

Equities

1 February 2012 | 9 pages

Tech Mahindra (TEML.BO)

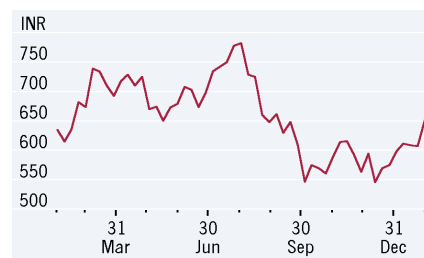
Satyam 3Q12 – Weaker Operationally, Currency Boosts PAT

- Key highlights of 3Q results** — (1) Revenues of Rs17.2bn (+9% qoq), -1.5% qoq in \$; flattish in constant currency; (2) Volumes down 1.3% qoq; pricing up qoq; (3) Recurring EBITDA margins of 16.2% (+87bps qoq); (3) Headcount of 32,280 (188 net hires); (4) Other income of Rs1.5bn (incl. forex gain of ~Rs660m).
- Earnings call takeaways** — (1) Attrition at ~16%, flattish over 2Q. (2) Utilization at ~75% (~74% in Q2). (3) BPO headcount at ~2,847 (~9% of company). (4) DSO at 98 days (99 post Q2). (5) Hedges for the next 18m stand at \$218m. (6) Capex of ~Rs500m in Q3 and ~Rs1.71b for 9MFY12. Capex budget for next year at ~Rs1.8b. (7) Satyam had rolled out ~5,000 offers for FY12 of which ~1,300 have been asked to join in 1QFY13. Total campus hires for FY13 to be ~2,300.
- What does it imply for future?** — (1) 3QFY12 revenue growth has fallen well short of ~5% CQGR over 2Q11-2Q12, at ~\$1.3b annual run rate. (2) While pace of EBITDA margin improvement is the key, currency-led improvements may be short-lived and recent wage hikes will weigh on margins if INR were to appreciate. (3) Loss of clients continues to be an overhang – decline of 11 active clients (5 in \$10m bucket) in Q3 – there could be some seasonality.
- What valuation does Satyam trade at?** — Satyam currently trades at ~10x FY13E EPS (Bloomberg consensus). Satyam's tax rates are still lower than industry due to tax benefits on historic unabsorbed losses. Larger peers like HCLT trade at ~12x FY13E – margin sustainability is the key going forward.
- We remain Neutral** — Although valuations appear moderate relative to peers (~9.5x FY13E on Bloomberg Consensus), TechM's core business remains challenged due to high client/domain concentration. While Satyam's turnaround so far has been encouraging, Q3 has been weaker and the demand environment seems to be slowing down. Resolution of Satyam's contingent liabilities and target merger valuations are key variables to be monitored.

Company Update

Neutral	2
Price (01 Feb 12)	Rs655.20
Target price	Rs640.00
Expected share price return	-2.3%
Expected dividend yield	0.6%
Expected total return	-1.7%
Market Cap	Rs83,478M
	US\$1,686M

Price Performance (RIC: TEML.BO, BB: TECHM IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	7,117	54.55	-25.2	12.0	2.8	29.5	0.5
2011A	7,458	57.22	4.9	11.4	2.4	23.9	0.6
2012E	7,362	55.71	-2.7	11.8	2.0	19.5	0.8
2013E	7,895	59.71	7.2	11.0	1.7	17.3	0.9
2014E	8,424	63.72	6.7	10.3	1.5	15.9	0.9

Source: Powered by dataCentral

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Tech Mahindra (TEML.BO)

