

# Tech Mahindra

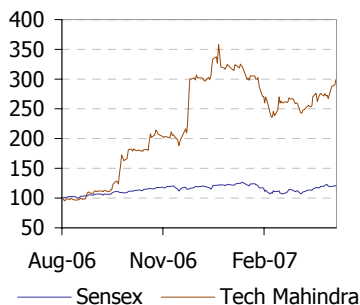
Relative to sector: **Neutral**

Lead Analyst: **Priya Rohira**  
Email: priya@enam.com  
Tel: +9122 6754 7611

Associate: **Meeshal Mehta**  
Email: meeshal.mehta@enam.com  
Tel: +9122 6754 7781

Associate: **Kashyap Desai**  
Email: kashyap@enam.com  
Tel: +9122 6754 7574

## Relative Performance



Source: Bloomberg, ENAM Research

## Stock data

No. of shares (basic) : 121mn  
Market cap : Rs 197bn  
52 week high/low : Rs 2,050/ Rs 365  
Avg. daily vol. (1mth) : 1.6mn shares  
Bloomberg code : TECHM IN  
Reuters code : TEMPL.BO

Shareholding (%)	Mar-07	QoQ chg
Promoters	83.7	(3.6)
FIIIs	1.5	(0.7)
MFs / UTI	1.5	(2.0)
Banks / FIs	0.1	0.1
Others	13.1	6.3

## Financial summary

Y/E Mar	Sales (Rs mn)	Adj. PAT (Rs mn)	Consensus EPS* (Rs.)	EPS (Rs.)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBIDTA (x)
2006	12,427	2,354	-	18.3	-	-	42.7	47.6	-
2007#	29,290	6,126	-	47.0	156	30.4	67.0	58.9	21.9
2008E	47,596	8,612	66.0	66.0	41	24.6	55.4	55.1	16.5
2009E	64,594	11,334	100.2	86.9	32	18.7	49.5	59.7	11.6

Source: \*Consensus broker estimates, Company, ENAM estimates; Note: # PAT is before exceptional losses of Rs 4.9bn

## LEVERAGING ITS CLIENT BASE

Tech Mahindra's Q4FY07 results were better than our expectations. Topline buoyed by high employee additions (1,975+, ↑ ~11% QoQ) and ~17% QoQ increase in BT (as expected). Non-BT clients grew recorded a comparatively lower growth at ~7% QoQ on account of completion of certain systems integration projects. EBIDTA at Rs2.2 bn, would have been better but for non-recurring SG&A expenses. PAT (before extra-ordinary provision of ~5.3 bn for the BT deal) at Rs 1.97bn was greater than our expectations.

### FY08: Instrumental for higher growth in FY09

The USD 100mn capex envisaged for FY08 and FY09 corroborates our optimism on Tech Mahindra's business pipeline.

**BT Deal:** The BT deal is expected to contribute in a material context from H2FY07 onwards. ~USD118 mn has been expensed in Q4FY07 (suggesting a conservative approach now and better margins in the ensuing quarters). We are given to understand that while the planning/negotiations phase has been complete, we could expect a meaningful contribution from Q3FY08 onwards.

**Employee Base:** Management has indicated ~7,500+ offers to freshers. Our estimates indicate a 28,000+ employee-base by FY08 end (v/s 35,700+ employee base currently for Satyam). This implies that Tech Mahindra is likely to reach a strategic size with a sizeable resource base. Though attrition rate is high at ~19% (non-BPOs), it has improved marginally from ~19.4% attrition in Q3FY07.

**Valuations:** Greater than expected employee additions have resulted in an upgrade in our FY08E and FY09E estimates to Rs 66 and Rs 87 respectively. Even with a higher P/E multiple of 25x FY08E EPS, and amidst higher business visibility in TSP segment in general and BT in particular, price upside stands limited at 2%. Hence we retain our sector **Neutral** rating on the stock. Key risks to our recommendation include additional deal wins and greater than expected employee additions.

