



Rating  
**Buy**

Asia  
India

Technology  
Software & Services

Company  
**Tech Mahindra Ltd**

Reuters  
TEML.BO

Bloomberg  
TECHM IN

Exchange  
BSE

Ticker  
TEML

Date  
18 September 2012

## Company Update

Price at 17 Sep 2012 (INR)	903.45
Price target - 12mth (INR)	990.00
52-week range (INR)	924.85 - 533.05
BSE 30	18,464

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## Acquires 51% stake in Comviva – good acquisition but overpriced

### Overpayment of INR713m to acquire controlling stake in Comviva Tech

Tech Mahindra's acquisition of a controlling stake (51%) in Bharti Group-promoted Comviva Tech helps it to: (a) enhance its positioning as a full services player for mobile network operators; and (b) gain share with key customers like Airtel and Vodafone. However, in our view, (1) the deal could be margin-dilutive and (2) Tech Mahindra seems to have overpaid for Comviva. Based on a comparison with OnMobile (a close competitor), Tech Mahindra seems to have overpaid INR713m for the controlling stake in Comviva. This translates to INR5.5 per share of Tech Mahindra (see Figure 3). Buy.

### Comviva adds mobile product capability to Tech Mahindra's service portfolio.

Comviva is a mobile value-added services (VAS) provider. The acquisition helps Tech Mahindra add capability to the mobile product space and diversifies its service portfolio beyond operating system support (OSS), business systems support (BSS), etc. The acquisition is also aimed at increasing market share with key customers like Airtel and Vodafone and providing customers with revenue-enhancing solutions rather than just focusing on cost-take-out projects.

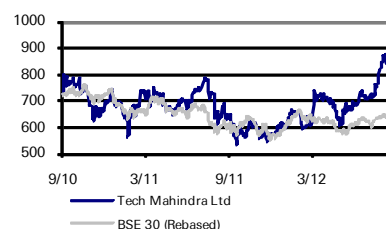
### Negative equity value of INR5.5 per share

When compared with OnMobile (its closest competitor), Tech Mahindra seems to have overpaid for Comviva. Though OnMobile's value may be depressed due to company-specific issues, even assuming a conservative FY12 EV/sales multiple of 1x, we believe Tech Mahindra overpaid for Comviva by INR713m or INR5.5 per share of Tech Mahindra.

### Valuation and risks

Our SOTP-based target price stands at INR990. Key risks: (1) project cancellation due to macroeconomic slowdown; and (2) high vertical and client concentration (see page 5 for details).

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	6.6	29.4	39.4
BSE 30	4.4	8.9	9.0

### Forecasts And Ratios

	2011A	2012A	2013E	2014E	2015E
Year End Mar 31					
Sales (INRm)	48,402.9	54,896.9	63,039.3	64,646.9	76,064.9
EBITDA (INRm)	9,894.9	8,514.9	11,360.7	12,703.6	14,881.1
Reported NPAT (INRm)	8,325.5	10,986.3	11,677.3	13,626.7	16,792.8
Reported EPS FD(INR)	64.04	84.51	88.46	103.23	127.22
DB EPS FD(INR)	64.04	84.51	88.46	103.23	127.22
DB EPS growth (%)	-10.7	32.0	4.7	16.7	23.2
PER (x)	11.2	7.7	10.2	8.8	7.1
EV/EBITDA (x)	7.5	7.2	7.3	5.9	4.6
DPS (net) (INR)	4.51	4.51	4.51	4.51	4.51
Yield (net) (%)	0.6	0.7	0.5	0.5	0.5

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

<sup>2</sup> 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

Deutsche Bank AG/Hong Kong

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Model updated: 09 August 2012

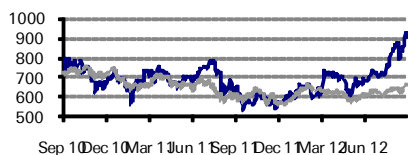
### Running the numbers

Asia	
India	
Software & Services	
<b>Tech Mahindra Ltd</b>	
Reuters: TEML.BO	
Bloomberg: TECHM IN	
<b>Buy</b>	
Price (17 Sep 12)	INR 903.45
Target Price	INR 990.00
52 Week range	INR 533.05 - 924.85
Market Cap (m)	INRm 109,317
	USDm 2,031

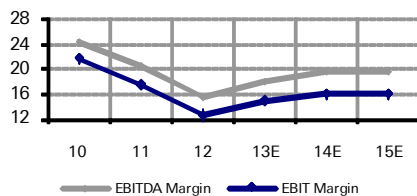
### Company Profile

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.