1 February 2012

TEML.BO: Fiscal year end 31-Mar						Price: Rs655.20; TP: Rs640.00; Market Cap: Rs83,478m; Recomm: Neutral					
Profit & Loss (Rsm)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	46,254	51,402	57,570	63,826	68,038	PE (x)	12.0	11.4	11.8	11.0	10.3
Cost of sales	-30,049	-35,463	-39,819	-44,033	-47,631	PB (x)	2.8	2.4	2.0	1.7	1.5
Gross profit	16,205	15,939	17,751	19,793	20,407	EV/EBITDA (x)	7.3	8.3	7.8	6.1	5.3
Gross Margin (%)	35.0	31.0	30.8	31.0	30.0	FCF yield (%)	-38.6	-0.1	-1.0	3.4	5.0
EBITDA	9,987	8,598	8,632	10,347	10,882	Dividend yield (%)	0.5	0.6	0.8	0.9	0.9
EBITDA Margin (%)	21.6	16.7	15.0	16.2	16.0	Payout ratio (%)	6	7	9	10	9
Depreciation	0	0	0	0	0	ROE (%)	29.1	20.7	24.7	17.3	15.9
Amortisation	0	0	0	0	0	Cashflow (Rsm)	2010	2011	2012E	2013E	2014E
EBIT	9,987	8,598	8,632	10,347	10,882	EBITDA	9,987	8,598	8,632	10,347	10,882
EBIT Margin (%)	21.6	16.7	15.0	16.2	16.0	Working capital	-5,394	-3,585	-5,102	-1,652	-1,112
Net interest	-1,430	175	410	-599	-385	Other	-3,789	-3,672	-1,744	-3,075	-2,894
Associates	0	0	0	0	0	Operating cashflow	804	1,341	1,786	5,620	6,876
Non-op/Except	0	0	0	0	0	Capex	-33,764	-1,435	-2,668	-2,681	-2,507
Pre-tax profit	8,557	8,773	9,042	9,748	10,496	Net acq/disposals	0	0	0	0	0
Tax	-1,440	-1,315	-1,680	-1,853	-2,072	Other	754	3,765	2,450	623	437
Extraord./Min.Int./Pref.div.	-85	-996	1,976	0	0	Investing cashflow	-33,010	2,330	-218	-2,058	-2,070
Reported net profit	7,032	6,462	9,338	7,895	8,424	Dividends paid	-520	-593	-752	-902	-902
Net Margin (%)	15.2	12.6	16.2	12.4	12.4	Financing cashflow	23,777	-5,077	-762	-6,902	-6,899
Core NPAT	7,117	7,458	7,362	7,895	8,424	Net change in cash	-8,429	-1,406	806	-3,340	-2,093
Per share data	2010	2011	2012E	2013E	2014E	Free cashflow to s/holders	-32,960	-94	-882	2,939	4,369
Reported EPS (Rs)	53.90	49.58	70.66	59.71	63.72						
Core EPS (Rs)	54.55	57.22	55.71	59.71	63.72						
DPS (Rs)	3.50	4.00	5.00	6.00	6.00						
CFPS (Rs)	6.16	10.29	13.51	42.51	52.01						
FCFPS (Rs)	-252.65	-0.72	-6.67	22.23	33.05						
BVPS (Rs)	236.05	270.20	332.11	386.79	446.06						
Wtd avg ord shares (m)	122	124	127	127	127						
Wtd avg diluted shares (m)	130	130	132	132	132						
Growth rates	2010	2011	2012E	2013E	2014E						
Sales revenue (%)	3.6	11.1	12.0	10.9	6.6						
EBIT (%)	-9.7	-13.9	0.4	19.9	5.2						
Core NPAT (%)	-24.9	4.8	-1.3	7.2	6.7						
Core EPS (%)	-25.2	4.9	-2.7	7.2	6.7						
Balance Sheet (Rsm)	2010	2011	2012E	2013E	2014E						
Cash & cash equiv.	2,637	2,666	5,190	3,638	3,450						
Accounts receivables	10,420	12,468	15,773	17,487	18,641						
Inventory	0	0	0	0	0						
Net fixed & other tangibles	9,251	7,275	8,224	9,118	9,720						
Goodwill & intangibles	276	638	638	638	638						
Financial & other assets	36,434	37,402	39,700	40,639	41,271						
Total assets	59,018	60,448	69,525	71,519	73,718						
Accounts payable	0	0	0	0	0						
Short-term debt	0	0	0	0	0						
Long-term debt	13,672	12,227	14,217	10,217	6,217						
Provisions & other liab	8,665	8,710	9,211	10,212	10,886						
Total liabilities	22,337	20,937	23,428	20,429	17,103						
Shareholders' equity	28,865	33,514	42,100	49,093	56,615						
Minority interests	7,816	5,997	3,997	1,997	0						
Total equity	36,681	39,511	46,097	51,090	56,615						
Net debt	11,035	9,561	9,026	6,579	2,767						
Net debt to equity (%)	30.1	24.2	19.6	12.9	4.9						

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Satyam Consolidated Financials

Figure 1. Satyam – 3QFY12 Results Summary

	3Q11	2Q12	3Q12	QoQ	YoY
Revenue (US\$ m) - US GAAP	284	330	325	-1.5%	14.6%
Revenue	12,793	15,777	17,181	8.9%	34.3%
Cost of revenue	9,089	9,620	10,463	8.8%	15.1%
Gross profit	3,704	6,157	6,718	9.1%	81.4%
Gross margin	29.0%	39.0%	39.1%	8bp	1015bp
Operating expenses	2,885	3,740	3,937	5.3%	36.5%
EBITDA	819	2,417	2,781	15.1%	239.5%
EBITDA margin	6.4%	15.3%	16.2%	87bp	978bp
Dep & amortization	381	396	385	-2.8%	1.1%
EBIT	438	2,021	2,396	18.5%	447.0%
EBIT margin	3.4%	12.8%	13.9%	113bp	1052bp
Other income	873	967	1,513	56.4%	73.3%
Profit before tax	1,288	2,968	3,881	30.8%	201.4%
Income tax expense	159	578	790	36.6%	396.9%
Income from operations	1,129	2,390	3,091	29.4%	173.8%
Affiliates/Minority	-7	-7	-7	n.a.	n.a.
Net income	1,122	2,382	3,084	29.5%	174.9%
Net Margin	8.8%	15.1%	18.0%	285bp	918bp

Source: Company Reports

Tech Mahindra

Company description

One of India's top 10 IT Services providers focusing on the telecom space, Tech Mahindra (TechM) services Telecom Service Providers (TSPs), Telecom Equipment Manufacturers (TEMs), Independent Software Vendors (ISVs) and Systems Integrators (SIs). It was formed in 1986 as a JV between M&M and British Telecom (BT). Key clients include BT, AT&T, Alcatel, Alltel, Convergys, Motorola, O2 and Vodafone. TechM is headquartered at Pune with development centers across India and a few centers in the UK. TechM is the only Indian player among the top 10 BSS vendors worldwide, as ranked by Gartner Dataquest.

