

Rs691

Tech Mahindra

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs87bn; US\$1.9bn

Analyst: Hitesh Shah, CFA (+91-22-6622 2565; hitesh.shah@idfc.com)
Anamika Sharma (+91-22-6622 2680; anamika.sharma@idfc.com)

Result: Q3FY11

Comment: Lackluster quarter – on expected lines

Last Report: 4 January 2011 (Price Rs712; Recommendation: Outperformer)

Key valuation metrics

Year to Mar (Rs m)	Sales	Chg yoy (%)	Recur. NP	Adj. EPS (Rs)	Chg yoy (%)	PER (x) [#]
2009	44,647	18.5	10,146	78.1	33.0	8.8
2010*	46,254	3.6	5,081	39.3	(49.7)	12.7
2011E*	51,215	10.7	4,904	37.6	(4.4)	13.3
2012E*	54,820	7.0	6,050	46.4	23.5	10.8
2013E*	62,921	14.8	7,723	59.3	27.7	8.4

*Adjusted for one time payment from BT & does not include contribution from Satyam; [#]PER adjusted for Mahindra Satyam stake at 25% holding co discount
Source: Company, IDFC Securities

Key result highlights

- **Flat revenues ex-SI; below expectations** – TechM reported revenues of US\$269m (-18.1% qoq; +5.9% yoy) vs. IDFC exp: US\$276m. In INR terms revenues were Rs12.1bn (-21% qoq; +2% yoy). Excluding the last quarter US\$63.5m SI deal, USD revenues were up 1.6% qoq and INR revenues were down 1.9% qoq. EBITDA margin (ex SI revenues) declined by ~210bp due to salary hikes (~3% for onsite employees) and stronger INR. Higher other income led to reported net profits of Rs2bn (+9.7% qoq; +18.2% yoy) vs. IDFC exp of Rs1.8bn.
- **Supply side concerns linger; Flat BT/Non-BT business** – Company had net hiring of only ~200 employees (0.6% of quarter ago base) with attrition running at 30% levels. While management plans to make 4,000 campus offers in FY12 and expects attrition to start reducing post the wage hikes announced this quarter, we believe that supply pressure remains a key investor concern. Non-BT revenues grew by 0.5% ex of last quarter SI revenues; however, declined ~29% including the same. As per management, BT revenues remained flat at ~£71m.
- **Cash levels and Hedges** – Company has cash of Rs5.2bn and debt of Rs13.5bn. Higher cash level was primarily due to lower DSO from a strong collection during last 2 weeks of Dec'10. As of Dec'10, there are hedges worth GBP270m (at US\$1.71/GBP) and US\$780m (at Rs48.1/USD).
- **Key deal wins:** (1) Chosen by a leading North America telco for testing of customer certified devices, (2) selected as the preferred services partner by a leading mobile operator in the Middle East, (3) engaged in transition process of BPO operations for a leading Indian TSP across 6 countries in Africa
- **Other highlights** – Sequentially, North America and Europe revenues grew by 3-5%, RoW revenues decreased by ~64% (because of one-off large SI deal last quarter); Top10 clients' revenues declined ~21% qoq while non-top10 declined by ~3% qoq. Added 2 new clients and >US\$20m clients decreased by 1 to 6.

Valuations and View: Decent quarterly results – missed revenue expectation though net profits were better – largely maintain our FY11-13E EPS. We value TechM organic business at Rs650/ share (based on 14x FY12E EPS) and add value of Satyam stake Rs190/ share (based on 25% hold-co discount to CMP of Satyam shares) giving a 12 month target of Rs840 (from Rs930 earlier – largely due to lower Satyam value). We go-back to 25% hold-co discount as TechM-Mahindra Satyam merger visibility has faded. Adjusted for the Mahindra Satyam's value, TechM trades at ~13x FY11E and ~11x FY12E recurring EPS. We maintain Outperformer rating on TechM stock.

IDFC Securities Ltd.

