

28th April 2009**HOLD**

| | |
|---------------|---------------|
| Price | Target Price |
| Rs 328 | Rs 303 |
| Sensex | 11,372 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|----------------|----|----|------|------|
| Absolute | 20 | 56 | 5 | (60) |
| Rel. to Sensex | 6 | 19 | (21) | (39) |

Source: Capitaline

Stock Details

| | |
|---------------------------------|--------------|
| Sector | IT Services |
| Reuters | TEML.BO |
| Bloomberg | TECHM@I N |
| Equity Capital(Rs mn) | 1217 |
| Face Value(Rs) | 10 |
| 52 Week H/L | 990/204 |
| Market Cap(Rs bn//US\$ mn) | 40/797 |
| Daily Avg Volume (No of shares) | 806689 |
| Daily Avg Turnover (US\$) | 5.2 |

Shareholding Pattern (%)(31st March'09)

| | |
|---------------|------|
| Promoters | 83.3 |
| FII/NRI | 1.8 |
| Institutions | 2.0 |
| Private Corp. | 2.0 |
| Public | 10.9 |

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Misses lowered expectations; Challenging outlook continues

TechM reports revenues of US\$ 211.5 mn, lower than estimates of US\$ 223 mn.

Reported op margins at 27% (-100 bps QoQ) on a/c of employee cost write back of ~Rs 250 mn. Adjusted for write back, margins decline by ~360 bps QoQ.

Net profits beat estimates driven by write back of provisions.

Steep slide in core BT business stalled for now; however negatively surprised by ~14% QoQ decline in revenues from BTGS contract.

Reduce FY10/FY11 revenue estimates by ~ 16%/19%. FY10/FY11E EPS changed marginally to Rs 58.6/Rs 61.5 (V/s Rs 58.6 and Rs 62 earlier).

Post ~56% up move in the stock over past 3 months, see downside bias to the stock in the near term. Cut rating to HOLD (from BUY earlier) leaving TP unchanged.

Q4FY09 Highlights

Tech Mahindra reported US\$ revenues of US\$ 211.5 mn (-9% QoQ, -18% YoY) missing lowered expectations (Emkay est of US\$ 223 mn). However reported operating profit margins at 27% were down only ~100 bps sequentially V/s our expectations of employee cost writeback of ~Rs 250 mn. Net profits at Rs 2305 mn (+3.4% QoQ, +5.3% YoY) beat estimates on account of cost writeback. Employee count reduced by ~500 employees QoQ during the quarter with co indicating to push off joining of ~5k campus hires for atleast the next 2 quarters and focusing on improving the utilization levels (up by ~300 bps sequentially to 70% during the quarter)

Steep Slide in core BT stalled for now, BTGS performance disappoints

Revenues from the top client declined ~5% in GBP terms (contribution in US\$ reported terms down by ~17% QoQ, 34% YoY). Revenues from core BT business were GBP 58 mn during March'09 (V/s GBP 60 mn during Dec'08 quarter). However we are negatively surprised by the decline in revenues from the BTGS contract to GBP 19 mn from GBP 22.4 mn. Co management noted that the contribution fro BTGS had been impacted due to recent restructuring of BTGS's external contracts and co expects the negative impact to sustain to continue for atleast 1 more quarter. We highlight that the co had made an upfront payment of US\$ 118 mn to BT for the GBP 500 mn BTGS 5 year contract and has over the past 5 quarters has booked revenues of GBP 87 mn over the past 5 quarters implying an average booking of GBP 27 mn over the next 15 quarters and the slower ramp up in the deal would hurt the contract's NPV. Further though the revenues from core BT business were relatively stable, co expects the business to be under pressure in the near term.

