

Asia India

Technology Software & Services

Deutsche Bank



28 September 2010

Tech Mahindra Ltd

Reuters: **TEML.BO** Bloomberg: **TECHM IN** Exchange: **BSE** Ticker: **TEML**

Financial health of Mahindra Satyam is the key concern

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Look for clarity on the nature and extent of Mahindra Satyam's liabilities

While tomorrow's announcement of Mahindra Satyam's re-stated financials should set a meaningful floor to FY11 earnings expectations, we believe the nature and extent of its liabilities will be key to watch. Our analysis indicates that at or above a FY11E revenue run-rate of US\$1.2bn and operating margins of 12-14% for Mahindra Satyam, the 42.7% stake owned by Tech Mahindra would be value accretive. Consolidated EPS could be as high as INR82, and thus offer meaningful potential upside. We maintain a Buy rating with a target price of INR1,100.

Senior management attrition at Satyam not impacting business greatly

Although Mahindra Satyam has seen high attrition amongst its senior ranks, it is still winning deals from existing and new clients. We the Co. should meet management's FY10 expected revenue run-rate of US\$1.1-1.3bn. What worries us though is the financial health of the company. Although new management has managed to resolve three of the five inherited disputes, fresh claims arising from the alleged fraud (INR34bn claim from Maytas) and class action suits could still negatively impact the company. We await further clarity on this issue.

FY11E consolidated EPS of TECHM could be as high as INR82

Following the announcement of re-stated financials by Mahindra Satyam, we believe investors will likely value Tech Mahindra (TECHM) on a consolidated basis. Our two-dimensional sensitivity analysis of Tech Mahindra's consolidated EPS to changes in Mahindra Satyam's revenue and operating margins indicates that, at or above a FY11E revenue run-rate of US\$1.2bn and operating margin of 12-14% for Mahindra Satyam, Tech Mahindra's 42.7% stake would be value accretive.

Valuing the company at 15x FY11E, risks

We value TECHM at 15x FY11E, which is at a 40% discount to Infosys's target PE multiple. We estimate Satyam could contribute 24% of TECHM's EPS for FY11E. Key risk: currency fluctuations and a potential global slowdown. See page 10.

Forecasts and ratios

Year End Mar 31	2009A	2010A	2011E	2012E	2013E
Sales (INRm)	44,647.0	46,254.0	51,646.2	62,808.4	73,697.0
EBITDA (INRm)	11,900.0	11,325.0	11,305.5	14,103.7	15,759.8
Reported NPAT (INRm)	8,929.0	7,057.0	8,204.1	9,648.7	11,065.3
Reported EPS FD(INR)	68.47	54.28	63.11	67.95	77.92
DB EPS FD(INR)	70.56	71.74	63.11	67.95	77.92
OLD DB EPS FD(INR)	70.56	71.74	64.54	-	-
% Change	0.0%	0.0%	-2.2%	-	-
DB EPS growth (%)	19.9	1.7	-12.0	7.7	14.7
PER (x)	7.6	11.4	12.5	11.6	10.1
EV/EBITDA (x)	4.7	7.2	6.6	4.8	3.9
DPS (net) (INR)	16.29	0.00	7.11	0.00	0.00
Yield (net) (%)	3.0	0.0	0.9	0.0	0.0

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Forecast Change

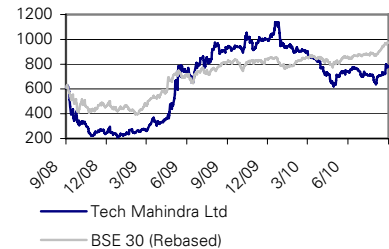
Buy

Price at 28 Sep 2010 (INR)	785.85
Price target - 12mth (INR)	1,100.00
52-week range (INR)	1,137.20 - 621.60
BSE 30	20,117

Key changes

Op prof margin (FYE)	18.7 to 18.8	↑	0.4%
Net profit (FYE)	8,389.6 to 8,204.1	↓	-2.2%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	19.8	5.7	-16.0
BSE 30	11.8	13.2	20.5

Stock data

Market cap (INRm)	95,088
Market cap (USDm)	2,106
Shares outstanding (m)	124.1
Major shareholders	M&M (44.4%)
Free float (%)	16
Avg daily value traded (USDm)	9.8

Key indicators (FY1)

ROE (%)	20.4
Net debt/equity (%)	20.8
Book value/share (INR)	337.09
Price/book (x)	2.3
Net interest cover (x)	404.5
Operating profit margin (%)	18.8

Company activity

MSat-Mgmt Conf Call	29 Sept 10	7:30pm	IST
Dial-in numbers			
Singapore	800 101 2045		
Hong Kong	800 964 448		
India	91 22 3065 0		
US	1 866 746 21		
UK	0 808 101 15		