Investment strategy

We rate TechM Neutral (2) based on a fundamental 12-month view. With high exposure to the telecom domain, TechM is likely to be affected by difficult fundamental trends in the telecom vertical. We expect revenue and EBIT CAGRs of ~11% and ~10% respectively over FY11-13E. Satyam acquisition will help in diversifying vertical exposure and add size; however, the key will be improving margins and sustaining the same. However, TechM is reasonable on valuations post a sharp correction and that is the reason for our Neutral rating.

Valuation

Tech Mahindra's organic business still carries higher domain (telecom) and client concentration (BT) risk. Given the risks and challenges at BT, Tech Mahindra will continue to struggle in the near term, in our view. The standalone business is valued at 6x Mar'13E EV/EBITDA, which is at a ~20% discount to more diversified players like HCLT. For Satyam, we use TechM's share of Satyam's Enterprise value based on the current market price of Satyam. Our target price of Rs640 is based on 6x Mar'13E EV/EBITDA and considering TechM's share of Satyam's current EV. We believe that this valuation measure is appropriate given limited operating disclosures of Satyam (which continue to improve though).

Risks

The key downside risks to our investment thesis on Tech Mahindra are: (1) Loss of part of business from large telecom clients; (2) Further worsening of IT spends in telecom sector (3) INR appreciation against key currencies.

Key upside risks are: 1) any significant depreciation of the rupee against the USD/EUR/GBP; 2) a sharp upturn in IT spending among TSPs; 3) large deal announcements; and 4) inorganic activity due to a stake sale or change in ownership.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our target price.

Appendix A-1

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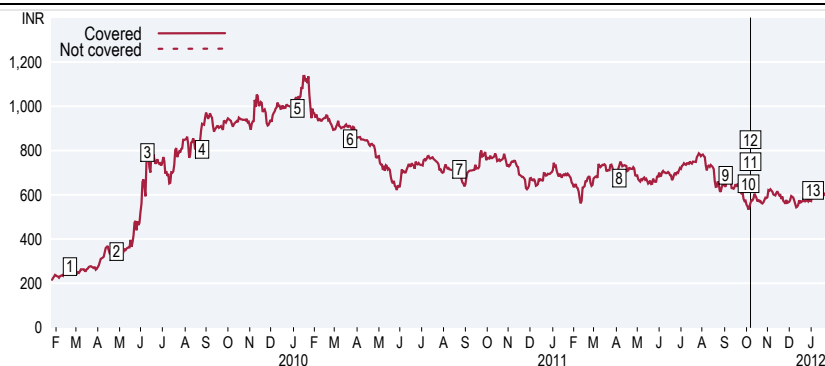
IMPORTANT DISCLOSURES

Tech Mahindra (TEML.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA



	Date	Rating	Target Price	Closing Price
1	20-Feb-09	*3H	245.00	269.65
2	28-Apr-09	3H	*300.00	318.20
3	10-Jun-09	3H	*640.00	784.85
4	26-Aug-09	*3M	*825.00	921.10
5	7-Jan-10	3M	*910.00	1,018.10

* Indicates change

	Date	Rating	Target Price	Closing Price
6	23-Mar-10	3M	*900.00	910.20
7	24-Aug-10	3M	*710.00	705.80
8	6-Apr-11	3M	*700.00	733.20
9	2-Sep-11	3M	*625.00	636.70
10	5-Oct-11	3M	*585.00	533.05

	Date	Rating	Target Price	Closing Price
11	7-Oct-11	Stock rating system changed		
12	7-Oct-11	*2	585.00	563.40
13	4-Jan-12	2	*640.00	603.85

Rating/target price changes above reflect Eastern Standard Time

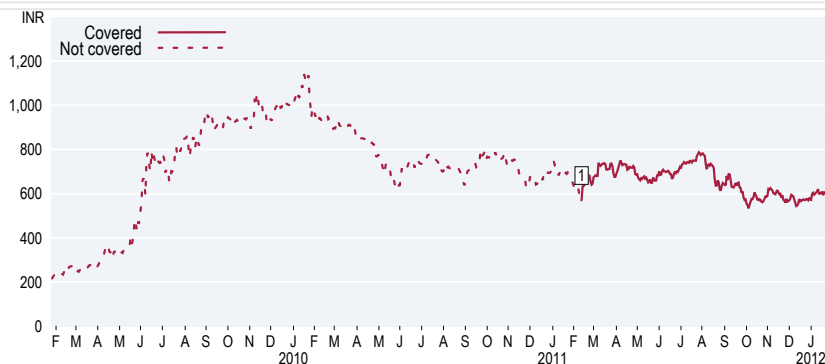
Tech Mahindra (TEML.BO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Surendra Goyal, CFA



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	571.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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