Cut FY10/FY11 revenue estimates by ~16%/19%, EPS estimates changed marginally on currency resets, higher margin

We have cut our FY10/FY11 INR revenue estimates by ~16%/19% and reset currency assumptions at US\$/INR of Rs 49/48 and GBP/US\$ at 1.46 thereby leaving our FY10/FY11 EPS estimates changing marginally to Rs 58.6 and Rs 61.5 (V/s Rs 58.6 and Rs 62 earlier) (refer table below). However after a 56% upmove in the stock over the past 3 months, we see downside bias in the stock and hence lower our rating to HOLD from BUY earlier with an unchanged target price of Rs 303. We believe that the challenges associated with the Satyma integration would add further negative pressure to the stock.

| In Rs mn | Q4FY09 | Q3FY09 | QoQ(%) | Q4FY08 | YoY (%) |
|-------------------------|--------------|--------------|---------------|--------------|--------------|
| Net sales | 10513 | 11322 | -7.1% | 10218 | 2.9% |
| Total Income | 10,513 | 11,322 | | 10,218 | |
| Operating expenses | 7671 | 8142 | | 7994 | |
| EBITDA | 2,842 | 3,180 | -10.6% | 2,224 | 27.8% |
| Margins (%) | 27.03 | 28.09 | | 21.8 | |
| Depreciation | 286 | 286 | | 229 | |
| EBIT | 2,556 | 2,894 | -11.7% | 1,995 | 28.1% |
| Margins (%) | 24.3 | 25.6 | | 19.5 | |
| Interest Paid | 23 | 0 | | 5 | |
| Other income | 78 | -397 | | 364 | |
| Pre-tax profit | 2,611 | 2,497 | | 2,354 | |
| Tax provided | 306 | 269 | | 165 | |
| Profit after tax | 2,305 | 2,228 | | -2,213 | |
| Emkay Net profit | 2,305 | 2,228 | 3.4% | 2,188 | 5.3% |
| EPS, Rs | 17.6 | 17.0 | | 16.7 | |

Cost control has been to the fore as revenue challenges have gathered steam.

| | Q3FY08 | Q4FY08 | Q1FY09 | Q2FY09 | Q3FY09 | Q4FY09 |
|------------------|--------|--------|--------|--------|--------|--------|
| Employee Costs | 3826 | 4088 | 4523.5 | 4720.5 | 4816 | 4498 |
| % of Sales | 39.4 | 40.0 | 40.5 | 40.5 | 42.5 | 42.8 |
| Travelling Costs | 1318 | 1492 | 1087.5 | 464.5 | 1005 | 885 |
| % of Sales | 13.6 | 14.6 | 9.7 | 4.0 | 8.9 | 8.4 |
| Other costs | 2426 | 2450 | 2683.9 | 2528.1 | 2322 | 2290 |
| % of Sales | 25.0 | 24.0 | 24.0 | 21.7 | 20.5 | 21.8 |

Revenues decline from the BTGS contract came in as a negative surprise. Revenues from the other major North American TSP continued to be strong.

| | Q3FY08 | Q4FY08 | Q1FY09 | Q2FY09 | Q3FY09 | Q4FY09 |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| Quarterly Revenues (in US\$ mn) | 245.2 | 257.8 | 272 | 270 | 232 | 212 |
| QoQ growth, % | 11.1% | 5.1% | 5.5% | -0.8% | -14.0% | -8.8% |
| YoY growth, % | 44% | 30.4% | 28.9% | 22.2% | -5.4% | -18.0% |
| Top client | 61% | 65% | 63% | 60% | 57% | 52% |
| Top client revenues (in US\$ mn) | 149.6 | 167.6 | 171.3 | 161.9 | 132.2 | 110.0 |
| QoQ growth, % | 4.2% | 12.0% | 2.2% | -5.5% | -18.3% | -16.8% |
| YoY growth, % | 35.0% | 26.5% | 26.9% | 12.8% | -11.6% | -34.4% |
| BTGS revenues(in US\$ mn) | 10.6 | 20.0 | 25.0 | 32.0 | 35.0 | 27.0 |
| QoQ growth, % | | | 25.0% | 28.0% | 9.4% | -22.9% |
| Top client revenues ex BTGS | 139.0 | 147.6 | 146.3 | 129.9 | 97.2 | 83.0 |
| QoQ growth, % | -2.0% | 6.2% | -0.9% | -11.2% | -25.2% | -14.6% |
| Top 2- 5 client revenues | 51.5 | 46.4 | 57.1 | 59.4 | 51.0 | 55.0 |
| QoQ growth, % | 11.1% | -9.9% | 23.0% | 4.0% | -14.0% | 7.8% |
| Top 5 | 82% | 83% | 84% | 82% | 79% | 78% |
| Top 5 client revenues | 201.1 | 214.0 | 228.4 | 221.2 | 183.2 | 165.0 |
| QoQ growth, % | 5.9% | 6.4% | 6.7% | -3.1% | -17.2% | -10.0% |
| Top 5-10 clients | 14.7 | 15.5 | 16.3 | 18.9 | 18.6 | 12.7 |
| QoQ growth, % | 122.1% | 5.1% | 5.5% | 15.8% | -1.8% | -31.6% |
| Top 10 | 88% | 89% | 90% | 89% | 87% | 84% |
| Top 10 client revenues | 215.8 | 229.4 | 244.7 | 240.1 | 201.8 | 177.7 |
| QoQ growth, % | 9.8% | 6.3% | 6.7% | -1.9% | -16.0% | -11.9% |
| Non Top 10 client revenues | 29.4 | 28.4 | 27.2 | 29.7 | 30.1 | 33.8 |
| QoQ growth, % | 21.1% | -3.6% | -4.1% | 9.2% | 1.6% | 12.2% |