Deutsche Bank AG/Hong Kong

All prices are those current at the end of the previous trading session unless otherwise indicated. Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies. Deutsche Bank does and seeks to do business with companies covered in its research reports. Thus, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MICA(P) 007/05/2010

Model updated: 28 September 2010

Running the numbers**Asia****India****Software & Services****Tech Mahindra Ltd**

Reuters: TEML.BO

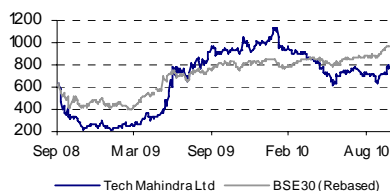
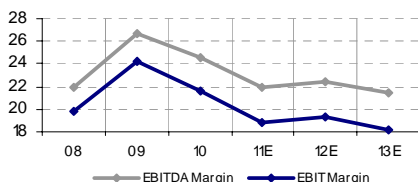
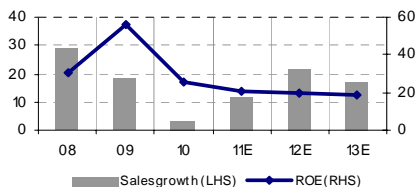
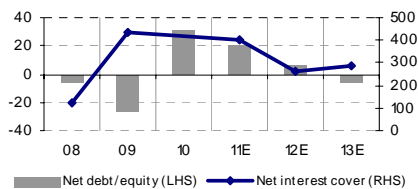
Bloomberg: TECHM IN

Buy

Price (28 Sep 10)	INR 785.85
Target price	INR 1,100.00
52-week Range	INR 621.60 - 1,137.20
Market Cap (m)	INRm 95,088 USDm 2,106

Company Profile

Tech Mahindra Limited is an India-based company that provides information technology (IT) services and solutions to the global telecommunications industry. The Company's service offerings include business process outsourcing, infrastructure management services and value-added services. As a result of its longstanding relationship with BT, the company has an established presence in the European market.

Price Performance**Margin Trends****Growth & Profitability****Solvency****Aniruddha Bhosale**

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Fiscal year end 31-Mar

	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (INR)	58.85	70.56	71.74	63.11	67.95	77.92
Reported EPS (INR)	25.21	68.47	54.28	63.11	67.95	77.92
DPS (INR)	6.72	16.29	0.00	7.11	0.00	0.00
BVPS (INR)	101.4	153.0	281.1	337.1	402.0	475.4
Weighted average shares (m)	121	122	122	124	138	135
Average market cap (INRm)	144,401	65,463	99,767	95,088	95,088	95,088
Enterprise value (INRm)	143,203	55,847	81,246	74,234	68,304	61,561
Valuation Metrics						
P/E (DB) (x)	20.2	7.6	11.4	12.5	11.6	10.1
P/E (Reported) (x)	47.2	7.9	15.0	12.5	11.6	10.1
P/BV (x)	6.97	1.73	3.04	2.33	1.95	1.65
FCF Yield (%)	1.2	12.8	4.3	6.0	8.0	9.8
Dividend Yield (%)	0.6	3.0	0.0	0.9	0.0	0.0
EV/Sales (x)	3.8	1.3	1.8	1.4	1.1	0.8
EV/EBITDA (x)	17.3	4.7	7.2	6.6	4.8	3.9
EV/EBIT (x)	19.2	5.2	8.1	7.6	5.7	4.6

Income Statement (INRm)

Sales revenue	37,661	44,647	46,254	51,646	62,808	73,697
Gross profit	13,807	18,269	17,543	18,298	22,269	25,340
EBITDA	8,258	11,900	11,325	11,305	14,104	15,760
Depreciation	796	1,097	1,338	1,597	2,017	2,377
Amortisation	0	0	0	0	0	0
EBIT	7,462	10,803	9,987	9,708	12,086	13,382
Net interest income/(expense)	-62	-25	0	-24	-46	-46
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	-4,401	-272	-2,269	0	0	0
Other pre-tax income/(expense)	1,044	-398	754	152	221	639
Profit before tax	8,444	10,380	10,741	9,836	12,261	13,975
Income tax expense	748	1,179	1,440	1,632	2,613	2,910
Minorities	-4	0	-25	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	3,299	8,929	7,057	8,204	9,649	11,065
DB adjustments (including dilution)	4,401	272	2,269	0	0	0
DB Net profit	7,700	9,201	9,326	8,204	9,649	11,065

Cash Flow (INRm)