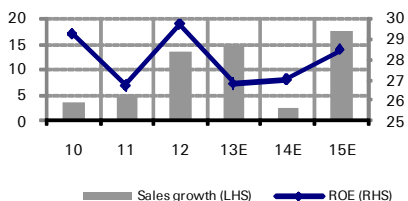
### Price Performance



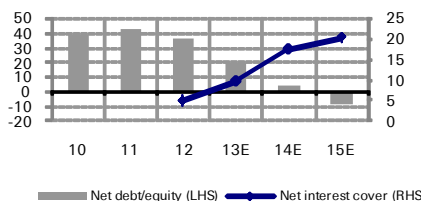
### Margin Trends



### Growth & Profitability



### Solvency



Fiscal year end 31-Mar

### Financial Summary

	2010	2011	2012	2013E	2014E	2015E
DB EPS (INR)	71.74	64.04	84.51	88.46	103.23	127.22
Reported EPS (INR)	54.28	64.04	84.51	88.46	103.23	127.22
DPS (INR)	3.85	4.51	4.51	4.51	4.51	4.51
BVPS (INR)	222.0	257.8	309.2	353.6	408.5	479.7
Weighted average shares (m)	122	124	126	130	130	130
Average market cap (INRm)	99,767	89,019	81,919	109,317	109,317	109,317
Enterprise value (INRm)	81,246	74,635	61,072	82,472	75,457	67,830

### Valuation Metrics

P/E (DB) (x)	11.4	11.2	7.7	10.2	8.8	7.1
P/E (Reported) (x)	15.0	11.2	7.7	10.2	8.8	7.1
P/BV (x)	3.84	2.62	2.33	2.55	2.21	1.88
FCF Yield (%)	9.4	nm	6.0	5.6	6.5	7.0
Dividend Yield (%)	0.5	0.6	0.7	0.5	0.5	0.5
EV/Sales (x)	1.8	1.5	1.1	1.3	1.2	0.9
EV/EBITDA (x)	7.2	7.5	7.2	7.3	5.9	4.6
EV/EBIT (x)	8.1	8.8	8.8	8.8	7.3	5.6

### Income Statement (INRm)

Sales revenue	46,254	48,403	54,897	63,039	64,647	76,065
Gross profit	17,543	17,236	18,115	21,359	23,047	27,051
EBITDA	11,325	9,895	8,515	11,361	12,704	14,881
Depreciation	1,338	1,435	1,614	2,002	2,362	2,723
Amortisation	0	0	0	0	0	0
EBIT	9,987	8,460	6,901	9,358	10,341	12,159
Net interest income/(expense)	0	0	-1,414	-960	-600	-600
Associates/affiliates	0	7	5,569	4,934	5,377	6,726
Exceptionals/extraordinary	-2,269	0	0	0	0	0
Other pre-tax income/(expense)	754	1,174	1,368	379	835	1,347
Profit before tax	10,741	9,634	6,855	8,778	10,576	12,906
Income tax expense	1,440	1,315	1,438	2,034	2,327	2,839
Minorities	-25	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	7,057	8,326	10,986	11,677	13,627	16,793
DB adjustments (including dilution)	2,269	0	0	0	0	0
DB Net profit	9,326	8,326	10,986	11,677	13,627	16,793

### Cash Flow (INRm)

Cash flow from operations	13,424	-2,769	8,218	9,569	10,616	11,228
Net Capex	-4,069	1,039	-3,332	-3,000	-3,001	-3,001
Free cash flow	9,355	-1,730	4,886	6,569	7,615	8,227
Equity raised/(bought back)	51	35	15	25	0	0
Dividends paid	-501	-587	-591	-596	-600	-600
Net inc/(dec) in borrowings	0	0	0	0	0	0
Other investing/financing cash flows	-25,799	71	0	0	0	0
Net cash flow	-16,894	-2,211	4,310	5,998	7,015	7,627
Change in working capital	7,019	-11,260	1,187	823	5	-1,561

### Balance Sheet (INRm)

Cash and other liquid assets	2,187	2,665	2,418	8,416	15,432	23,058
Tangible fixed assets	9,251	6,777	8,495	9,493	10,131	10,410
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	30,145	29,080	35,876	35,876	35,876	35,876
Other assets	17,435	22,030	22,401	23,622	24,198	28,296
Total assets	59,018	60,552	69,190	77,406	85,637	97,640
Interest bearing debt	13,672	17,202	17,447	17,447	17,447	17,447
Other liabilities	16,342	9,677	11,235	13,279	13,861	16,397
Total liabilities	30,014	26,879	28,682	30,726	31,308	33,844
Shareholders' equity	28,865	33,514	40,508	46,681	54,330	63,796
Minorities	139	159	0	0	0	0
Total shareholders' equity	29,004	33,673	40,508	46,681	54,330	63,796
Net debt	11,485	14,537	15,029	9,031	2,015	-5,611