Naman Chambers, C-32, G- Block, Bandra-Kurla Complex, Bandra (East), Mumbai 400 051 Tel: 91-22-6622 2600 Fax: 91-22-6622 2501
SEBI Registration Nos.: INB23 12914 37, INF23 12914 37, INB01 12914 33, INF01 12914 33

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Q3FY11 results – excluding Mahindra Satyam contribution

Rs m	Q3FY10	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
Revenue (US\$ m)	253.8	328.2	268.9	(18.1)	5.9
Revenue	11,873	15,339	12,111	(21.0)	2.0
Cost of revenue	7,514	10,701	7,882	(26.3)	4.9
Gross profit	4,359	4,638	4,229	(8.8)	(3.0)
Gross margin (%)	36.7	30.2	34.9	468bp	(179bp)
Operating expenses	1,552	1,820	1,731	(4.9)	11.5
EBITDA	2,807	2,818	2,498	(11.4)	(11.0)
EBITDA margin (%)	23.6	18.4	20.6	225bp	(302bp)
Dep. & amortization	331	347	347	0.0	4.8
EBIT	2,476	2,471	2,151	(13.0)	(13.1)
EBIT margin (%)	20.9	16.1	17.8	165bp	(309bp)
Profit before tax	2,023	2,284	2,420	6.0	19.6
Income tax expense	285	418	359	(14.1)	26.0
Income from operations	1,738	1,866	2,061	10.5	18.6
Minority interest	(1)	(7)	6	n.a.	n.a.
Reported net profit	1,739	1,873	2,055	9.7	18.2
Reported EPS - basic (Rs)	14.18	12.17	20.65	69.7	45.6
Reported EPS - fully diluted (Rs)	13.26	11.57	19.73	70.5	48.8

Source: Company

Other key result tables

Key HR and Execution metrics

	3Q10	4Q10	1Q11	2Q11	3Q11	QoQ (%)	YoY (%)
Total headcount	30,404	33,524	35,267	34,007	34,208	0.6	12.5
- IT delivery	22,199	24,405	25,711	24,449	24,673	0.9	11.1
- net add	2,161	2,206	1,306	(1,262)	224	(117.7)	(89.6)
- BPO delivery	7,199	8,067	8,426	8,489	8,489	0.0	17.9
- net add	1,749	868	359	63	0	n.a.	n.a.
- Sales & Support	1,006	1,052	1,130	1,069	1,046	(2.2)	4.0
Utilization	73.0	73.0	69.0	75.0	76.0	100bp	300bp

Source: Company

Revenue Mix

(%)	3Q10	4Q10	1Q11	2Q11	3Q11	QoQ	YoY
Geography wise							
North America	30.0	30.0	32.0	25.0	32.0	4.9	13.0
Europe	56.0	57.0	55.0	43.0	54.0	2.9	2.2
Rest of World	14.0	13.0	13.0	32.0	14.0	(64.2)	5.9
Segment wise							
- IT services - TSP	86.4	86.1	87.3	89.3	87.3	(19.9)	7.0
- IT services - TEM	4.9	5.9	5.1	4.5	4.8	(11.6)	4.5
- BPO services	5.3	5.8	5.9	5.0	6.3	3.2	27.0
- Others	3.4	2.2	1.7	1.3	1.6	5.0	(50.5)
Delivery location wise							
Onsite	39.0	38.0	37.0	30.0	37.0	1.0	0.5
Offshore	61.0	62.0	63.0	70.0	63.0	(26.3)	9.4

Source: Company

Client metrics

	3Q10	4Q10	1Q11	2Q11	3Q11	QoQ	YoY
No. of active clients	110	113	117	124	126	2	16
Client relationship size							
> US\$ 1m	49	48	52	52	53	1	4
> US\$ 2m	30	33	36	39	39	0	9
> US\$ 5m	18	18	20	21	20	(1)	2
> US\$ 10m	9	11	13	14	15	1	6
> US\$ 15m	8	8	8	8	8	0	0
> US\$ 20m	5	5	6	7	6	(1)	1
> US\$ 25m	4	4	4	5	5	0	1
> US\$ 50m	2	2	2	3	3	0	1
Client concentration (%)							
Top client	46.0	46.0	45.0	35.0	44.0	3.0	1.3
Top 5	75.0	72.0	74.0	77.0	72.0	(23.4)	1.7
Top 10	82.0	81.0	82.0	84.0	81.0	(21.0)	4.7