Cash flow from operations	4,095	10,026	8,395	9,801	11,666	13,443
Net Capex	-2,371	-1,621	-4,069	-4,000	-3,000	-3,000
Free cash flow	1,724	8,405	4,326	5,801	8,666	10,443
Equity raised/(bought back)	921	0	10,053	0	0	0
Dividends paid	-833	-2,069	0	-924	-813	-968
Net inc/(dec) in borrowings	130	-300	13,672	-3,950	-750	0
Other investing/financing cash flows	341	-3,712	-25,772	0	0	0
Net cash flow	2,283	2,324	2,279	928	7,103	9,475
Change in working capital	-1,975	2,082	-5,474	-2,545	-1,923	-2,732

Balance Sheet (INRm)

Cash and other liquid assets	976	5,382	2,187	570	5,750	12,493
Tangible fixed assets	5,996	6,520	9,251	11,654	12,636	13,259
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	633	4,346	30,145	30,145	30,145	30,145
Other assets	14,646	12,184	17,435	21,666	26,286	30,994
Total assets	22,251	28,432	59,018	64,034	74,817	86,891
Interest bearing debt	300	0	13,672	9,722	8,972	8,972
Other liabilities	9,268	8,888	8,665	10,351	13,048	15,024
Total liabilities	9,568	8,888	22,337	20,073	22,020	23,996
Shareholders' equity	12,572	19,432	36,542	43,822	52,658	62,756
Minorities	111	112	139	139	139	139
Total shareholders' equity	12,683	19,544	36,681	43,961	52,797	62,895
Net debt	-676	-5,382	11,485	9,152	3,222	-3,521

Key Company Metrics

Sales growth (%)	28.6	18.5	3.6	11.7	21.6	17.3
DB EPS growth (%)	18.8	19.9	1.7	-12.0	7.7	14.7
EBITDA Margin (%)	21.9	26.7	24.5	21.9	22.5	21.4
EBIT Margin (%)	19.8	24.2	21.6	18.8	19.2	18.2
Payout ratio (%)	24.7	22.2	0.0	10.7	0.0	0.0
ROE (%)	30.3	55.8	25.2	20.4	20.0	19.2
Capex/sales (%)	6.3	3.6	8.8	7.7	4.8	4.1
Capex/depreciation (x)	3.0	1.5	3.0	2.5	1.5	1.3
Net debt/equity (%)	-5.3	-27.5	31.3	20.8	6.1	-5.6
Net interest cover (x)	120.4	432.1	nm	404.5	262.7	290.9

Source: Company data, Deutsche Bank estimates

Mahindra Satyam financials - key issues to watch for

Financial health a key concern

With Mahindra Satyam's (42.7%-owned by Tech Mahindra) announcement that it would publish re-audited and re-stated FY09 and FY10 results on 29 September, investor attention has been largely focused on the likely revenue and margin profile of the company. While the non-availability of the 1HFY11 financial statements until 15 November 2010 could provide some difficulty in assessing the current state of the business of the company, the re-stated financials should provide enough detail to make meaningful forecasts about the company's future earnings and cash flows. Moreover, in our view, apart from the revenue run rate and profitability, the financial health of the company should now assume importance. To get a fair sense of the current state of the business and factors that could potentially affect the company's financial health, we studied press reports and statements made by the company in CY10.

We note that, although the company has seen high attrition among its senior ranks, it is still winning deals from existing and new clients. Hence, we are not too worried about the revenue run-rate of the company, which will likely meet the US\$1.1-1.3bn range as per management expectations. What worries us though is the financial health of the company which could be affected by liabilities incurred due to fraud. In the following sections, we highlight the state of the company on each of the key business parameters of demand, supply, costs and financial health. As things hang in balance, we await the re-stated financials.

Demand – improvement in deal wins from new and existing clients

Following the admission of fraud by the erstwhile management of the company, questions have been raised about the company's ability to retain and attract business from clients. Although there was considerable damage to the business with a few large clients pulling the plug, we believe that with the help of the new management and focus on quality of delivery, the company has managed to abate the loss.

In this light, Mahindra Satyam's fortunes at retaining and attracting business can be best described with the example of the FIFA World Cup deal executed during the transition period. The company was the official IT services provider for the 2010 FIFA World Cup, for which it developed a unique and complex event-management solutions system. Appreciating Mahindra's impeccable quality of execution, FIFA has renewed the company's contract for the 2014 edition of the world cup. Following the success of the FIFA World Cup, the company bagged a deal for the Singapore Youth Olympics, held in Aug-10. Several press reports also suggest that the company is tying up with the men's professional basketball league in North America, the National Basketball Association (NBA). On a similar note, General Electric (top 5 customer) and GlaxoSmithKline have extended their existing contracts with Mahindra Satyam. Importantly, after securing a big order from BASF IT Services, the World Bank said that it would reconsider the ban imposed on the IT major when it was under the previous management.

