

Result Update

Sector: IT

Target Price	Rs1,890
Market cap (bn)	Rs187.0/US\$4.6
52-week range	Rs2,050/365
Shares in issue (mn)	115.1
6-mon avg daily vol (no of shares)	1,608,599
6-mon avg daily vol (mn)	Rs2,614/US\$64
Bloomberg	TECHM IN
Reuters	TEML.BO
BSE Sensex	13879
Website	www.techmahindra.com

Shareholding Pattern (%)

Promoters	87.3
M&M	46.3
BT	32.5
MBTM	8.6
FII's	2.3
MFs/FIs/Banks	3.6
Others	6.8

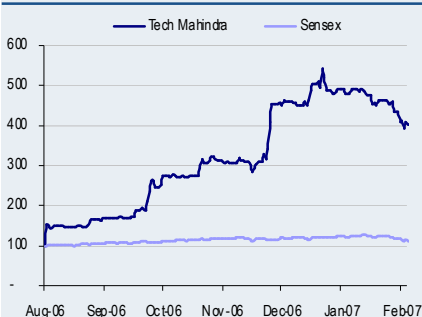
(As of 31 December 2006)

Price Performance (%)

	1M	3M	12M
Absolute	18.5	(8.8)	-
Relative*	10.6	(3.5)	-

* To the BSE Sensex

Relative Performance



(As of 7 May 2007)

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Another good quarter

Tech Mahindra (TechM) reported 4Q FY07 results slightly ahead of our expectations. Revenue came in at Rs8.75 bn (+13.6% QoQ; our estimate of Rs8.55 bn) whereas PAT (pre-exceptional items) was at Rs1.96 bn (+17.6% QoQ; our estimate of Rs1.84 bn). The upside has mainly come from non-operating items like higher other income component (gain of Rs154 mn as against a loss of Rs32 mn in 3Q FY07) and lower effective tax rates (9.4% versus 11.8% of PBT in 3Q FY07). On the auditor's advice, the company has fully expensed Rs5.25 bn, the one-time payment made to BT Global Services (BTGS). Thus, post-exceptional items, the company has actually incurred a loss of Rs3.29 bn in 4Q FY07.

We had assumed that the upfront payment made to BTGS would be amortized over the period of the contract (five years). But, with the company expensing it out completely in 4Q FY07, our EPS estimates for FY08E and FY09E get revised upward to Rs67.5 (+8.2%) and Rs90.0 (+4.2%) respectively. As a result of this, we are increasing our target price to Rs1,890 (21x FY09E EPS) from the earlier target price of Rs1,815. The stock trades at 24x FY08E and 18x FY09E EPS. **Maintain Buy.**

Highlights

- **Strong sequential revenue growth story continues:** Revenue growth, in dollar terms, came in strong at about 16.0% on a sequential basis. However, this was offset by rupee appreciation to a certain extent leading to an overall revenue growth of 13.6% QoQ in rupee terms. Growth in this quarter has been mainly due to BT, which recorded a rise of 17.1% QoQ. As a result of this, the European geography also showed good growth at 18.3% on a sequential basis. Also, with five new clients in this quarter, TechM has maintained its historical trend of client additions.

Exhibit 1: Financial summary

(Rs mn)

Y/E March	FY05	FY06	FY07	FY08E	FY09E
Revenues	9,456	12,427	29,290	44,917	59,290
EBITDA	1,350	2,680	7,365	10,780	14,407
EBITDA (%)	14.3	21.6	25.1	24.0	24.3
Net Profit	1,023	2,355	1,215	8,848	11,799
FD EPS (Rs)	9.0	18.7	47.0	67.5	90.0
EPS Growth (%)	42.6	108.7	150.9	43.8	33.4
RoCE (%)	23.0	41.4	85.9	71.8	56.7
RoE (%)	22.9	42.8	77.7	64.1	50.2
PE (x)	181.1	86.8	34.6	24.1	18.0
Price/Book Value (x)	34.0	27.3	19.1	11.1	7.0
EV/EBITDA (x)	136.7	68.9	24.3	16.5	11.7

Source: Company data, ASK Securities Note: Valuations as of 7 May 2007.