## Results update

(Rs mn)	Quarter ended					12 months ended		
	Mar-07	Mar-06	% Chg	Dec-06	% Chg	Mar-08E	Mar-07	% Chg
<b>Net Sales</b>	<b>8,745</b>	<b>4,212</b>	<b>107.6</b>	<b>7,698</b>	<b>13.6</b>	<b>47,596</b>	<b>29,290</b>	<b>62.5</b>
<b>EBIDTA</b>	<b>2,218</b>	<b>980</b>	<b>126.3</b>	<b>2,072</b>	<b>7.0</b>	<b>10,956</b>	<b>7,366</b>	<b>48.7</b>
Other income	154	127	21.5	(32)	-	94	77	21.5
<b>PBIDT</b>	<b>2,372</b>	<b>1,107</b>	<b>114.3</b>	<b>2,040</b>	<b>16.3</b>	<b>11,050</b>	<b>7,443</b>	<b>48.5</b>
Depreciation	158	111	42.9	137	15.3	1,033	515	100.7
Interest	49	-	-	12	308.3	212	61	248.1
<b>PBT</b>	<b>2,165</b>	<b>996</b>	<b>117.3</b>	<b>1,891</b>	<b>14.5</b>	<b>9,804</b>	<b>6,867</b>	<b>42.8</b>
Tax	204	106	93.0	224	(8.9)	1,192	740	61.0
<b>Adjusted PAT</b>	<b>1,960</b>	<b>891</b>	<b>120.0</b>	<b>1,667</b>	<b>17.6</b>	<b>8,612</b>	<b>6,126</b>	<b>40.6</b>
Extra ordinary income/ (exp.)	(5,249)*	-	-	-	-	-	(4,911)#	-
<b>Reported PAT</b>	<b>(3,289)</b>	<b>891</b>	<b>-</b>	<b>1,667</b>	<b>-</b>	<b>8,612</b>	<b>1,215</b>	<b>-</b>
No. of shares (mn)	130	129	-	128	-	130	130	-
EBIDTA margins (%)	25.4	23.3	-	26.9	-	23.0	25.1	-
PBIDT margins (%)	27.1	26.3	-	26.5	-	23.2	25.4	-
<b>EPS (Rs.)</b>	<b>60.1</b>	<b>27.7</b>	<b>117.1</b>	<b>51.9</b>	<b>15.7</b>	<b>66.0</b>	<b>47.0</b>	<b>40.6</b>

Source: Company, ENAM Research Note: \*on account of expensing USD118mn paid upfront to acquire USD1bn deal from BT, # includes write-back of tax provisions of Rs 339mn

## Q4FY07 Result Analysis

	Q4FY07	% Change		Remarks
		QoQ	YoY	
<b>Financials (Rs mn)</b>				
<b>Topline</b>	<b>8,745</b>	<b>13.6</b>	<b>107.6</b>	Better than our expectations mainly due to higher than anticipated employee additions
Operating Profit	2,372	16.3	114.3	OPM lower due to impacted of certain one-time SG&A costs
PAT	1,960	17.6	120.0	Aided by lower effective tax rates
EPS (Rs.)	15.3	17.6	120.0	
OPM (%)	25.4	-	-	
<b>Client Data</b>				
Active Clients (nos)	83	-	-	Growth primarily led by BT account and this phenomenon should continue to exist in FY08 as the USD1bn deal progresses. Although non-BT accounts grew slower than company average, 7.1% QoQ growth appears healthy.
Top Client (Rs mn)	5,859	17.1	104.6	
Top 2-5 (Rs mn)	1,399	6.9	74.8	
Top 6-10 (Rs mn)	525	(14.8)	149.1	Top 6-10 accounts slowed down due to completion of select system integration projects
Top 10 clients (Rs mn)	7,783	12.3	100.8	
Remaining (Rs mn)	962	25.0	185.5	
<b>Mix</b>				
Onsite (Rs mn)	3,585	16.4	166.8	Onsite effort has been on an uptrend since the past few quarters mainly due to new clients / projects. Management has indicated that offshore proportion would not increase significantly in next few quarters as company engages newer clients and executes the large BT deal.
Offshore (Rs mn)	5,160	11.7	79.9	
<b>Employees (nos)</b>				
Total	19,749	11.1	88.2	Unlike last qtr (when most additions were concentrated in BPO division), there was heavy addition in S/w division in Q4.
Net adds	1,975	-	-	Even sales and support function was beefed up with 108 net additions (as compared to just 38 in Q3).
Gross attrition* (%)	19			
<b>Geography (Rs mn)</b>				
Europe	6,646	18.3	110.4	Both key regions grew well. Smaller geographies took a pause due to completion of certain projects. Apart from traditional locations, company is looking to expand its footprint into untapped regions.
US	1,662	13.6	87.8	
Others	437	(29.0)	159.5	

Source: Company, ENAM Research, Note: \* for non-BPO business

**Client Quality**

(Nos)	Q4FY06	Q3FY07	Q4FY07
>USD1 mn	14	22	29
>USD2 mn	9	15	18
>USD5 mn	6	8	8
>USD10 mn	2	5	6
>USD15 mn	2	4	4
>USD20 mn	2	3	3
>USD25 mn	1	2	2
>USD50 mn	1	1	1

Source: Company, ENAM Research

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