Figure 1: Large deals won by Mahindra Satyam (YTD)

Month	Customer	Size of the deal (US\$ mn)	Comments
Jan-10	General Electric	NA	Extension of its multi- million dollar contract till end of 2012.
Feb-10	South American companies	Multi-million dollar	Two multi-million dollar contracts in South America to deploy enterprise business systems technology.
Mar-10	KMD - an IT major from Denmark	48mn	
May-10	Nissan	40mn	The deal valued at US\$40mn involves outsourcing new technology for application maintenance and operation services of Nissan. The deal will be for three years from now and can be extended a further two years.
May-10	British national Grid		Shortlists Infosys, Satyam and Cognizant for a US\$250mn contract
May-10	BASF		3 year contract with 2 year extension option for providing SAP, messaging and groupware management services. Launched a new ODC in Chennai.
May-10	GlaxoSmithKline		5 year deal - contract renewal
Jun-10	Qantas	NA	Reporting and data warehouse integration.
Jul-10	NBA, Singapore Youth Olympic Games	NA.	The company bagged a deal for the Singapore Youth Olympics, held on Aug-10. Also in place is a tie-up with men's professional basketball league in North America, the National Basketball Association (NBA).
Jul-10	Government of India	NA	The Unique Identification Authority of India (UIDAI) has selected three consortiums, led by tech firms Accenture, Mahindra Satyam and L-1 Identity Solutions, respectively, to provide technology solutions to capture the fingerprints and iris scans (known as biometrics) of the country's 1.2 billion people. The biometrics will be provided at INR2.75 per person, almost 70 per cent lower than the initial price UIDAI had pegged. Each solution provider will receive INR2.75 per de-duplicated identity for the service. The work will be divided in the ratio of 5:3:2 among the three.
Aug-10	NA	NA	The WSJ reported that Satyam computer was chasing 5-10 contracts worth over INR500mn each.
Sep-10	Large health insurer in the USA	Multi-million dollar	Economic times, Reuters

Source: Company data, Press Reports

For growth, the company is focussing on:

- Engineering and infrastructure management services.
- It is also planning to take advantage of the strong aerospace and defence markets by building on existing relationships and entering new partnerships.
- It is looking to tap opportunities emanating from the recent reforms in the US healthcare sector. It has recently launched a software solution for insurance companies that would meet the new federal rules in the US.
- Also, following the success of the FIFA world cup, the company intends to increase its presence in South Africa to cash in on the 'newfound goodwill' for the company in that country.

Supply – Fighting senior management attrition

Recently, senior manager attrition at Mahindra Satyam has been a persistent cause for concern.

Figure 2: Recent high profile exits

Name of the Employee	Designation	Moved to	Source
Manish Mehta	Chief Delivery officer -Europe, ME and Asia-Pac	Patni Computers	Press release by Patni Computers dated 19 th Aug 2010
Keshub Panda	SVP	L&T	The Business Line dated 4 th Sept 2009
Subu D Subramanian	Head of Automotive group	MD and CEO of Defiance Technologies, a Hinduja Group Company	Business Standard dated 12 th June 2010
Deepak Nangia	Company head Australia	NA	Business Standard dated 28 th May 2009
Naresh Jhangiani	Global head Satyam BPO	NA	Business Standard dated 26 th May 2009
Ravi Bommakanti	Delivery head, US	NA	The Economic Times 25 th Aug 2009
Varinder Agarwal	Head, Asia-Pac	HCL Tech	The Business Line dated 30 th April 2009

TR Anand Head, Telecom and infrastructure business Retire The Business Line dated 14th October 2009
 Source: Company data, Press Reports

Based on an article published in the Business Standard dated 12th June 2010, we believe that one of the biggest contributors to the high attrition at middle and senior management levels at Mahindra Satyam has been a mass move to Defiance Technologies, a Hinduja Group company. The Hinduja Group was one of the unsuccessful bidders for Satyam Computers and has hence managed to recruit senior executives from Satyam.

