

Management meeting highlights

We organized investor meetings with Tech Mahindra (TML) in Asia where management highlighted opportunities for TML in telecom vertical and provided update on its 42% subsidiary Mahindra Satyam (Satyam).

Worst behind in telecom

It expects IT spends in telecom vertical to recover in 2H FY12 driven by new initiatives such as cloud and adoption of new technologies. Management highlighted that over last 2-3 years TML has expanded service offerings beyond applications to include Infrastructure management, BPO, security, VAS & network services. Revenue contribution from these services improved from 5% to 25% during this period and offers 3-4x opportunity than traditional application business.

BT - stable revenues

Expects BT revenues (43% revs) to be stable in the range of 70-72mn GBP per quarter and remains bullish on growth in non BT i.e. AT&T and emerging markets. Non BT revenues grew at CAGR of 30% during FY08-10. 80% of BT revs are from maintenance services and likely to remain stable in our view.

Mahindra Satyam.. progress on track

Management reiterated that performance at Satyam was on expected lines and the subsidiary should achieve industry level growth and profitability over next 15-18 months. Margin expansion likely to be driven by revenue growth given scope to leverage on SG&A (23% of revs) and expand employee pyramid. On merger management indicated that while minor hurdles remain larger issues such as Unpaid case & Class Action Lawsuit has been settled successfully. Our adj. consolidated EPS projection for TML is at Rs57 for FY12e and Rs71 for FY13e.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	7,458	5,274	4,852	5,032	6,121
EPS	57.37	40.57	37.33	38.71	47.08
EPS Change (YoY)	34.3%	-29.3%	-8.0%	3.7%	21.6%
Dividend / Share	4.01	3.50	3.86	4.00	4.87
Free Cash Flow / Share	79.80	85.00	31.37	29.77	37.81

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	11.94x	16.89x	18.36x	17.70x	14.55x
Dividend Yield	0.585%	0.511%	0.563%	0.584%	0.710%
EV / EBITDA*	8.57x	9.42x	12.98x	11.78x	9.66x
Free Cash Flow Yield*	11.27%	12.07%	4.58%	4.34%	5.52%

* For full definitions of *iQmethod*SM measures, see page 4.

Equity | India | Computer Services
07 March 2011

Bank of America Merrill Lynch

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Stock Data

Price	Rs685.25
Price Objective	Rs740.00
Date Established	20-Feb-2011
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs476.85-Rs958.00
Mrkt Val / Shares Out (mn)	US\$1,915 / 125.7
Average Daily Volume	246,150
BofAML Ticker / Exchange	TMHAF / BSE
Bloomberg / Reuters	TECHM IN / TEML.BO
ROE (2011E)	15.6%
Net Dbt to Eqty (Mar-2010A)	39.6%
Est. 5-Yr EPS / DPS Growth	10.0% / 10.0%
Free Float	12.5%

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Refer to important disclosures on page 5 to 7. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11027088

iQprofileSM Tech Mahindra Ltd.

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	44,647	45,753	46,187	52,728	62,874
Gross Profit	25,831	25,162	16,872	17,774	21,425
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	9,041	8,171	6,429	7,041	8,619
Net Interest & Other Income	(403)	(1,430)	(74)	(256)	(219)
Associates	NA	NA	NA	NA	NA
Pretax Income	8,638	6,741	6,355	6,785	8,400
Tax (expense) / Benefit	(1,179)	(1,440)	(1,503)	(1,753)	(2,279)
Net Income (Adjusted)	7,458	5,274	4,852	5,032	6,121
Average Fully Diluted Shares Outstanding	130	130	130	130	130

Key Cash Flow Statement Data

Net Income	7,458	5,274	4,852	5,032	6,121
Depreciation & Amortization	2,851	2,655	1,421	1,611	1,929
Change in Working Capital	1,317	(2,649)	(744)	(1,088)	(1,604)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	599	9,224	0	0	0
Cash Flow from Operations	12,225	14,503	5,530	5,555	6,446
Capital Expenditure	(2,513)	(4,108)	(1,586)	(1,812)	(1,692)
(Acquisition) / Disposal of Investments	(3,778)	3,868	0	0	0
Other Cash Inflow / (Outflow)	153	123	0	0	0
Cash Flow from Investing	(6,138)	(117)	(1,586)	(1,812)	(1,692)
Shares Issue / (Repurchase)	31	51	0	0	0
Cost of Dividends Paid	(1,352)	0	(556)	(576)	(701)
Cash Flow from Financing	(1,321)	(1,484)	(556)	(575)	(699)
Free Cash Flow	9,712	10,395	3,944	3,743	4,754
Net Debt	(5,382)	11,485	8,096	4,929	877
Change in Net Debt	(4,766)	(12,902)	(3,389)	(3,167)	(4,053)

Key Balance Sheet Data

Property, Plant & Equipment	4,979	6,043	6,737	6,939	6,702
Other Non-Current Assets	5,887	33,353	33,353	33,353	33,353
Trade Receivables	9,022	10,420	10,503	11,990	14,297
Cash & Equivalents	5,382	2,187	3,076	3,743	6,295
Other Current Assets	3,149	7,001	7,463	7,990	8,619
Total Assets	28,419	59,004	61,132	64,015	69,267
Long-Term Debt	0	13,672	11,172	8,672	7,172
Other Non-Current Liabilities	NA	7,677	7,677	7,677	7,677
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	8,888	8,665	8,967	9,895	11,228
Total Liabilities	8,888	30,014	27,816	26,244	26,077
Total Equity	19,543	29,002	33,194	37,650	43,070
Total Equity & Liabilities	28,431	59,016	61,010	63,894	69,147

iQmethodSM - Bus Performance*

Return On Capital Employed	48.3%	20.7%	11.0%	10.7%	11.8%
Return On Equity	46.6%	21.8%	15.6%	14.2%	15.2%
Operating Margin	20.2%	17.9%	13.9%	13.4%	13.7%
EBITDA Margin	26.6%	23.7%	17.0%	16.4%	16.8%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.6x	2.7x	1.1x	1.1x	1.1x
Asset Replacement Ratio	2.3x	3.1x	1.1x	1.1x	0.9x
Tax Rate (Reported)	13.6%	21.4%	23.6%	25.8%	27.1%
Net Debt-to-Equity Ratio	-27.5%	39.6%	24.4%	13.1%	2.0%
Interest Cover	NM	3.7x	6.2x	8.3x	12.0x

Key Metrics

* For full definitions of iQmethodSM measures, see page 4.

