

February 06, 2013

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Rating	<b>Accumulate</b>
Price	Rs980
Target Price	Rs1,100
Implied Upside	12.2%
Sensex	19,640
Nifty	5,959

(Prices as on February 06, 2013)

### Trading data

Market Cap. (Rs bn)	120.0
Shares o/s (m)	122.5
3M Avg. Daily value (Rs m)	709.6

### Major shareholders

Promoters	47.51%
Foreign	22.19%
Domestic Inst.	20.08%
Public & Other	10.22%

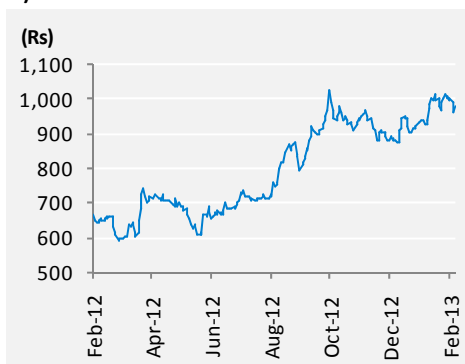
### Stock Performance

(%)	1M	6M	12M
Absolute	3.9	30.5	52.2
Relative	4.7	17.7	41.3

### How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2014	112.8	95.8	17.8
2015	123.8	102.7	20.5

Price Performance (RIC: TEML.BO, BB: TECHM IN)



Tech Mahindra (TECHM) reported revenue/margin ahead of PLe/Consensus expectation. Moreover, forex gain has pushed the bottom-line performance despite lower contribution from Satyam. Revenue growth has been contributed by non-BT, Comviva and HGS. We reiterate our 'Accumulate' rating, with a TP of **Rs1,100**.

- **Revenue touch ahead, margin strong:** TECHM's Q3FY13 results were ahead of our expectation. The company reported revenue of Rs17.91bn (PLe: Rs17.71bn, Cons: Rs17.59bn), a growth of 9.8% QoQ (10% QoQ in USD terms). Operating margins improved by 31bps to 21% (PLe: 19.7%, Cons: 19.4%), despite integration with Comviva and HGS. Excluding Satyam, PAT grew by 40% to Rs.2.48bn (PLe: 1.76bn), due to forex gain of Rs301m (Q2FY13 loss of Rs640m). EPS' contribution, including Satyam's, declined by 6.9% QoQ to Rs20.74 (PLe: Rs23.34, Cons: Rs22.47).
- **Deal restructuring is throwing good opportunity:** The management continues to see stronger deal pipeline for the large deals. As telecom service providers 'need to do more for less', the opportunity for a player like TechM emerges. The company sees improved traction in Managed Service deals also. There are 5-6 large deals in the pipeline of which 2-3 are in advance stages.
- **Margin levers getting stretched:** Despite full integration of HGS and Comviva, TechM managed to improve margin by 31bps. According to the management, utilization level is peaking out along with currency headwinds. The management sees tailwind from productivity improvement, weeding out of less profitable projects and pyramid rationalization.
- Revising our estimates for FY13 and FY14 upwards (Exhibit 2).
- **Valuation & Recommendation:** We expect demand environment to be stable with recovery in deal pipeline from telecom service provider and aggressive inorganic strategy to improve the revenue momentum. Moreover, Satyam would provide respite at the bottom-line. We retain our 'Accumulate' rating, with a TP of **Rs1,100**, 10x FY14e earnings estimate.

Key financials (Y/e March)	2012	2013E	2014E	2015E
Revenues (Rs m)	54,897	68,072	74,879	81,619
Growth (%)	6.8	24.0	10.0	9.0
EBITDA (Rs m)	9,194	14,227	14,227	15,099
PAT (Rs m)	10,952	13,009	14,391	15,789
EPS (Rs)	85.9	102.0	112.8	123.8
Growth (%)	68.0	18.8	10.6	9.7
Net DPS (Rs)	4.6	8.2	9.0	9.9

Profitability & Valuation	2012	2013E	2014E	2015E
EBITDA margin (%)	16.7	20.9	19.0	18.5
RoE (%)	29.6	29.3	27.6	26.0
RoCE (%)	25.6	24.1	23.3	22.5
EV / sales (x)	2.4	1.9	1.6	1.4
EV / EBITDA (x)	14.4	9.0	8.6	7.7
PE (x)	11.4	9.6	8.7	7.9
P / BV (x)	3.1	2.6	2.2	1.9
Net dividend yield (%)	0.5	0.8	0.9	1.0

Source: Company Data; PL Research

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**Exhibit 1: Q3FY13 results: Beaten expectation**