Figure 3: Senior management move to Defiance Technologies, a Hinduja Group Company

Name of the Employee	Designation at Mahindra Satyam	Role at Defiance Technologies, a Hinduja Group Company	Other comments
Ramesh Babu	SVP and member of Management council	Head of enterprise applications and SAP practice	
Lakshmi Kumar	VP - Automotive practice	Head of IT services and infrastructure management services practice	
Krishna Kumaraswamy	VP- Global head of SAP Services	Head of enterprise technology practice	
Varadarajan K N	NA	Head of plant lifecycle management (PLM) and digital manufacturing solutions	Played a key role in founding and growing the PLM practice within Satyam during his almost nine-year stint, prior to joining Defiance.
Mahendra PA	NA	Head - green technology solutions and quality	Was responsible for establishing market research and customer analytics business operations and delivery at Satyam,
Hari Vedadri	NA	Head - cloud computing and strategic initiatives	
Sampath Thirumalai	NA	Head - business development, RoW and IT infrastructure	
Uma Raman	NA	Head - business integration, Europe	
Prakash Challa	Senior VP and global head of retail & consumer products industry group and head of solution architecture group	Head of business and operations in the Americas	
Vetriselvan Somasundaram	Executive client partner	Head of business development and alliances, Europe	
Suresh K V		Heads business development in Europe	Worked with Satyam as a VP and "led the growth of the manufacturing and automotive vertical in Europe between 2006 and 2009".
Sai Krishna	Head - BFSI	NA	NA
Pawan Kumar	Pre-sales head	NA	NA

Source: Press reports, The Business Standard dated 12th June 2010

Although investors are concerned that this would have had a considerable impact on the business, based on the steady deal wins outlined in Figure 1, we believe that this has been largely arrested by immediate external and internal replacements by the new management. We think this should augur well for future growth and demonstrates that new management is taking proactive measures to bring the company back on track.

Figure 4: Recent senior management hires

Month	Name of the Employee	Designation	Comments
May-10	Ram Ramachandran	Sales head- ASEAN region	
May-10	Rahul Girotra	Head of SAP practice, ASEAN region	
May-10	Pranab Choudhury	Country Manager- Thailand	
Jul-10	Daryn Mckay	Country Manager - New Zealand	
Jul-10	Roger van Lier	Business Development Executive- Benelux	Lier, in his new role, will be responsible for driving customer relationships in the manufacturing sector. In his previous assignment, he was working with Intenz Group, a SAP consultancy company as their Sales Director. He has also been associated with Caggemini and Atos Origin.
Aug-10	Gaurav Gupta	Associate Vice President, Strategic Partnerships in Europe	Gaurav would lead development of customized partnership arrangements in the sectors of aerospace and defense.
Aug-10	Azlan Othman	Snr. Sales manager - Malaysia	NA
Aug-10	Rasedi Mohamed	Snr. Sales manager - Malaysia	Rasedi joins from IBM and has over 15 years of experience

Sep-10 Kunihiko Higashi

Country Manager - Japan

Kunihiko has over 25 years of experience in the IT industry and has held several senior management positions at SSA, CA, Cisco Systems PeopleSoft, Cognos, Infor Global Solutions. He began his career with IBM.

Source: Company data

Following the high attrition along with the revival in IT services demand, reports on the website siliconindia.com dated 12th Sept 2010 suggest that the company is expected to go on a hiring spree over the next 12 months and is targetting hiring freshers. They are looking to hire 3,000 (~10% of existing base) employees across various technologies and competencies with a special emphasis on domains such as SAP, enterprise solutions, oracle and business intelligence. This estimated increase follows the company winning more than 35 new clients and securing contract extensions with existing clients such as GE and GlaxoSmithKline. Moreover, the Business Standard dated 18th July 2010 indicates that the company was also contemplating giving wage hikes in Jul-10 to address the issue of abnormally high attrition.

New initiatives to expand delivery footprint

We believe that the new management is taking steps to ensure a speedy revival of business at Mahindra Satyam. The following illustrate the forward focus:

- The company has launched 'Delivery xPress' to accelerate the service delivery for all its ERP customers. It is a technology portal which contains accelerators to support different services. This would also enable faster conversion of data from legacy to target systems. The tool can be used across all Oracle streams including Oracle eBusiness, PeopleSoft, Siebel and JDE among others.
- An article appearing in The Hindu Business Line dated 25th June 2010 suggests that Mahindra Satyam's board has given its back-office unit in-principle approval to build platform-based BPO capabilities through acquisitions. The company could make up to three acquisitions in the \$50-100 million range.

Company could pay a very high fee for re-statement of the books

Another article published in The Hindu Businessline dated 30th July 2010 suggests that the company would have to shell out approximately INR600mn (~US\$13-14mn) by Sept-10 for the restatement of the accounts. This, if true, could impact Mahindra Satyam's FY10 operating margins by ~100-160bps. We would thus urge investors to consider this as an extraordinary expense in evaluating the true performance of the company.

Extent of liabilities could be the key overhang

Liabilities from the various law suits filed against the company could be an overhang on the stock.