| (All fig in Rs mn except EPS) | FY10E | | | FY11E | | |
|--------------------------------|--------|--------|----------|--------|--------|----------|
| | Old | New | % change | Old | New | % change |
| Revenues(US\$ mn) | 1,061 | 856 | -19.3 | 1,224 | 956 | -21.9 |
| Revenues | 49,865 | 41,964 | -15.8 | 56,293 | 45,890 | -18.5 |
| EBITDA | 9,728 | 9,810 | 0.8 | 11,053 | 10,904 | -1.3 |
| Net profits | 7,678 | 7,672 | -0.1 | 8,127 | 8,060 | -0.8 |
| EPS | 58.6 | 58.6 | -0.1 | 62.0 | 61.5 | -0.8 |

Income Statement

| Y/E, Mar (Rs. m) | FY08 | FY09 | FY10E | FY11E |
|--------------------------|--------------|---------------|--------------|---------------|
| Net Sales | 37,661 | 44,647 | 41,964 | 45,890 |
| Growth (%) | | 19 | (6) | 9 |
| Total Expenditure | (29,403) | (32,495) | (32,153) | (34,987) |
| Growth (%) | | 11 | (1) | 9 |
| EBIDTA | 8,258 | 12,152 | 9,810 | 10,904 |
| Growth (%) | | 47 | (19) | 11 |
| EBIDTA % | 21.9 | 27.2 | 23.4 | 23.8 |
| Other Income | 1,044 | (378) | 240 | 520 |
| Depreciation | (796) | (1,097) | (1,232) | (1,349) |
| EBIT | 8,506 | 10,677 | 8,819 | 10,074 |
| Interest | (61) | - | - | - |
| EBT | 8,445 | 10,677 | 8,819 | 10,074 |
| Tax | (748) | (1,179) | (1,146) | (2,015) |
| EAT | 7,697 | 9,498 | 7,672 | 8,060 |
| Growth (%) | | 23 | (19) | 5 |
| EAT (%) | 20.4 | 21.3 | 18.3 | 17.6 |