Y/e March	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY	Cons (e)	PLe	Variance
Sales (\$ m)	329	299	10.0%	289	14.0%		325	1.4%
Sales	17,911	16,314	9.8%	14,449	24.0%	17,593	17,718	1.1%
EBITDA	3,763	3,377	11.4%	2,343	60.6%	3,373	3,490	7.8%
EBITDA Margin	21.0%	20.7%	31 bps	16.2%	479 bps	19.2%	19.7%	131 bps
PBT	3,297	2,028	62.6%	1,762	87.1%	2,794	2,255	46.2%
Tax	808	251	221.9%	294	174.8%	NA	496	62.8%
Tax Rate	24.5%	12.4%	1213 bps	16.7%	782 bps	NA	22.0%	251 bps
Net Income	2,488	1,777	40.0%	1,468	69.5%		1,759	41.4%
PAT (incl. Satyam)	2,758	2,962	-6.9%	2,760	-0.1%	2,896	3,104	-11.2%
EPS (Incl. Satyam)	20.74	22.27	-6.9%	20.85	-0.5%	22.47	23.34	-11.2%

Source: Company Data, Bloomberg, PL Research

- BT Update – Revenue run-rate continues to see downward pressure:** According to the management, BT is going through restructuring. Post-restructuring, there is a likelihood of downward pressure on the current run-rate of BT revenue. The impact is likely to be unfolded over the next few quarters. We expect continuing pressure in BT account.
- Conference call highlights:**
  - Organic revenue growth: 0.1%, Non-BT: 2% QoQ
  - HGS contribution: US\$37m, Comviva: US\$6m (19 days)
  - Deals TCV: ~US\$100m
  - UK deal already captured in margin performance, European deal will be captured in Q4FY13, and Others in Q1FY14
  - Tax Rate: 23-25%
  - AT&T revenue is flattish
  - OCI: US\$80m
  - Interest rate on debt from Satyam is 11%
  - Fresher offer for FY14 would be finalized in Q4FY13

**Exhibit 2: Revising estimates for FY13 and FY14 upwards**

	New		Old		Revision	
	FY13	FY14	FY13	FY14	FY13	FY14
Sales	68,072	74,879	67,606	74,366	0.7%	0.7%
EBITDA Margin	20.9%	19.0%	20.3%	19.0%	60 bps	0 bps
Satyam's contribution	4,309	5,119	5,375	5,119	-19.8%	0.0%
PAT (after Satyam)	13,009	14,391	12,603	14,307	3.2%	0.6%
EPS	99.73	110.32	96.62	109.68	3.2%	0.6%
Target Price	1100		1100		0%	

Source: PL Research

**Exhibit 3: Onsite upswing is largely due to inorganic contribution**

Delivery Split (\$ m)	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY
Onsite	132	117	12.9%	113	16.9%
Offshore	197	182	8.2%	176	12.1%
<b>% of Total</b>					
Onsite	40.0%	39.0%	100 bps	39.0%	100 bps
Offshore	60.0%	61.0%	-100 bps	61.0%	-100 bps

Source: Company Data, PL Research

**Exhibit 4: Stable outlook for North America, ROW uptick is due to HGS**

Geo Spread (\$ m)	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY
North America	102	100	2.1%	95	7.1%
Europe	151	138	9.3%	130	16.5%
ROW	76	61	24.7%	64	19.1%
<b>Total</b>	<b>329</b>	<b>299</b>	<b>10.0%</b>	<b>289</b>	<b>14.0%</b>
<b>% of Total</b>					
North America	31.0%	33.4%	-240 bps	33.0%	-200 bps
Europe	46.0%	46.3%	-30 bps	45.0%	100 bps
ROW	23.0%	20.3%	270 bps	22.0%	100 bps
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0 bps</b>	<b>100.0%</b>	<b>0 bps</b>

Source: Company Data, PL Research

**Exhibit 5: Number of client increased because of inorganic contribution**

Customer Size Distribution	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY
≥ \$1m clients	58	57	1.8%	63	-7.9%
≥ \$2m clients	39	41	-4.9%	41	-4.9%
≥ \$5m clients	25	27	-7.4%	28	-10.7%
≥ \$10m clients	13	12	8.3%	15	-13.3%
≥ \$15m clients	7	7	0.0%	9	-22.2%
≥ \$20m clients	7	7	0.0%	7	0.0%
≥ \$25m clients	6	6	0.0%	4	50.0%
≥ \$50m clients	4	3	33.3%	2	100.0%
Number Of active clients	140	126	11.1%	130	7.7%

Source: Company Data, PL Research

**Exhibit 6: Non-BT account witnessed healthy growth of 2% QoQ**

Client Concentration (\$ m)	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY
Top Client	95	99	-3.3%	101	-5.6%
Top 2-5 Clients	148	114	30.3%	92	60.3%
Top 5 Clients	243	212	14.7%	193	25.9%
Top 6-10 Clients	26	30	-12.0%	29	-8.8%
Top 10 Clients	270	242	11.4%	222	21.4%
Non Top 10 Clients	59	57	4.2%	66	-10.8%
<b>% of Total</b>					
Top Client	29.0%	33.0%	-400 bps	35.0%	-600 bps
Top 5 Clients	74.0%	71.0%	300 bps	67.0%	700 bps
Top 10 Clients	82.0%	81.0%	100 bps	77.0%	500 bps
Non Top 10 Clients	18.0%	19.0%	-100 bps	23.0%	-500 bps

