

## Frost Sullivan Asia Pacific Market Insights

*Frost & Sullivan's commentary on the Asia Pacific ICT industry, addressing opportunities, best practices, and major events*

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# ■ Tech Mahindra moves beyond telecom with strategic Satyam acquisition

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## Background

Tech Mahindra held a 2 day briefing to industry analysts in India where their top management shared the strategic direction of the company, solution footprint and key focus areas. There were several customer presentations that provided a rich perspective into the engagement models deployed by Tech Mahindra. Last week, it was announced that Satyam Computer Services will be rechristened as Mahindra Satyam and merged with Tech Mahindra in an effort to create one single entity. Although the briefing to analysts did not focus specifically on the acquisition, as the deal still has to go through an open offer for a majority stake, the indications are that Tech Mahindra is vigorously preparing a joint strategic plan for the two entities.

## Market Overview

As Communication Service Providers (CSPs) across the world grapple with price based competition, threats from internet players and device manufacturers, deregulation, and market maturation, they need solution providers who can help them attain the agility and ability to roll-out innovative offerings, manage costs through effective network management and ensure a high level of customer experience through a transformative approach. This has led to a lucrative market for solution providers led by large system integrators like Accenture and IBM, OSS-BSS product vendors like Amdocs, Oracle, Comverse and network equipment vendors like NSN and Ericsson.

Tech Mahindra during its journey to cross the \$1bn revenue threshold has become a significant competitor in this space and has entered the active consideration set of CSPs and equipment vendors for major projects. Frost and Sullivan had formally recognized Tech Mahindra for its growth leadership in 2008 and this Analyst briefing marks an interesting juncture.

## Our Strategic Assessment

Based on our interactions with Tech Mahindra's top management, we believe the company is attractively positioned for the future due to the following

- Although FY09 growth of 19% didn't show the sizzling growth rates that Tech Mahindra had charted during 2005-08 where it more than trebled its revenues in two years, we believe that the top management has consolidated the company's business development and execution engine to create a sustainable business model that is well geared and aligned to customer needs. The

reduced revenue contribution from BT to 52% and the resultant expansion of the customer base to multiple geographies and types of operators is an encouraging sign along with the operating profit improvement from 19.8% to 24.9%

- The focus on long term deals has lead to a healthy revenue backfill of over \$ 2bn for the next few years and almost one-third of these are outcome-based. Frost and Sullivan believes that the successful delivery of outcome based deals is a significant achievement since it is a demonstration of several key success factors, management's risk appetite, customer value delivery and creation of an execution engine that can deliver cost efficiencies. Good examples include BT using Tech Mahindra through end to end contracts to wring cost efficiencies for its troubled Global Services unit and Greenfield operators like HCPT and Etisalat outsourcing their IT estate to Tech Mahindra. Given top management's articulation that innovative deals are an important element of their strategy these recent examples show that the company appears to be on the right track here as well. .
- Lastly, Tech Mahindra's acquisition of Satyam at 'not a distress sale price' would be an overall positive. Firstly the price has signaling value to the employees and clients in helping retention and is still a fair value especially if we consider Satyam's reported profitability in the last quarter. We believe this acquisition has the classic signs of '**buy for size now, engineer for scale later**' and the current approach of keeping the entities independent with a centralized management team is a step in the right direction. From a growth perspective, we believe the long-term outlook is intact but this acquisition and eventual integration would be an acid test for the top management of Tech Mahindra in the short term. Moreover the uptick in the stock markets after the deal announcement has raised a new set of challenges in consummating the open offer, any increase in the price paid for the acquisition would stretch the already high debt to equity ratio of Tech Mahindra ( close to 1 , compared to 0.3 for industry peers)

## Key Highlights

### Comprehensive Solution Portfolio

### Rating: Competitive

Tech Mahindra has expanded its solution footprint into 6 pillars viz. Applications Management, Network Services, Security, VAS, Infrastructure Management and BPO. Although, applications still continues to be the largest pillar in terms of revenue contribution, the BPO pillar seems robustly positioned whereas infrastructure management services, network services, VAS and security are showing encouraging traction. We also believe the VAS space and infrastructure management would grow faster as these solutions fill market gaps whereas the other pillars have significant competition. Even in the applications pillar, Tech Mahindra has entered deals that have transformative impact whether it is Greenfield mobile operators or the Andes contract with BT rather than pure application management. The BPO pillar is the most interesting, where Tech Mahindra has converted a late start into an advantage by focusing on the domestic sector first, honing its competencies and then moving global. Last year the BPO pillar achieved a revenue growth that was 1.5 times greater than headcount growth which means that a lot of this growth is based on profitable and productive execution models. With these 6 pillars and the additional focus on TEM (Telecom Equipment Manufacturers) we believe Tech Mahindra has a solid solution footprint and good set of client testimonials to gain further traction. However this solution portfolio only puts them as competitive compared to top-tier system integrators like Accenture and IBM, if Tech Mahindra wants to achieve its ambition of being number one in telecom, there needs to be further improvement in the next few years.

### Strong Customer Engagement

Rating: Competitive +

Customer engagement can be viewed from the customer satisfaction in current projects and the alignment to customer needs to deliver value. The % of Tech Mahindra customers who were delighted with their services increased from 22% in H105 to 86% in H108 and this is a creditable achievement considering the sheer growth in revenues and manpower. The revenue growth through addition of new clients (over 20 added last year) is a derived indicator of the customer engagement value and the testimonials provided by large customers like BT, T-Mobile and AT&T (a unique feature of this Analyst briefing) supplemented it. This coupled with the ability to execute complex outcome based deals (currently less than 15% of revenues), the on-ground traction at several telecom operators and the growth in profitability makes us believe that Tech Mahindra is more than competitive in its customer engagement model.

### Strategic Focus

Rating: Differentiated (past) although Satyam changes this

By crossing the \$1bn revenue threshold as a pure play telecom IT solution provider, Tech Mahindra had affirmed its differentiated focus that combined the execution experience honed through a marquee (albeit arguably captive) customer like BT with the cost efficiency of Indian software engineers and a strong focus on telecom unlike the other IT outsourcers and SIs. Although Mahindra Satyam (the rechristened Satyam) and Tech Mahindra will continue as separate entities, we believe there will be a significant diversion of the core Tech Mahindra management team that was instrumental in driving this growth. In the long term we believe this transition to an eventual merger would make Tech Mahindra lose some of its differentiation as a telecom focused player.

### Key Concerns

#### Winning with emerging market mobile operators

Tech Mahindra still has a BT heritage in its customer wins i.e. fixed line operators in developed markets. We believe that Tech Mahindra is playing catch up with IBM in the emerging markets, where IBM was an early mover with large IT outsourcing deals like Bharti. As emerging markets enter a mature growth phase, a focus on greenfield operators that are likely to have lower market share reduces the addressable opportunity for Tech Mahindra.

#### Diversion due to Satyam acquisition can hamper growth trajectory

The Satyam deal can stretch top management bandwidth and it is largely clear that the top management will be split between the two entities with the announcement of Mr. C.P Gurnani as the CEO of Mahindra Satyam and Mr. Sanjay Kalra's elevation to the CEO of Tech Mahindra. Frost and Sullivan also believes the work on expanding the solution footprint and client base is only half-done in terms of what Tech Mahindra needs to compete more aggressively with some of the more established global system integrators.

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