Figure 5: Cases pending against the company when Tech Mahindra acquired controlling stake in Satyam Computers (9 June 2009)

Plaintiff	Reason	Cost/Demand	Status as of 9 June 2010
Caterpillar Inc	Alleged failed bid to acquire business unit from caterpillar Inc USA	US\$40mn	Negotiating to amicably resolve the outstanding issues.
Bridge Strategy group	Notice served by key executives of Bridge demanding balance consideration to executives	US\$16mn	Negotiating to amicably resolve the outstanding issues and persuade sellers to stay with Bridge for the full retention period.
S&V Management Consultants	Asking for guarantees for all future payments owed under the acquisition agreement.	EUR11mn	Satyam is in the process of paying the €1mn in past due payments
US class action law suits	Filed against the company, its former directors, auditors, etc. after the admission of fraud by the erstwhile Chairman	NA	Proceedings yet to begin. Lead plaintiff appointed

Upaid Litigation	Alleged forgery of the documents necessary for transfer of proper title to patent	NA	Next date of hearing is 8 Sept 2009. Upaid has claimed damages worth US\$1bn which most experts believe are excessive.
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Source: Company data and press reports

After disposing of the Upaid case in Dec-09 for US\$70mn, an article published in The Hindu Businessline dated 6th March 2010, suggests that the company seems to have amicably resolved two of the three acquisition-related disputes that had surfaced after the founder Mr Raju admitted fraud. The three companies in question – the US-based Bridge Strategy Group, Belgium-based S&V Management Consultants and the research unit of construction major Caterpillar – had served legal notices to Mahindra Satyam seeking termination of the asset purchase pacts or asking for guarantees on payments due under the buyout agreements.

S&V Consultants is still part of the Mahindra group after all the dues were paid as per the share purchase agreement. At the Bridge Strategy Group, the company and Mahindra Satyam seem to have ironed out their differences, and the company continues to be headed by the CEO, Stephen Sheridan, and the team of founding directors. However, there looks to be some ambiguity about Mahindra Satyam's acquisition of Caterpillar's market research and customer analytics business unit. The case still seems to be subjudice. Also there is no clarity on the US Class Action law suits, and the company expects some transparency to emerge by the end of CY10.

In addition to the abovementioned cases, a former sister concern of Mahindra Satyam, Maytas Infra, has recently claimed INR3.2bn (~US\$77mn) that it claims to have lent Satyam before Mahindra acquired a controlling stake in the company. The large sum came into picture after the examination of Maytas' books. It is still not clear whether Maytas has the right to claim the money, but the company has also approached the MCA (Ministry of Corporate Affairs) to resolve the issue. Until now, Mahindra Satyam has expressed its inability to refund the money as the company was in the process of restating the accounts. However, after the restated accounts are submitted tomorrow, we will watch the course of this claim closely.

The integration of Tech Mahindra Ltd and Mahindra Satyam has started

The management intends to merge the two companies only after Mahindra Satyam comes into line with the other companies in terms of financial reporting. Thus we believe a formal announcement of the process will likely be made post 15 Nov 2010 when the 1HFY11 results are likely to be announced.

Even then, articles appearing in The Economic Times dated 3rd Sept 2010 suggesting that the integration of a few business teams has already started. For instance:

- The sales and finance teams of the business process outsourcing, or BPO, divisions of the two companies are beginning to work together. The teams are working jointly on bids and proposals for future outsourcing projects, and have been pitching jointly to prospective clients.
- Execution of projects is being shared between the companies. The two companies are working jointly in marketing and execution of various projects. Major telecom projects are being diverted to Tech Mahindra which has expertise in the domain. Recently telecom major MTNL awarded a contract of the converged billing solution project to a consortium of 10 members that includes Mahindra Satyam, BEL, and IBM. Tech Mahindra has set up a joint task force with 4-5 people including one senior person each from Tech Mahindra and Mahindra Satyam in areas of infrastructure, human resources, technology and purchases. These groups decide on what initiatives can be done jointly. The two companies may use different names, but they have common orientation programs, use the same resources and training during placements.

Valuations still compelling

The FY11 consolidated EPS of Tech Mahindra could be in the range of INR52-82

While we are confident that Mahindra Satyam management's revenue run-rate expectation of US\$1.1-1.3bn will be met, we are concerned about the company's margin profile. The high attrition of middle and senior management along with wage inflation could affect margins. Moreover, with the overall liabilities still not quantified, we believe it is difficult to comment on the attractiveness or otherwise of an investment case for Satyam. We would look to the publication of the financials tomorrow for further clarity on these issues.

