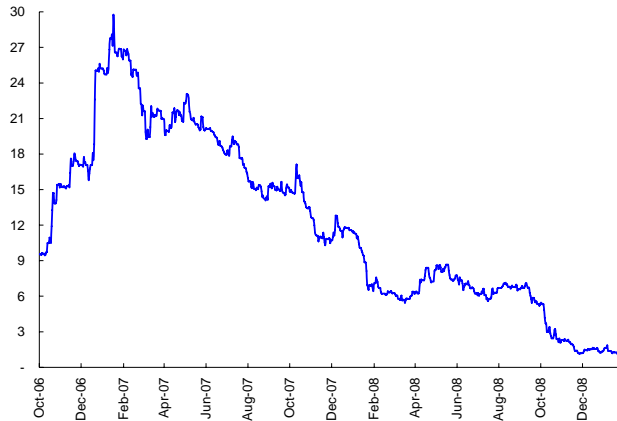


Source: Bloomberg, Company data, Morgan Stanley Research

January 26, 2009
Tech Mahindra Limited

Exhibit 6

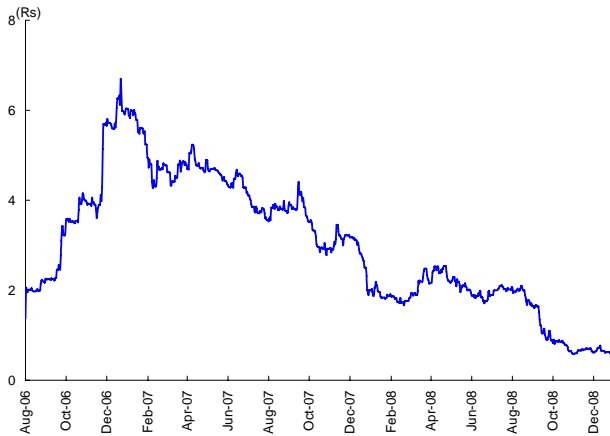
Tech Mahindra: EV/EBITDA chart



Source: Bloomberg, Company data, Morgan Stanley Research

Exhibit 7

Tech Mahindra: Price to Sales Chart



Source: Bloomberg, Company data, Morgan Stanley Research

Exhibit 8

Tech Mahindra: Comparative Price Performance (%)

Comp Peers/Index	1d	1w	1m	3m	6m	1yr	Ytd
HCL TECH	-4.3	-9.1	-7.7	-22.4	-49.0	-53.5	-7.2
INFOSYS	-2.1	-5.0	2.6	-3.3	-23.1	-14.4	8.0
SATYAM	31.3	58.6	-71.1	-86.5	-89.5	-90.3	-77.3
TCS	-2.1	-3.4	1.7	-2.5	-39.4	-42.3	1.7
WIPRO	-2.0	-10.4	-8.1	-9.2	-47.6	-48.1	-8.5
TECH MAHINDRA	-8.8	-12.9	-15.1	-38.0	-70.4	-69.5	-15.4
I-FLEX	8.9	7.8	8.4	13.0	-64.1	-49.3	6.9
MPHASIS	0.1	0.0	0.9	-14.5	-21.1	-32.0	-3.6
POLARIS	-0.1	26.5	11.5	-1.2	-46.6	-44.9	-0.7
PATNI	-1.0	-4.3	-10.9	-17.7	-51.8	-51.7	-12.9
HEXWARE	0.0	-0.2	1.0	-5.7	-60.0	-69.4	-5.2
MINDTREE	-4.0	-16.4	-16.1	-18.1	-44.6	-40.1	-15.4
E-CLERX	-0.7	-3.5	-4.1	0.3	-55.4	-73.3	-2.0
EDUCOMP	-2.4	-16.3	-31.9	-2.6	-48.2	-52.9	-27.4
HCL INFO	0.3	-2.7	-8.8	-7.0	-41.3	-59.9	-17.6
INFOEDGE	-4.2	4.7	5.3	1.0	-50.7	-53.3	4.7
KPIT CUMMINS	-0.5	-5.4	-21.8	-23.1	-62.6	-73.5	-22.1
MASTEK	0.3	-3.9	-14.4	-33.0	-59.3	-48.4	-11.0
NIIT LTD	-0.7	-3.9	-7.2	-20.7	-76.0	-80.3	-17.3
NUCLEUS SOFT	-1.8	-5.2	12.4	-20.1	-71.5	-80.7	6.2
SASKEN	0.2	-0.3	-24.3	-48.9	-71.2	-69.8	-28.0
SUBEX	1.6	0.8	-21.1	-19.1	-68.8	-91.0	-19.6
TANLA	9.1	2.3	-38.8	-46.7	-79.7	-85.6	-36.0
BSE SENSEX	-1.6	-7.0	-7.0	-0.3	-39.2	-52.8	-10.1
MSCI INDIA IT IND	-1.5	-4.4	-0.6	-16.9	-37.8	-39.2	-3.6
NASDAQ COMP	0.8	-2.3	-3.5	-4.8	-36.1	-36.5	-6.3