Company Description

Set up as JV between M&M and British Telecom, Tech Mahindra is a leading offshoring company with a focus on the telecom sector. It derives more than 40% of revenues from its top client, BT, and now is a strategic partner in BT's 21CN initiative. It was ranked 8th in terms of exports by Nasscom and derives more than 60% of revenues from offshoring.

Investment Thesis

Our Neutral rating is driven by our view that revenues from top client BT have now stabilised and unlikely to surprise negatively. Traction from AT&T and emerging markets remain strong and valuations are attractive. Upside to earnings possible from strong recovery in telecom spends and synergies from merger with subsidiary Satyam. Downside risk- lower margin expansion at subsidiary Mahindra Satyam & concerns on potential liabilities from advances claimed by ex promoter companies.

Stock Data

Price to Book Value 2.6x

Price objective basis & risk

Tech Mahindra (TMHAF)

Our PO of Rs740 is set at 13x FY12E, a 30pc discount to target multiple for peers such as HCLT. We believe the discount is fair given uncertainty in BT revenues, high client concentration in BT and limited exposure to high growth segment such as infrastructure & BPO. Our valuations are based on consolidated earnings including Satyam. Our standalone TML earnings are adjusted for BT contract restructuring fees reported in revenue line by company over FY10-14.

Upside risk from faster recovery in telecom IT spends, synergies from merger with subsidiary Mahindra Satyam and large new deal wins in telecom. Downside risk from lower than expected margin expansion at Mahindra Satyam and legal cases against Mahindra Satyam.

Link to Definitions

Technology

Click [here](#) for definitions of commonly used terms.

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India - Software & IT Services Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	D.B.Corp Ltd	XDDCF	DBCL IN	Pratish Krishnan
	Educomp Solu	EUSOF	EDSL IN	Pratish Krishnan
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	HCL	XHCLF	HCLT IN	Mitali Ghosh
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
	Jagran Prakashan Ltd	JGRPF	JAGP IN	Pratish Krishnan
	Persistent Systems	XPSYF	PSYS IN	Kunal Tayal
	Rollta India	RLTAF	RLTA IN	Pratish Krishnan
	Rollta India-GDR	XLROF	RTI LI	Pratish Krishnan
	Sun TV Network Ltd	SUTVF	SUNTV IN	Pratish Krishnan
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Zee Entertainment	XZETF	Z IN	Pratish Krishnan
NEUTRAL				
	ExlService Holdi	EXLS	EXLS US	Mitali Ghosh
	Infotech Enterprises Ltd	IFKFF	INFTC IN	Pratish Krishnan
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh
UNDERPERFORM				
	Genpact Ltd	G	G US	Mitali Ghosh
	Mastek	MSKDF	MAST IN	Pratish Krishnan
	Mphasis Ltd	MPSSF	MPHL IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	$\text{Market Cap.} = \text{Current Share Price} * \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

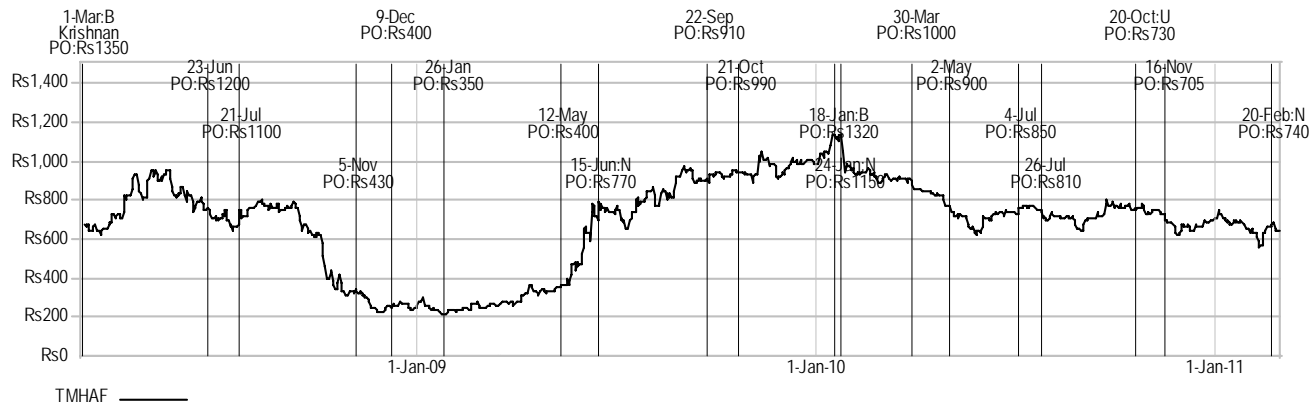
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Investment Rating Distribution: Technology Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	128	54.01%	Buy	53	46.49%
Neutral	48	20.25%	Neutral	21	46.67%
Sell	61	25.74%	Sell	16	27.59%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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