Tech Mahindra, on the other hand, is still valued at a PE multiple of 14.5x FY11E (consensus-standalone), which is at a 58% discount to Infosys (Buy; INR3025.45). This is higher than the 30% average discount at which it has traded since listing. Moreover, the street EPS of INR54 incorporates the interest cost that Tech Mahindra bears for funding the Satyam acquisition and will likely see upside once the corresponding revenues are incorporated post the disclosure of FY10 financials. Our analysis indicates that the consolidated EPS of the company (including the 42.7% stake in Satyam) could be in the range of INR52-82; thus, even if the PE multiple remains the same, it could offer upside of 50% from the current market price. We maintain our Buy rating and target price of INR1,100 on the stock.

Figure 6: Scenarios for Tech Mahindra's consolidated EPS

Particulars	-----Scenario 1-----		-----Scenario 2-----		-----Scenario 3-----		-----Scenario 4-----	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Satyam								
Revenue (US\$ mn)	800	936	1,000	1,170	1,200	1,404	1,400	1,638
yoy revenue growth		17%		17%		17%		17%
INR/US\$	45.6	44.4	45.6	44.4	45.6	44.4	45.6	44.4
Revenue (INR mn)	36,465	41,581	45,581	51,976	54,697	62,371	63,813	72,766
EBITDA Margin	12%	12%	14%	14%	16%	16%	18%	18%
EBITDA	4,376	4,990	6,381	7,277	8,752	9,979	11,486	13,098
Depreciation	3,225	3,791	3,225	3,791	3,225	3,791	3,225	3,791
EBIT	1,150	1,199	3,156	3,486	5,526	6,188	8,261	9,307
Other Income	1,654	1,935	1,654	1,935	1,654	1,935	1,654	1,935
Interest	965	894	965	894	965	894	965	894
Profit before tax	1,839	2,240	3,845	4,527	6,215	7,230	8,950	10,348
Tax	300	448	627	905	1013	1446	1459	2070
Tax rate	16.3%	20.0%	16%	20%	16%	20%	16%	20%
Net Income	1540	1792	3218	3621	5202	5784	7491	8279
Tech Mahindra								
Net Income (INR mn)	8,204	9,649	8,204	9,649	8,204	9,649	8,204	9,649
Add: 42.7% stake in Satyam	657	765	1374	1546	2221	2470	3199	3535
Less: Interest cost for funding the Satyam acquisition	1287	1028	1287	1028	1287	1028	1287	1028
Consolidated revenues	7,575	9,386	8,292	10,167	9,139	11,090	10,116	12,155
No of shares	130	142	130	142	130	142	130	142
EPS								
Standalone EPS (including interest cost)	53.2	60.7	53.2	60.7	53.2	60.7	53.2	60.7

Per share contribution from Satyam	5.1	5.4	10.6	10.9	17.1	17.4	24.6	24.9
Consolidated EPS	58.3	66.1	63.8	71.6	70.3	78.1	77.8	85.6
Current Price	783							
Current P/E	13.4	11.8	12.3	10.9	11.1	10.0	10.1	9.1

Source: Deutsche Bank estimates

Since the revenue run rate and operating margins are the two key unknowns with respect to Mahindra Satyam, we present below a two-dimensional sensitivity analysis of Tech Mahindra's consolidated EPS to changes in these two variables. We believe that at or above a FY11E revenue run-rate of US\$1.2bn and operating margins of 12-14% for Mahindra Satyam, Tech Mahindra's 42.7% stake in Satyam would be value accretive.

Figure 7: Sensitivity analysis of Tech Mahindra's FY11E consolidated EPS to changes in Mahindra Satyam's revenue and margin profile

		-----EBITDA margin-----					
		8%	10%	12%	14%	16%	18%
FY11E US\$ revenues	600	52.3	53.8	55.3	56.8	58.3	59.8
	800	54.3	56.3	58.3	60.3	62.3	64.3
	1000	56.3	58.8	61.3	63.8	66.3	68.8
	1200	58.3	61.3	64.3	67.3	70.3	73.3
	1400	60.3	63.8	67.3	70.8	74.3	77.8
	1600	62.3	66.3	70.3	74.3	78.3	82.3