Balance Sheet

| Y/E, Mar (Rs. m) | FY08 | FY09E | FY10E | FY11E |
|--------------------------------|---------------|---------------|---------------|---------------|
| Equity share capital | 1,214 | 1,214 | 1,214 | 1,214 |
| Reserves & surplus | 11,358 | 20,136 | 27,046 | 34,339 |
| Minority Interest | 111 | 111 | 111 | 111 |
| Networth | 12,683 | 21,461 | 28,371 | 35,664 |
| Secured Loans | - | - | - | - |
| Unsecured Loans | 300 | - | - | - |
| Loan Funds | 300 | - | - | - |
| Total Liabilities | 12,983 | 21,461 | 28,371 | 35,664 |
| Goodwill | - | - | - | - |
| Gross Block | 7,457 | 9,153 | 9,232 | 10,325 |
| Less: Depreciation | 3,101 | 4,198 | 5,430 | 6,779 |
| Net block | 4,356 | 4,955 | 3,802 | 3,546 |
| Capital WIP | 1,640 | 1,500 | 1,500 | 1,500 |
| Investment | 633 | 632 | 632 | 632 |
| Current Assets | 15,562 | 25,591 | 33,091 | 41,517 |
| Inventories | 17 | - | - | - |
| Sundry debtors | 10,965 | 12,966 | 12,072 | 13,201 |
| Cash & bank balance | 976 | 8,344 | 16,995 | 23,915 |
| Loans & advances | 3,604 | 4,281 | 4,024 | 4,400 |
| Other current assets | - | - | - | - |
| Current Liab & Prov | 9,268 | 11,278 | 10,715 | 11,592 |
| Current liabilities | 6,505 | 7,706 | 7,358 | 7,921 |
| Provisions | 2,763 | 3,572 | 3,357 | 3,671 |
| Net current assets | 6,294 | 14,314 | 22,376 | 29,925 |
| Misc exps | - | - | - | - |
| Deferred Tax | 60 | 60 | 60 | 60 |
| Total Assets | 12,983 | 21,461 | 28,371 | 35,663 |

Cash Flow

| | FY08 | FY09E | FY10E | FY11E |
|-------------------------------|----------------|----------------|----------------|----------------|
| Net Profit after Tax | 7,697 | 9,498 | 7,672 | 8,060 |
| Add : Depreciation | 516 | 516 | 516 | 516 |
| Add : Misc exp w/off | (4,401) | - | - | - |
| Net changes in WC | (2,297) | (8,020) | (8,062) | (7,549) |
| Operational Cash Flows | 7,718 | 9,997 | 9,493 | 8,781 |
| Capital expenditure | (2,371) | (1,556) | (79) | (1,093) |
| Investments | (4,401) | - | - | - |
| Investing Cash Flows | (6,772) | (1,556) | (79) | (1,093) |
| Borrowings | 130 | (300) | - | - |
| dividend paid | (781) | (766) | (766) | (766) |
| Issue of shares | 19 | (7) | 4 | (0) |
| Share Premium | 10 | - | - | - |
| Financing Cash Flows | (637) | (1,073) | (762) | (766) |
| changes in cash | 308 | 7,369 | 8,651 | 6,921 |
| Opening balance | 668 | 976 | 8,344 | 16,995 |
| Closing balance | 976 | 8,344 | 16,995 | 23,915 |

Key ratios

| | FY08 | FY09E | FY10E | FY11E |
|---------------------------------|------|-------|-------|-------|
| EPS (Rs) | 58.8 | 72.5 | 58.6 | 61.5 |
| CEPS (Rs) | 64.8 | 80.9 | 68.0 | 71.8 |
| Book Value Per Share (Rs) | 96.8 | 163.8 | 216.6 | 272.2 |
| Dividend Per Share (Rs) | 5.1 | 5.0 | 5.0 | 5.0 |
| Valuations Ratios (x) | | | | |
| PER | 4.8 | 3.9 | 4.8 | 4.6 |
| P/CEPS | 3.5 | 2.8 | 3.3 | 3.1 |
| P/BV | 2.9 | 1.7 | 1.3 | 1.0 |
| EV/EBIDTA | 4.4 | 2.3 | 2.0 | 3.4 |
| EV/Sales | 1.0 | 0.6 | 0.5 | 0.8 |
| M-Cap/sales | 1.0 | 0.8 | 0.9 | 0.8 |
| Profitability Ratios (%) | | | | |
| RoCE | 55.8 | 54.2 | 30.2 | 26.9 |
| RoNW | 70.0 | 55.6 | 30.8 | 25.2 |
| EBITDA Margin | 21.9 | 27.2 | 23.4 | 23.8 |
| EBIT Margins | 19.8 | 24.8 | 20.4 | 20.8 |
| Net Profit Margin | 20.4 | 21.3 | 18.3 | 17.6 |

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