

8 May 2007

BUY

Price **Rs 1550** Target Price **Rs1800**

Sensex - 13,765

Price Performance

(%)	1M	3M	6M	12M
Absolute	18	(9)	64	NA
Rel. to Sensex	10	(5)	58	NA

Source: Bloomberg

Stock Details

Sector	IT Services
Reuters	TEML.BO
Bloomberg	TECHM@IN
Equity Capital (Rs mn)	1210
Mkt. Cap (Rs bn)	187.6
Face Value (Rs)	10
52 Week H/L (Rs)	2050/521
Daily Avg Volume (No of shares)	1004017
Daily Avg Turnover (US\$ mn)	15.5

Shareholding Pattern (%)

Promoters	83.7
FII's /NRI's	1.7
Institutions	1.7
Private Corp	1.4
Public	11.5

Source: BSE, 31.03.2007

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Tech Mahindra

Impressive growth

Results
Update

Tech Mahindra posted revenue growth of 13.6% qoq to Rs 8.75 bn on the back of strong growth in BT account (17.1% qoq) and Top 2-5 clients, above our expectations of Rs 8.4 bn. EBITDA margins declined by 150 bps qoq to 25.4% due to higher SG and A expenses. EBITDA jumped by 7% to Rs 2.22 bn, in line with our expectations. Interest costs increased to Rs 49 mn on account of the debt of US\$ 95 mn taken for the US\$ 115 mn upfront payment to BT. However, due to higher foreign exchange gain, PAT before exceptional items grew by 17.6% to Rs 1.96 bn, above our expectations of Rs 1.8 bn. The company decided to take write off of full amount of upfront payment made to BT GS to the tune of Rs 5.25 bn in a single quarter, resulting in a loss of Rs 3.29 bn for the quarter.

Stunning FY07 results

Revenues were up 136% to Rs 29.3 bn backed by 121% growth in BT revenues. BT contributes 64% of revenues for FY07. BT is currently US\$ 400+ mn account for Tech Mahindra. EBITDA was up 175% to Rs 7.37 bn, while PAT (before exceptional items) was up 160% to Rs 6.12 bn. Since the company decided to take write off of full amount of upfront payment made to BT GS to the tune of Rs 5.25 bn during Q4FY07, PAT stood at Rs 876 mn. EPS on fully diluted equity of 132 mn works out to Rs 46.5.

Key Highlights for FY07

- Added 21 new clients, taking total clients to 83.
- 2 clients contributing > US\$ 50 mn. 29 clients contributing > US\$ 1 mn.
- BT contributions still high at 64% of the revenues. Similarly, Europe contributions still high at 73% of the revenues.
- Added 9300 employees (i.e up by 88% yoy), taking total employees to 19,749.
- Utilisations low at 67%, Attrition at 19% (non-BPO).
- Forex cover of US\$ 270 mn as on 31st March, 2007.

Robust growth outlook

The management has indicated that US\$ 1 bn BT deal may remain in the investment mode for the next 2 quarters and would have significant ramp-up in H2FY08 onwards. BPO and IMS would be new areas of growth. Top 10 clients mining would be strong. Also, newer clients additions would continue to remain healthy. The company intends to hire 7000+ for FY08, out of which 4000 would be freshers. Capex over next two years is expected to be in the range of US\$ 100 mn. We believe established client relationships and rapid ramp up of newer clients would fuel the growth of the company.

Margin levers

We believe the company has multiple margin levers in the form of (a) increasing utilizations, which currently is at 67% (b) increased offshoring, which currently stood at 61% for FY07 (c) more hiring of freshers and (d) S G and A leverage (50-100 bps improvement expected). We believe above margin levers would provide substantial cushion against future margin erosion. We expect EBITDA margins to be in the range of 24-25% for next 2 years.

Risks and concerns

Single vertical presence and high client concentrations remains key risk for the company. Wage inflation in the range of 15%+ and attritions at around 20% are the other areas of concerns for Tech Mahindra.

Valuations

We expect 43% CAGR in revenues and profits over FY07-09E. We expect FDEPS of Rs 66.9 and 94.6 for FY08E and FY09E respectively on a fully diluted equity base of 132 mn shares. At CMP of Rs 1,550, the stock is available at 23.2x FY08E and 16.4x FY09E. With leadership position in high growth telecom vertical, sustainable margins, healthy large deal pipeline and triggers from acquisitions, we believe Tech Mahindra offers an attractive investment opportunity. We maintain BUY with a revised one year price target of Rs 1,800 (19x FY09E EPS of Rs 94.6).

Q4FY07 Results Analysis

Particulars (Rs mn)	Q3FY07	Q4FY07
Revenues	7698	8745
QoQ (%)	10.3	13.6
Cost of Services	4528	5135
Gross Profit	3170	3610
Gross margins	41.2	41.3
SG&A	1098	1392
EBITDA	2072	2218
QoQ (%)	17.1	7.0
EBITDA (%)	26.9	25.4
Interest	12	49
Depreciation	137	158
Other Income	-32	154
PBT	1891	2165
Taxes	224	204
PAT	1667	1961
QoQ (%)	16.5	17.6
PAT (%)	21.7	22.4
Basic EPS	14.6	16.3
Diluted EPS	12.8	14.9

Source: Company

Key Financials

Consolidated Income Statement

Mar end (Rs mn)	FY06	FY07	FY08E	FY09E
Revenues	12,427	29,290	44,503	60,265
Y-o-Y growth	31.4%	135.7%	51.9%	35.4%
Cost of services	7,396	17,536	27,034	36,651
S, G and A expenses	2,351	4,389	6,538	8,656
EBITDA	2,679	7,366	10,931	14,958
Y-o-Y growth	98.4%	174.9%	48.4%	36.8%
EBITDA (%)	21.6%	25.1%	24.6%	24.8%
Depreciation	397	516	801	1,085
Other income	340	76	150	270
Interest		61	196	100
PBT	2,621	6,866	10,084	14,043
Taxes	268	740	1,160	1,461
PAT	2,354	6,125	8,825	12,483
Y-o-Y growth	129.9%	160.2%	44.1%	41.5%
PAT (%)	18.4%	20.9%	19.8%	20.6%
Basic EPS	22.6	52.9	72.9	103.2
Diluted EPS	18.3	46.5	66.9	94.6
Y-o-Y growth	104.2%	153.5%	43.9%	41.5%

Source: Company, Emkay Research