Source: Company Data, PL Research

**Exhibit 7: Management indicates limited room for utilization improvement**

People Management	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY
Software Professional	25,009	24,224	3.2%	25,218	-0.8%
BPO Professionals	22,565	25,003	-9.8%	16,419	37.4%
Sales & Support	1,485	1,252	18.6%	1,109	33.9%
Total Employees	49,059	50,479	-2.8%	42,746	14.8%
IT Attrition	18.0%	16.0%	200 bps	19.0%	-100 bps
IT Utilization(excluding trainees)	76.0%	77.0%	-100 bps	75.0%	100 bps
IT Utilization(including trainees)	76.0%	74.0%	200 bps	73.0%	300 bps

Source: Company Data, PL Research

**Exhibit 8: Employee headcounts decline organically in TSP and BPO**

Segment Revenue (Rs m)	Q3FY13	Q2FY13	QoQ	Q3FY12	YoY
Telecom Service Provider	12,679	12,602	0.6%	11,351	11.7%
Telecom Equipment Manufacturer	1,089	1,019	6.9%	1,061	2.7%
BPO	3,505	2,228	57.3%	1,389	152.4%
Others	638	465	37.1%	648	-1.7%
Other Income	0	0	NA	0	NA
<b>Total</b>	<b>17,911</b>	<b>16,314</b>	<b>9.8%</b>	<b>14,449</b>	<b>24.0%</b>
<b>% of Sales</b>					
Telecom Service Provider	70.8%	77.2%	-646 bps	78.6%	-777 bps
Telecom Equipment Manufacturer	6.1%	6.2%	-16 bps	7.3%	-126 bps
BPO	19.6%	13.7%	591 bps	9.6%	996 bps
Others	3.6%	2.9%	71 bps	4.5%	-93 bps
Other Income	0.0%	0.0%	0 bps	0.0%	0 bps

Source: Company Data, PL Research

**Income Statement (Rs m)**

Y/e March	2012	2013E	2014E	2015E
<b>Net Revenue</b>	<b>54,897</b>	<b>68,072</b>	<b>74,879</b>	<b>81,619</b>
Raw Material Expenses	36,782	42,885	48,073	52,399
Gross Profit	18,115	25,187	26,807	29,219
Employee Cost	—	—	—	—
Other Expenses	8,921	10,960	12,580	14,120
<b>EBITDA</b>	<b>9,194</b>	<b>14,227</b>	<b>14,227</b>	<b>15,099</b>
Depr. & Amortization	1,614	1,942	2,088	2,199
Net Interest	1,413	927	927	927
Other Income	1,368	(345)	673	722
<b>Profit before Tax</b>	<b>7,535</b>	<b>11,013</b>	<b>11,886</b>	<b>12,696</b>
Total Tax	1,438	2,313	2,615	2,666
<b>Profit after Tax</b>	<b>6,097</b>	<b>8,701</b>	<b>9,271</b>	<b>10,030</b>
Ex-Od items / Min. Int.	6,283	4,309	5,119	5,759
<b>Adj. PAT</b>	<b>10,952</b>	<b>13,009</b>	<b>14,391</b>	<b>15,789</b>
<b>Avg. Shares O/S (m)</b>	<b>127.5</b>	<b>127.5</b>	<b>127.5</b>	<b>127.5</b>
<b>EPS (Rs.)</b>	<b>85.9</b>	<b>102.0</b>	<b>112.8</b>	<b>123.8</b>

**Cash Flow Abstract (Rs m)**

Y/e March	2012	2013E	2014E	2015E
C/F from Operations	7,117	8,354	8,984	11,125
C/F from Investing	(4,204)	(2,383)	(2,995)	(3,265)
C/F from Financing	(3,161)	(1,041)	(1,151)	(1,263)
Inc. / Dec. in Cash	(248)	4,931	4,837	6,597
Opening Cash	2,666	2,418	7,348	12,185
Closing Cash	2,418	7,348	12,185	18,783
FCFF	15,567	10,280	11,108	13,619
FCFE	13,635	10,280	11,108	13,619

**Key Financial Metrics**

Y/e March	2012	2013E	2014E	2015E
<b>Growth</b>				
Revenue (%)	6.8	24.0	10.0	9.0
EBITDA (%)	(8.4)	54.7	—	6.1
PAT (%)	70.0	18.8	10.6	9.7
EPS (%)	68.0	18.8	10.6	9.7
<b>Profitability</b>				
EBITDA Margin (%)	16.7	20.9	19.0	18.5
PAT Margin (%)	19.9	19.1	19.2	19.3
RoCE (%)	25.6	24.1	23.3	22.5
RoE (%)	29.6	29.3	27.6	26.0

