

Tech Mahindra

ADD

HGS acquisition to boost revenue visibility and EPS

CMP: Rs821

Target Price: Rs840

- **TECHM acquired HGS for US\$87.1mn, which has US\$160mn in revenues, US\$20mn in net cash, and mid-teen EBITDA margins**
- **Deal includes a US\$845mn business commitment and TECHM is likely to fund it using combination of debt and internal accruals**
- **Estimate incremental EPS accretion of Rs3 in FY13 and Rs5 in FY14. Raise target to Rs840. Maintain Add.**

Tech Mahindra (TECHM) acquired Hutchinson global services (HGS) in a US\$87.1mn deal. HGS has 11,500 employees across Mumbai and Pune and provides BPO services (mostly voice-based lifecycle CRM) to UK, Ireland and Australia-based clients.

EPS accretive deal for TECHM: HGS has annual revenues of US\$160mn with EBITDA margins in “mid teens”. Deal offers revenue and margin visibility as it includes a business commitment worth US\$845mn over 5 years with margin stability at current levels. We estimate incremental EPS of Rs3 for FY13 and Rs5 for FY14 assuming 2/3rd funding of the deal value through new debt.

Deal structure in line with other “client-vendor” deals in India: We believe TECHM’s deal with HGS is the latest in the line of deals, in which clients are selling their India captives to service providers and the deal structure is quite similar to previous ones. Earlier examples are UBS’ and Cognizant’s US\$75mn deal including US\$442mn business commitments over 5 years, and Citigroup’s and TCS’ US\$505mn deal, which includes ~US\$2.5bn business commitment over 9.5 years.

Deal boosts TECHM’s capability in the managed services space: We believe HGS’ deal fits TECHM’s effort to drive growth through wider services across BPO and managed services in a cost-savings-focused demand environment.

Valuation and outlook: The stock trades at 13x FY13 and 10.7x FY14 on our core earnings (excluding Satyam). We raise FY13/14 core earnings estimates by 4.8/7.2% to factor in HGS’ acquisition. We raise target to Rs840 (from Rs790) assigning (unchanged) P/E of 12x to our average FY13-14 core net earnings. Maintain ADD.

KEY FINANCIALS	(Rs mn)			
Y/E 31 March	2011	2012	2013E	2014E
Revenue	51,402	54,897	68,974	80,257
EBITDA	10,033	9,194	13,655	15,623
EBITDA margin (%)	19.5	16.7	19.8	19.5
PAT	7,458	6,098	8,056	9,794
FDEPS (Rs)	58.4	47.8	63.1	76.7
% growth	3.6	(18.2)	32.1	21.6
P/E (x)	14.1	17.2	13.0	10.7
RoCE avg (%)	18.7	14.4	18.4	18.5

Source: Company, BRICS Research

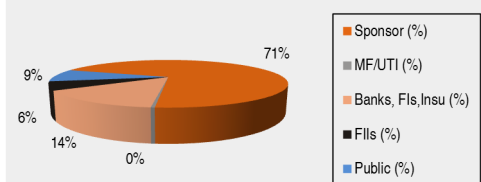
- Corporate development
- Earnings estimate change
- Target price change
- Rating change

KEY DATA

Bloomberg	TECHM IN
Reuters	TEML.BO
52-wk H/L (Rs)	887.7/524.2
6-m avg trd value	US\$5.8mn
Market cap	Rs104.8bn/US\$1.9bn
Shares o/s	127.6mn
Face value	Rs10

Source: Bloomberg

SHAREHOLDING (%)



Source: Ace equity

PRICE PERFORMANCE



Source: Bloomberg

Sushil Sharma
+91 22 66360073
sushil.sharma@bricssecurities.com

Manav Patel
+91 22 66360072
manav.patel@bricssecurities.com

Exhibit 1: Estimate changes

Particulars	New		Old		%change	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Sales	68,974	80,257	63,877	71,193	8.0	12.7
EBITDA	13,655	15,623	12,891	14,263	5.9	9.5
EBITDA Margin(%)	19.8	19.5	20.2	20.0		
PAT	8,056	9,794	7,688	9,138	4.8	7.2
PAT Margin(%)	11.7	12.2	12.0	12.8		
FDEPS(Rs)	63.1	76.8	60.3	71.6	4.8	7.2
PAT (Post exceptional)	12,759	14,997	12,391	14,341	3.0	4.6
PAT Margin(%)	18.5	18.7	19.4	20.1		
FDEPS(Rs)	100.0	117.6	97.6	112.9	2.5	4.1