Source: Bloomberg, Morgan Stanley Research; Based on prices closed on January 23, 2009

Exhibit 9

Global Software Valuations: P/E and PEG Ratio

Company	Ticker	Curr	Price (Local)	M Cap (\$mil)	EPS (Respective Currency)			P/E (x)			EPS Growth			EPS CAGR 08-10	PEG
					FY08	FY09e	FY10e	FY08	FY09e	FY10e	FY08	FY09e	FY10e		
US Listed															
Accenture	ACN	USD	31	19,059	2.7	2.9	3.1	11.8	10.9	10.2	34.5%	8.7%	6.9%	7.8%	1.4
Amdocs*	DOX	USD	17	3,470	2.1	1.9	2.0	8.2	9.1	8.6	25.1%	NM	6.6%	NM	NM
BearingPoint *	BE	USD	2	8	-84.0	-13.6	-1.0	NM	NM	NM	66.3%	NM	NM	NM	NM
Cognizant Solutions	CTSH	USD	19	5,515	1.2	1.4	1.5	16.4	13.1	12.4	49.2%	25.2%	6.0%	15.2%	0.9
Computer Sciences *	CSC	USD	36	5,446	3.8	4.2	4.2	9.4	8.5	8.5	11.6%	9.9%	0.6%	5.1%	1.7
Infosys - ADR	INFY	USD	26	14,923	2.0	2.1	2.2	12.8	12.2	11.9	32.7%	5.2%	2.8%	4.0%	3.1
Patni - ADR	PTI	USD	5	310	1.7	1.3	1.2	2.9	3.9	4.0	15.0%	NM	NM	NM	NM
Wipro - ADR	WIT	USD	7	9,704	0.6	0.5	0.6	11.8	12.8	12.0	25.1%	NM	6.5%	NM	NM
European Listed															
Cap Gemini	CAP	EUR	25	4,581	2.4	2.9	2.8	10.3	8.6	8.9	54.2%	19.8%	NM	7.7%	1.1
Logica PLC	LOG	GBp	64	1,387	10.4	9.9	8.6	6.1	6.4	7.4	24.4%	NM	NM	NM	NM
India Listed															
HCL Tech	HCLT	INR	107	1,489	19.9	21.2	21.0	5.4	5.0	5.1	25.5%	6.7%	NM	2.9%	1.8
Hexaware	HEXW	INR	20	59	7.7	5.2	6.2	2.6	3.8	3.2	NM	NM	19.3%	NM	NM
Infosys - Local	INFO	INR	1,204	14,036	81.3	102.9	107.0	14.8	11.7	11.3	23.8%	26.6%	4.0%	14.8%	0.8
MindTree*	MTCL	INR	200	159	26.7	21.9	41.3	7.5	9.1	4.8	NM	NM	88.2%	24.3%	0.4
Mphasis @	MPHL	INR	150	639	14.1	14.1	23.3	10.6	10.6	6.4	15.7%	NM	65.3%	28.6%	0.4
Patni - Local	PATNI	INR	114	324	33.3	25.5	30.0	3.4	4.5	3.8	29.5%	NM	17.5%	NM	NM
TCS	TCS	INR	486	9,690	51.3	52.9	56.9	9.5	9.2	8.5	21.5%	3.2%	7.6%	5.4%	1.7
Tech Mahindra	TECHM	INR	210	560	58.9	74.5	72.1	3.6	2.8	2.9	18.9%	26.5%	NM	10.6%	0.3
Wipro - Local	WPRO	INR	214	6,358	22.5	26.8	28.3	9.5	8.0	7.6	10.3%	19.0%	5.7%	12.2%	0.7
BPO															
Genpact	G	USD	9	1,823	0.46	0.72	0.73	18.4	11.8	11.6	6.4%	55.9%	1.8%	26.0%	0.5
WNS	WNS	USD	8	322	0.87	1.11	1.13	8.7	6.8	6.7	11.4%	27.2%	2.0%	13.9%	0.5
Convergys	CVG	USD	7	850	1.23	1.05	0.83	5.7	6.7	8.3	4.9%	NM	NM	NM	NM
Teletech	TTEC	USD	7	480	1.05	1.21	0.96	7.0	6.1	7.6	40.9%	16.1%	NM	NM	NM
EXL*	EXLS	USD	9	247	0.93	0.37	0.42	9.2	22.9	20.3	132.5%	NM	12.5%	NM	3.8
ADP*	ADP	USD	37	18,837	2.18	2.37	2.56	17.0	15.6	14.5	8.5%	8.9%	7.8%	8.3%	1.9
ACS*	ACS	USD	42	3,864	3.53	3.65	4.24	12.0	11.6	10.0	33.2%	3.5%	16.2%	9.7%	1.5