### Key Company Metrics

Sales growth (%)	3.6	4.6	13.4	14.8	2.6	17.7
DB EPS growth (%)	1.7	-10.7	32.0	4.7	16.7	23.2
EBITDA Margin (%)	24.5	20.4	15.5	18.0	19.7	19.6
EBIT Margin (%)	21.6	17.5	12.6	14.8	16.0	16.0
Payout ratio (%)	6.7	6.7	5.2	5.0	4.3	3.5
ROE (%)	29.2	26.7	29.7	26.8	27.0	28.4
Capex/sales (%)	8.8	0.0	6.1	4.8	4.6	3.9
Capex/depreciation (x)	3.0	0.0	2.1	1.5	1.3	1.1
Net debt/equity (%)	39.6	43.2	37.1	19.3	3.7	-8.8
Net interest cover (x)	nm	nm	4.9	9.7	17.2	20.3

Source: Company data, Deutsche Bank estimates

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# Acquires controlling stake in Comviva technologies

## Good acquisition but overpriced

Tech Mahindra has announced the acquisition of 51% stake in Comviva Technologies Ltd. Comviva (promoted by the Bharti Group – also promoters of Airtel) provides mobile value-added solutions (VAS). The acquisition helps Tech Mahindra expand its footprint beyond services like operating systems support (OSS), business systems support (BSS), etc. into the mobile products space. It also helps Tech Mahindra pursue opportunities to enhance customer revenue versus its current positioning as an offshore service provider. The acquisition will moreover help Tech Mahindra gain share with key customers like Airtel and Vodafone.

### Tech Mahindra seems to have overpaid for the controlling stake

Tech Mahindra will pay INR2.6bn for the 51% stake in Comviva, with an upfront payment of INR1.25bn. The balance of INR1.35bn will be paid over the next five years after Comviva achieves its agreed performance targets. The consideration is to be paid as follows (please see Figure 1).

Figure 1: Comviva – consideration

Particulars	INR mn
Upfront payment	1,250
To be paid over the next two years	700
Performance based	650
<b>Total</b>	<b>2,600</b>

Source: Company data

Though the acquisition is a step in the right direction, we believe that:

1. It could be margin-dilutive and
2. Tech Mahindra seems to have overpaid for the controlling stake in Comviva, when compared with other players in this space

In FY12, Comviva has reported mid-teens operating margins (EBITDA). This is in line with those reported by Tech Mahindra. However, in FY13E, we expect Tech Mahindra's operating margins to move up to 18%, driven primarily by benefits from operational efficiencies. Assuming Comviva's operating margins do not improve in FY13E, the deal could be margin-dilutive.

Figure 2: Comparative financials

INR mn	FY12		
	Comviva	OnMobile	Tech Mahindra
<b>Revenue</b>	<b>3,700</b>	<b>6,380</b>	<b>54,897</b>
EBITDA	592	1,399	8,515
<i>EBITDA Margin</i>	<i>16%</i>	<i>21.9%</i>	<i>15.5%</i>
EV	5,098	4,347	61,072
<b>EV/Sales (x)</b>	<b>1.4</b>	<b>0.7</b>	<b>1.1</b>
<b>EV/EBITDA (x)</b>	<b>8.6</b>	<b>3.1</b>	<b>7.2</b>

Source: Company data, Bloomberg Finance L.P.



Moreover, when compared with OnMobile (closest competitor), Tech Mahindra seems to have overpaid for Comviva. Though OnMobile's value may be depressed due to company-specific issues (its CEO, Mr. Arvind Rao, resigned recently following allegations that he indulged in related-party transactions and compromised corporate governance ethics), even adjusting for these issues, we believe Tech Mahindra overpaid for Comviva by INR713m or INR5.5 per share of Tech Mahindra.