Source: Deutsche Bank

Valuation and risks

Valuation

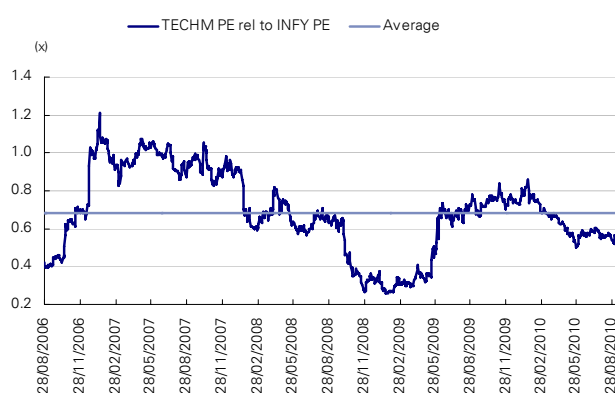
Given the partial disclosure of Satyam's financials, we believe that it is appropriate to value Tech Mahindra on a consolidated basis. We estimate that Satyam could contribute ~24% of Tech Mahindra's consolidated EPS in FY11E and thus it would be erroneous to ignore Satyam's financials altogether. We have retained our valuation methodology of valuing stocks on a 1-year rolling forward PE. We thus value Tech Mahindra on FY11E consolidated earnings at a PE multiple of 15x, which is at a 40% discount to Infosys's target PE multiple. We believe this discount is justified given the sluggish growth in Tech Mahindra's standalone business and the lack of clarity on the current state of Mahindra Satyam's financials.

Figure 8: Tech Mahindra – 1-year rolling forward PE



Source: Bloomberg Finance L.P., Company data, Deutsche Bank

Figure 9: Tech Mahindra PE relative to Infosys PE



Source: Bloomberg Finance L.P., Company data, Deutsche Bank

Risks

Key risks for Tech Mahindra are:

1. High vertical and client concentration with more than 90% of revenues from communications service providers, and within that, c45% of revenues are from a single client, BT.
2. Currency fluctuation risk, with the bulk of its earnings coming from exports (c50% GBP denominated),
3. Risk of a potential global slowdown which could lead to project deferrals or the lowering of growth rates
4. Indirect liability from class action suits filed against Satyam.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Tech Mahindra Ltd	TEML.BO	785.85 (INR) 28 Sep 10	8

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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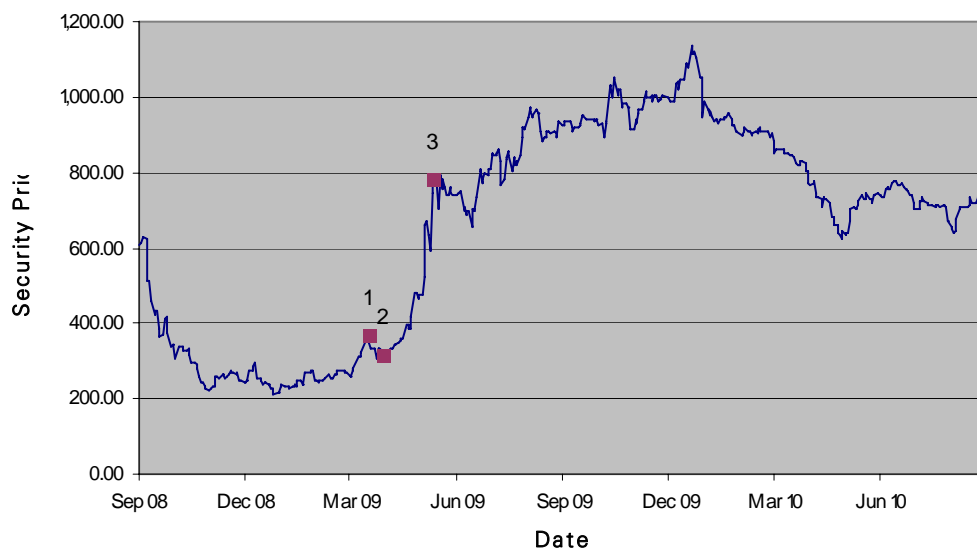
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Historical recommendations and target price: Tech Mahindra Ltd (TEML.BO)

(as of 9/28/2010)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9, 2002

1. 15/4/2009:	Buy, Target Price Change INR425.00	3. 10/6/2009:	Buy, Target Price Change INR1,100.00
2. 28/4/2009:	Buy, Target Price Change INR400.00		

Equity rating key Equity rating dispersion and banking relationships

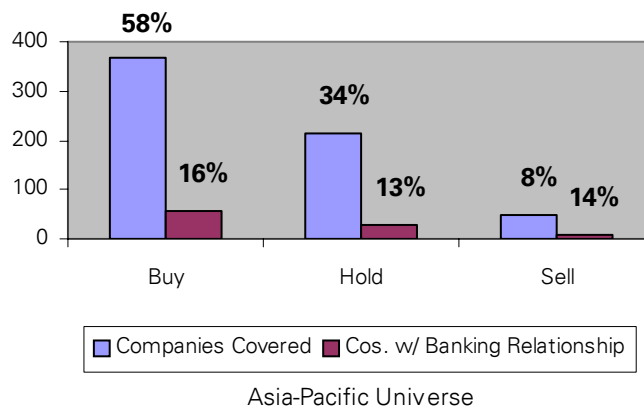
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