Source: BRICS Research

Financial summary

Income statement					Balance sheet				
(Rs mn)					(Rs mn)				
Y/E 31 March	2011	2012	2013E	2014E	Y/E 31 March	2011	2012	2013E	2014E
Revenue	51,402	54,897	68,974	80,257	Net fixed assets	7,275		12,430	14,666
Revenue growth (%)	11.1	6.8	25.6	16.4	Investments	29,080	35,857	41,848	44,778
Operating exp	41,369	45,703	55,319	64,634	Current assets	23,455	20,456	24,730	30,661
EBITDA	10,033	9,194	13,655	15,623	Inventories	6	21	21	21
EBITDA margin (%)	19.5	16.7	19.8	19.5	Sundry debtors	12,468	13,172	16,174	18,495
Depreciation	1,435	1,614	1,886	2,247	Cash & bank balance	2,666	2,418	2,786	5,738
EBIT	8,598	7,580	11,769	13,376	Loans & advances	8,315	4,845	5,749	6,407
MTM profit / (loss)	—	—	—	—	Other current assets	—	—	—	—
Other income	1,174	982	(323)	408	Total assets	60,448	69,191	79,388	90,385
Interest paid	(999)	(1,026)	(813)	(823)	Net worth	32,254	39,233	47,782	57,800
PBT	8,773	7,536	10,632	12,961	Share capital	1,260	1,275	1,275	1,275
Tax	1,316	1,438	2,576	3,167	Reserves & surplus	30,994	37,959	46,507	56,526
PAT	7,458	6,098	8,056	9,794	Minority interest	159	—	—	—
Minority interest	(13)	(22)	(28)	(26)	Total debt	12,227	12,181	14,731	13,378
EO income	—	—	—	—	Secured loans	12,227	12,181	14,731	13,378
APAT	7,445	6,076	8,028	9,768	Unsecured loans	—	—	—	—
PAT growth (%)	3.6	(18.2)	32.1	21.6	Current liabilities & prov	8,711	9,643	9,851	10,812
Shares o/s (mn)	128	128	128	128	Current liabilities	5,631	6,042	5,899	6,149
Fully diluted o/s shrs (mn)	128	128	128	128	Provisions	3,080	3,600	3,952	4,663
FDEPS (Rs) recurring	58.4	47.8	63.1	76.7	Net deferred tax liab	—	—	—	—
					Total liabilities	60,448	69,191	79,388	90,385
Cash flow statement					Key ratios				
(Rs mn)					Y/E 31 March				
Y/E 31 March	2011	2012	2013E	2014E	Y/E 31 March	2011	2012	2013E	2014E
PBT	8,773	7,536	10,632	12,961	Valuation ratios				
Depreciation	1,435	1,614	1,744	1,993	PE (x)	14.1	17.2	13.0	10.7
Amortisation	—	—	—	—	CEPS (Rs)	69.7	60.4	77.9	94.4
Interest paid	999	1,026	666	566	PCE (x)	11.8	13.6	10.5	8.7
Tax paid	—	—	—	—	BVPS (Rs)	253	307	374	453
Chg in working capital	(2,424)	3,749	(3,223)	(1,669)	Price/Book (x)	3.2	2.7	2.2	1.8
Int/div in other income	—	—	—	—	EV/EBITDA (x)	11.4	12.5	8.5	7.2
Other operations	(2,060)	(982)	374	(320)	EV/Revenue (x)	2.2	2.1	1.7	1.4
CF from operations (a)	4,636	11,505	7,774	10,646	Dividend yield (%)	—	—	—	—
Capital expenditure	(1,534)	(3,295)	(3,298)	(2,846)	Cash flow yield (%)	3.2	1.4	(1.4)	4.6
Chg in investments	(226)	(6,777)	(5,991)	(2,929)	Performance ratios				
Other investing act	426	—	—	—	Raw material to sales (%)	66.2	67.0	64.6	65.7
Int/div in other income	—	—	—	—	SGA to sales (%)	14.3	16.3	15.6	14.8
CF from investments (b)	(1,334)	(10,072)	(9,290)	(5,775)	Effective tax rate (%)	15.0	19.1	24.2	24.4
Free cash flow (a+b)	3,302	1,434	(1,515)	4,871	PAT margin (%)	14.5	11.1	11.7	12.2
Equity raised/(repaid)	260	—	—	—	DPS (Rs)	—	—	—	—
Debt raised/(repaid)	(1,560)	(46)	2,550	(1,353)	Dividend payout ratio (%)	—	—	—	—
Interest paid	(1,059)	(1,026)	(666)	(566)	Return ratios				
Dividend (incl tax)	(508)	—	—	—	RoE avg (%)	24.9	17.0	18.5	18.5
Other fin activities	—	—	—	—	RoCE avg (%)	18.7	14.4	18.4	18.5
CF from financing (c)	(2,867)	(1,072)	1,884	(1,919)	Fixed asset turnover (x)	7.1	5.7	5.7	5.9
Net chg in cash (a+b+c)	479	344	368	2,952	Working capital ratios				
Opening balance	2,187	2,666	3,010	3,379	Inventory (days)	—	—	—	—
Closing balance	2,666	3,010	3,379	6,330	Payable (days)	50	63	58	57
					Receivable (days)	89	88	86	84
					Working capital (days)	39	25	28	27
					Leverage ratios				
					Interest cost (%)	(7.7)	(8.4)	(6.0)	(5.9)
					Net debt/equity (x)	0.3	0.2	0.2	0.1
					Interest coverage (x)	(8.6)	(7.4)	(14.5)	(16.3)

BRICS RECOMMENDATION SCALE

BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and -15%)
SELL:	More than 15% downside

Head Office: Sadhana House, 1st Floor, 570, P. B. Marg, Behind Mahindra Tower,
Worli, Mumbai - 400 018. Tel: (91-22) 6636 0000

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