**Figure 3: Tech Mahindra overpaid for Comviva**

<b>Sr.No</b>	<b>Particulars</b>	<b>INRmn</b>
<b>Enterprise Value of Comviva</b>		
A	based on TechM's acquisition price	5,098
B	assuming FY12 Ev/sales of 1x	3,700
<b>C= A-B</b>	<b>Overestimation of Comviva's value by TechM</b>	<b>1,398</b>
D= C*51%	Excess payment by TechM (51% share)	713
E	Excess payment per share of TechM	5.5

Source: Deutsche Bank



# Valuation and risks

## Valuation

With the availability of the audited and restated financials of Mahindra Satyam, we had reintroduced forecasts for that company. Moreover, a significant reduction in the uncertainty surrounding the potential liabilities has led to a corresponding reduction in the risk profile of Mahindra Satyam, in our opinion. While retaining our sum-of-the parts (SOTP) valuation methodology, we continue to value the constituent parts of the consolidated entity on a PE basis, with a 10% holding company discount for the stake in Mahindra Satyam. We believe this should adequately account for the risk of any further potential liabilities (especially the Aberdeen complaint) affecting the financial health of the company. Our target price for the company is INR990.

Figure 4: Sum-of-the-parts valuation

INRMn	Valuation method	FY13 Net income	Share	Effective Net Income	Interest Cost	Net Income (post interest)	Holding Company discount	Target PE multiple	Market Capitalisation	Per share
Tech Mahindra	PE/ 1 year fwd	7.703	100%	7.703	0	7,703	0%	10	77.031	<b>611</b>
Mahindra Satyam	PE/ 1 year fwd	11.568	42.66%	4.935	960	3.975	0%	12	47.701	<b>379</b>
<b>Total</b>									<b>124.732</b>	<b>990</b>
No of shares (mn)									126	
<b>Target Price (INR/share)</b>									<b>990</b>	

Source: 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, c38% of revenues from a single client, BT; 2) currency fluctuation risk, with the bulk of earnings coming from exports (c40% GBP-denominated); 3) risk of a potential global slowdown, which could lead to project deferrals or the lowering of growth rates; and 4) indirect liability from potential 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	903.45 (INR) 17 Sep 12	NA

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

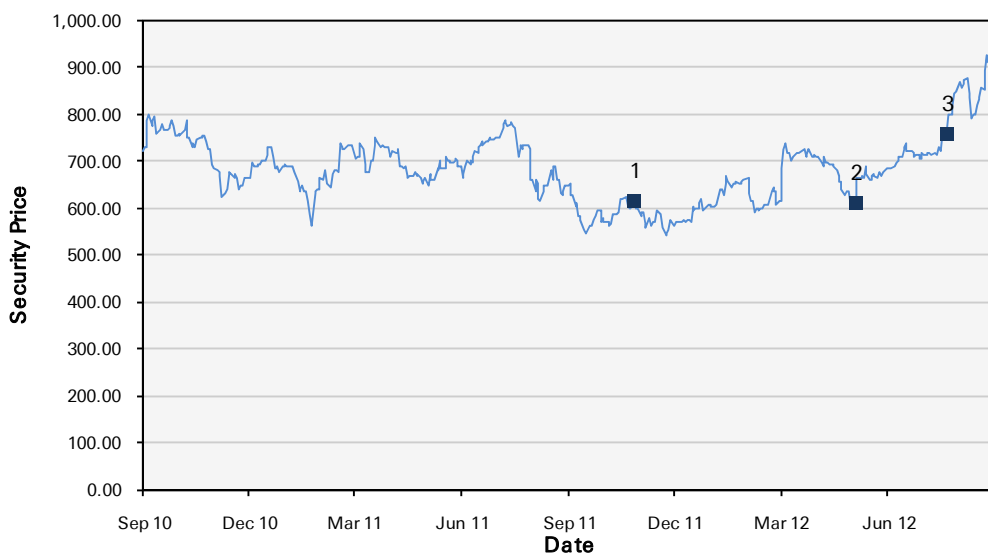
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### Historical recommendations and target price: Tech Mahindra Ltd (TEML.BO)

(as of 9/17/2012)



#### 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.	15/11/2011:	Buy, Target Price Change INR1,000.00	3.	09/08/2012:	Buy, Target Price Change INR990.00
2.	23/05/2012:	Buy, Target Price Change INR905.00			



Equity rating key

Equity rating dispersion and banking relationships

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield ) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

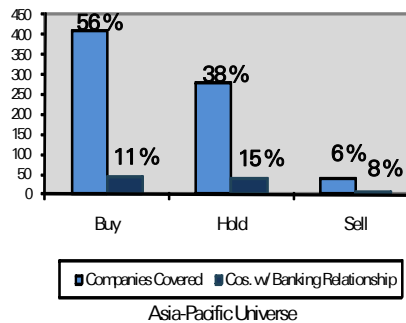
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1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:

Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period





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