- **US\$1 bn BTGS deal update:** According to the management, the US\$1 bn deal bagged from BTGS is progressing as per plans. The groundwork of deciding the initial work to start with and transition is almost complete, with the first few projects starting to trickle in. As stated previously, the company expects the deal to take a J-shaped curve and significant revenues are expected only in 3Q FY08. TechM had also given an upfront discount of Rs5.25 bn to BTGS and this amount has been fully expensed in this quarter. The US\$90 mn debt taken to make this payout has also been substantially repaid (only US\$4 mn remained at the end of March 2007) due to the strong internal accruals.
- **Margins to remain under pressure:** TechM showed a QoQ operating margin decline of 155 bps in 4Q FY07. However, for the full year FY07, margins have improved by 358 bps. Going forward in FY08E, we expect a margin dip of 115 bps mainly due to the initial costs in the BTGS deal. However, we expect the margins to bounce back in FY09E as the company has sufficient levers like the flattening of the employee pyramid, increased utilization levels, knowledge reuse and transaction based pricing. Thus, over FY07-09E, the margin dip is expected to be limited to about 85 bps.
- **Employee additions continue to be strong:** Attrition, after being above the 20% levels for two consecutive quarters, has finally come below those levels (these exclude the BPO numbers). In this quarter, TechM has added 1,975 employees (+11.1% QoQ) on a net basis. For FY07, the net additions have been 9,256 employees, a sharp 88% YoY increase. The utilization levels have been running a bit lower at 67% but this a fallout of the high growth as the company needs to hire aggressively in advance to meet expected project requirements.
- **Maintain Buy with price target of Rs1,890:** We had assumed that the upfront payment made to BTGS would be amortized over the period of the contract (five years). But, with the company expensing it out completely in 4Q FY07, our EPS estimates for FY08E and FY09E get revised upward to Rs67.5 (+8.2%) and Rs90.0 (+4.2%) respectively. As a result of this, we are increasing our target price to Rs1,890 (21x FY09E EPS) from the earlier target price of Rs1,815. The stock trades at 24x FY08E and 18x FY09E EPS. Maintain Buy.

Exhibit 2: Quarter results**(Rs mn)**

Y/E March	4Q FY07	3Q FY07	QoQ (%)	4Q FY06	YoY (%)
Sales	8,745	7,698	13.6	4,212	107.6
Cost of services	5,135	4,528	13.4	2,377	116.0
Gross profits	3,610	3,170	13.9	1,835	96.7
Revenue (%)	41.3	41.2		43.6	
SG&A	1,392	1,098	26.8	855	62.8
Revenue (%)	15.9	14.3		20.3	
EBITDA	2,218	2,072	7.0	980	126.3
Revenue (%)	25.4	26.9		23.3	
Depreciation	158.0	137.0	15.3	111.0	42.3
EBIT	2,060	1,935	6.5	869	137.1
Revenue (%)	23.6	25.1	(1.6)	20.6	2.9
Interest	49	12.0		-	
Other Income	154	(32)	(581.3)	127	21.3
PBT	2,165	1,891	14.5	996	117.4
Tax	204	224	(8.9)	106	92.5
PBT (%)	9.4	11.8		10.6	
PAT	1,961	1,667	17.6	890	120.3
Minority Interest	1	-	-	-	-
Extraordinary Items	(5,249)	-	-	-	-
Reported PAT	(3,289)	1,667	(297.3)	890	(133.4)
Revenue (%)	(37.6)	21.7		21.1	
Diluted no of shares (mn)	130.5	130.0	0.3	128.6	(99.7)
EPS (Rs)	15.0	12.8	17.2	6.9	117.2

Source: Company data.

Exhibit 3: Key operating metrics

	1Q FY07	2Q FY07	3Q FY07	4Q FY07
By Geography (%)				
North America	18	18	19	19
Europe	67	73	73	76
Rest of the world	15	9	8	5
By Delivery (%)				
Onsite	34	38	40	41
Offshore	66	62	60	59
Utilisation (%)	74	69	67	67
Attrition (%)	17	21	22	19
Client data (Nos)				
Active Clients	65	70	78	83
Number of > US\$1 mn clients	17	17	22	29
Number of > US\$10 mn clients	5	5	5	6
Number of > US\$50 mn clients	1	1	1	2
Client Contribution (%)				
Revenues - top client	58	64	65	67
Revenues - top 5 clients	86	82	82	83
Revenues - top 10 clients	91	90	90	89
Number of employees (Nos.)	12,366	15,080	17,774	19,749
Software Professionals	11,721	14,413	15,527	17,181
BPO	~ 100	~ 500	1,542	1,755
Sales & Support	645	667	705	813

Source: Company data.

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