Source: Company

IDFC Securities

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6622 2600
Pathik Gandotra	Head of Research; Financials, Strategy	pathik.gandotra@idfc.com	91-22-662 22525
Shirish Rane	Construction, Power, Cement	shirish.rane@idfc.com	91-22-662 22575
Nikhil Vora	FMCG, Media, Mid Caps, Education, Exchanges	nikhil.vora@idfc.com	91-22-662 22567
Nitin Agarwal	Pharmaceuticals, Real Estate	nitin.agarwal@idfc.com	91-22-662 22568
Chirag Shah	Metals & Mining, Telecom, Pipes, Textiles	chirag.shah@idfc.com	91-22-662 22564
Bhoomika Nair	Logistics, Engineering	bhoomika.nair@idfc.com	91-22-662 22561
Hitesh Shah, CFA	IT Services	hitesh.shah@idfc.com	91-22-662 22565
Bhushan Gajaria	Automobiles, Auto ancillaries, Retailing	bhushan.gajaria@idfc.com	91-22-662 22562
Sallil Desai	Construction, Power, Cement	sallil.desai@idfc.com	91-22-662 22573
Ashish Shah	Construction, Power, Cement	ashish.shah@idfc.com	91-22-662 22560
Probal Sen	Oil & Gas	probal.sen@idfc.com	91-22-662 22569
Chinmaya Garg	Financials	chinmaya.garg@idfc.com	91-22-662 22563
Abhishek Gupta	Telecom, Metals & Mining	abhishek.gupta@idfc.com	91-22-662 22661
Ritesh Shah	Pharmaceuticals	ritesh.shah@idfc.com	91-22-662 22571
Saumil Mehta	Metals, Pipes	saumil.mehta@idfc.com	91-22-662 22578
Vineet Chandak	Real Estate	vineet.chandak@idfc.com	91-22-662 22579
Kavita Kejriwal	Strategy, Financials	kavita.kejriwal@idfc.com	91-22-662 22558
Anamika Sharma	IT Services	anamika.sharma@idfc.com	91-22-662 22680
Varun Kejriwal	FMCG, Mid Caps	varun.kejriwal@idfc.com	91-22-662 22685
Swati Nangalia	Media, Education, Exchanges, Midcaps	swati.nangalia@idfc.com	91-22-662 22576
Nikhil Salvi	Construction, Power, Cement	nikhil.salvi@idfc.com	91-22-662 22566
Dharmendra Sahu	Database Analyst	dharmendra.sahu@idfc.com	91-22-662 22580
Rupesh Sonawale	Database Analyst	rupesh.sonawale@idfc.com	91-22-662 22572
Dharmesh R Bhatt, CMT	Technical Analyst	dharmesh.bhatt@idfc.com	91-22-662 22534
Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6622 2500
Naishadh Paleja	MD, CEO	naishadh.paleja@idfc.com	91-22-6622 2522
Paresh Shah	MD, Dealing	paresh.shah@idfc.com	91-22-6622 2508
Vishal Purohit	MD, Sales	vishal.purohit@idfc.com	91-22-6622 2533
Nikhil Gholani	MD, Sales	nikhil.gholani@idfc.com	91-22-6622 2529
Sanjay Panicker	Director, Sales	sanjay.panicker@idfc.com	91-22-6622 2530
Rajesh Makharia	Director, Sales	rajesh.makharia@idfc.com	91-22-6622 2528
Nirbhay Singh	SVP, Sales	nirbhay.singh@idfc.com	91-22-6622 2595
Suchit Sehgal	AVP, Sales	suchit.sehgal@idfc.com	91-22-6622 2532
Pawan Sharma	MD, Derivatives	pawan.sharma@idfc.com	91-22-6622 2539
Jignesh Shah	AVP, Derivatives	jignesh.shah@idfc.com	91-22-6622 2536
Sunil Pandit	Director, Sales trading	sunil.pandit@idfc.com	91-22-6622 2524
Mukesh Chaturvedi	SVP, Sales trading	mukesh.chaturvedi@idfc.com	91-22-6622 2512
Viren Sompura	SVP, Sales trading	viren.sompura@idfc.com	91-22-6622 2527
Rajasheshkar Hiremath	VP, Sales trading	rajasheshkar.hiremath@idfc.com	91-22-6622 2516

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