Prices as closed on January 23, 2009

E = Morgan Stanley Research estimates, except for those marked with an asterisk (*), which are consensus estimates as provided by FactSet

NM = Not Meaningful

@ Mphasis EPS include EDS India from F2007; Mphasis FY09e represent actual EPS for the period of 7 months from April08-October08; FY10e represent our Estimates for the period of Nov08-Oct09

#, Amdocs, ACS, ADP, Teletech, Convergys F2008 EPS numbers represent estimates.

WNS EPS represent company-adjusted numbers; Genpact EPS represent MS adjusted numbers (GAAP EPS adjusted for formation-related expense and FBT costs).

Estimates for Indian ADRs are taken from FactSet.

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Bearing Point, Cognizant, EDS, Cap Gemini, Logica, Hexaware and Patni have a December-ending fiscal year, Accenture has an August-ending FY, Amdocs has a September-ending FY, HCL Tech has a June-ending FY, and the rest have a March-ending FY. For companies with a December-ending fiscal year, F2008 represents their actual CY07 numbers.

Sources: Company data, FactSet, Morgan Stanley Research

Company Description

Tech Mahindra provides offshore-based information technology services to clients across the value chain of the telecom industry. The company offers a range of IT services such as application development, product engineering & life cycle management, testing, and solution integration. Tech Mahindra is jointly promoted by Indian auto major Mahindra & Mahindra and British Telecom; the latter is Tech Mahindra's largest customer. Tech Mahindra was publicly listed in August 2006.

India Software


Industry View: Cautious

We believe the demand environment is likely to remain challenging for the offshore vendors, with the worsening economic environment in US. Furthermore, specific factors like the imposition of tax rates post F2010 for STPs, the inability of smaller vendors to migrate to SEZs, and rising offshore wage costs due to increasing competition would imply significantly lower profitability for sub-scale offshore IT vendors.

MSCI Country: India

Asia Strategist's Recommended Weight: 3.0%

MSCI Asia/Pac All Country Ex Jp Weight: 6.8%

	<p>Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.</p>
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(as of December 31, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	811	34%	240	40%	30%
Equal-weight/Hold	1060	45%	271	45%	26%
Not-Rated/Hold	33	1.4%	8	1.3%	24.2%
Underweight/Sell	463	20%	87	14%	19%
Total	2,367		606		

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Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Not-Rated/Hold (NA or NAV) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months. Please note that NA or NAV may also be used to designate stocks where a rating is not currently available for policy reasons. For the current list of Not-Rated/Hold stocks as counted above in the Global Stock Ratings Distribution Table, please email morganstanley.research@morganstanley.com.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Other Important Disclosures

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Industry Coverage:India Software

Company (Ticker)	Rating (as of)	Price (01/23/2009)
Vipin Khare		
Genpact Limited (G.N)	E (08/26/2008)	US\$8.5
HCL Technologies (HCLT.BO)	U (09/29/2008)	Rs107
Hexaware Technologies Limited (HEXT.BO)	E (02/22/2008)	Rs20
Infosys Technologies (INFY.BO)	E (07/14/2008)	Rs1,203.95
Mindtree Ltd. (MINT.BO)	NA (06/29/2008)	Rs199.95
Mphasis Limited (MBFL.BO)	E (11/09/2007)	Rs150
Patni Computer Systems (PTNI.BO)	E (05/01/2008)	Rs113.75
Tata Consultancy Services (TCS.BO)	E (04/22/2008)	Rs485.7
Tech Mahindra Limited (TEML.BO)	E (01/29/2008)	Rs210.15
WNS Global Services (WNS.N)	U (08/05/2008)	US\$7.48
Wipro Ltd. (WIPR.BO)	E (01/29/2008)	Rs213.85

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