**Balance Sheet**

Net Debt : Equity	0.2	0.1	—	(0.1)
Net Wrkng Cap. (days)	—	—	—	—

**Valuation**

PER (x)	11.4	9.6	8.7	7.9
P / B (x)	3.1	2.6	2.2	1.9
EV / EBITDA (x)	14.4	9.0	8.6	7.7
EV / Sales (x)	2.4	1.9	1.6	1.4

**Earnings Quality**

Eff. Tax Rate	19.1	21.0	22.0	21.0
Other Inc / PBT	18.2	(3.1)	5.7	5.7
Eff. Depr. Rate (%)	11.1	11.5	10.5	9.5
FCFE / PAT	124.5	79.0	77.2	86.3

Source: Company Data, PL Research.

**Balance Sheet Abstract (Rs m)**

Y/e March	2012	2013E	2014E	2015E
Shareholder's Funds	40,509	48,169	56,289	65,055
Total Debt	10,295	10,295	10,295	10,295
Other Liabilities	1,886	1,886	1,886	1,886
<b>Total Liabilities</b>	<b>52,690</b>	<b>60,350</b>	<b>68,470</b>	<b>77,236</b>
Net Fixed Assets	8,496	8,937	9,844	10,910
Goodwill	—	—	—	—
Investments	35,876	35,876	35,876	35,876
Net Current Assets	3,936	11,155	18,368	26,069
<i>Cash &amp; Equivalents</i>	<i>2,418</i>	<i>7,348</i>	<i>12,185</i>	<i>18,783</i>
<i>Other Current Assets</i>	<i>18,019</i>	<i>22,541</i>	<i>26,088</i>	<i>28,435</i>
<i>Current Liabilities</i>	<i>16,501</i>	<i>18,734</i>	<i>19,905</i>	<i>21,149</i>
Other Assets	4,382	4,382	4,382	4,382
<b>Total Assets</b>	<b>52,690</b>	<b>60,350</b>	<b>68,470</b>	<b>77,236</b>

**Quarterly Financials (Rs m)**

Y/e March	Q4FY12	Q1FY13	Q2FY13	Q3FY13
<b>Net Revenue</b>	<b>14,190</b>	<b>15,434</b>	<b>16,314</b>	<b>17,911</b>
<b>EBITDA</b>	<b>2,391</b>	<b>3,302</b>	<b>3,377</b>	<b>3,763</b>
<i>% of revenue</i>	<i>16.8</i>	<i>21.4</i>	<i>20.7</i>	<i>21.0</i>
Depr. & Amortization	383	421	481	505
Net Interest	131	240	228	263
Other Income	(211)	(174)	(640)	301
<b>Profit before Tax</b>	<b>1,666</b>	<b>2,467</b>	<b>2,028</b>	<b>3,296</b>
Total Tax	242	585	251	808
<b>Profit after Tax</b>	<b>3,023</b>	<b>3,384</b>	<b>2,962</b>	<b>2,758</b>
<b>Adj. PAT</b>	<b>3,023</b>	<b>3,384</b>	<b>2,962</b>	<b>2,758</b>

**Key Operating Metrics**

Y/e March	2012	2013E	2014E	2015E
Rev from BT	20,411	21,431	20,360	20,563
Rev. from Non BT Clients	34,486	46,641	54,520	61,055
Satyam Contribution	5,569	4,309	5,119	5,759
SW Devp. Cost (% of sales)	67.0	63.0	64.2	64.2
SG&A (% of sales)	16.3	16.1	16.8	17.3
EBITDA Margin Expansion/(Erosion) (bps)	(277)	415	(190)	(50)
Tax Rate (%)	21.9	21.0	22.0	21.0

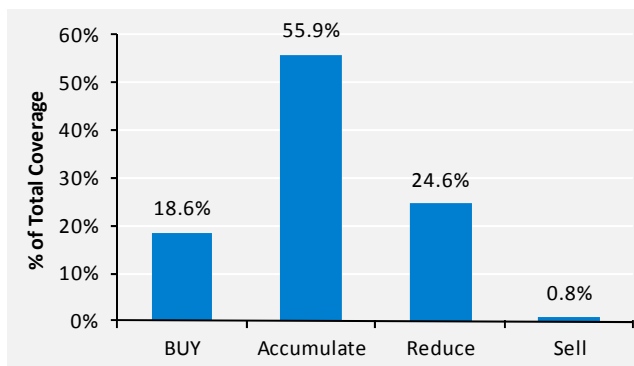
Source: Company Data, PL Research.

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#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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