

## Satyam Computer

STOCK INFO. BLOOMBERG  
BSE Sensex: 7,935 SCS IN  
REUTERS CODE  
S&P CNX: 2,395 SATY.BO

20 October 2005

Buy

Rs588

Previous Recommendation: Buy

Equity Shares (m)	325.9
52-Week Range	606/349
1,6,12 Rel. Perf. (%)	12/29/15
M.Cap. (Rs b)	191.5
M.Cap. (US\$ b)	4.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	34,824	7,654	23.7	38.1	24.8	5.8	26.4	30.3	4.7	18.1
3/06E	48,171	10,238	31.6	33.5	18.6	4.7	28.3	32.9	3.3	12.8
3/07E	61,688	13,049	39.7	25.4	14.8	2.5	28.9	34.2	2.5	9.4

- ✍ Satyam Computer has reported revenue of Rs11.5b for 2QFY06, up 9.1% QoQ, as against our estimate of Rs11.1b on the back of 8.6% QoQ volume growth, aided by marginal increase in billing rates and better offshore utilization.
- ✍ The top client declined 5.6% QoQ, while the top 2-5 clients grew 0.3% QoQ. The top 6-10 clients grew rapidly at 10.8%. Europe continued to dominate revenue growth at 11% QoQ. Banking & Finance grew fastest at 14.4% QoQ.
- ✍ Net employee addition was the highest in the last 12 quarters at 1,977 employees, indicating the robustness of the order pipeline for the second half of the year.
- ✍ EBITDA margin expanded 120bp due to higher offshore employee utilization rates. Reported net profit was up 24.7% at Rs2.37b, buoyed by higher other income at Rs315.5m and lower effective tax rate.
- ✍ Satyam has revised its revenue guidance upwards to Rs47b-47.18b, implying a YoY growth rate of 33.5-34%, as against its earlier guidance of 29-30% growth. It has also revised its earnings guidance upwards to Rs29.12-29.23, implying growth of 30-30.5% from its earlier guidance of 21.5-22.5%. We are upgrading our EPS estimates from Rs29.8 and Rs37.9 in FY06 and FY07 to Rs31.6 and Rs39.7, respectively. At 14.8x FY07E earnings, the stock appears quite attractive given the growth prospects for the company. We maintain **Buy**.

### QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY05				FY06E				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
<b>Revenues</b>	<b>7,799</b>	<b>8,621</b>	<b>9,074</b>	<b>9,715</b>	<b>10,587</b>	<b>11,550</b>	<b>12,517</b>	<b>13,517</b>	<b>35,208</b>	<b>48,171</b>
Q-o-Q Change (%)	8.2	10.5	5.3	7.1	9.0	9.1	8.4	8.0	38.5	36.8
Direct Expenses	4,397	4,955	5,269	5,640	6,391	6,779	6,985	7,389	20,261	27,543
Sales, General & Admin. Expenses	1,460	1,538	1,575	1,692	1,789	2,007	2,249	2,320	6,266	8,366
<b>Operating Profit</b>	<b>1,941</b>	<b>2,128</b>	<b>2,230</b>	<b>2,383</b>	<b>2,407</b>	<b>2,764</b>	<b>3,283</b>	<b>3,808</b>	<b>8,682</b>	<b>12,262</b>
Margins (%)	24.9	24.7	24.6	24.5	22.7	23.9	26.2	28.2	24.7	25.5
Other Income	309	240	22	298	234	316	317	337	868	1,205
Depreciation	271	280	282	300	313	347	413	446	1,133	1,519
Interest	25	2	3	1	5	8	5	5	30	11
<b>PBT bef. Extra-ordinary</b>	<b>1,954</b>	<b>2,085</b>	<b>1,968</b>	<b>2,380</b>	<b>2,323</b>	<b>2,725</b>	<b>3,183</b>	<b>3,694</b>	<b>8,387</b>	<b>11,936</b>
Provision for Tax	301	304	289	283	392	333	446	517	1,176	1,670
Rate (%)	15.4	14.6	14.7	11.9	16.9	12.2	14.0	14.0	14.0	14.0
Share of loss in associate companies	16	13	29	36	29	0	0	0	94	29
<b>PAT bef. Extra-ordinary</b>	<b>1,637</b>	<b>1,769</b>	<b>1,649</b>	<b>2,062</b>	<b>1,902</b>	<b>2,392</b>	<b>2,737</b>	<b>3,177</b>	<b>7,117</b>	<b>10,238</b>
Q-o-Q Change (%)	16.3	8.0	-6.8	25.0	-7.7	25.7	14.4	16.1	31.4	43.8

E: MOSSt Estimates

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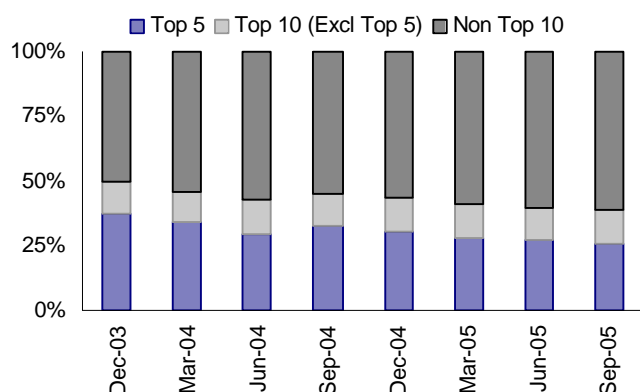
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### Revenue growth buoyed by higher employee utilization and good volumes

Satyam Computer has reported revenue of Rs11.5b for 2QFY06, up 9.1% QoQ, as against our estimate of Rs11.1b on the back of 8.6% QoQ volume growth, aided by marginal increase in billing rates and better offshore utilization. Both the onsite and offshore volumes reported strong QoQ growth at 7.5% and 8.2%, respectively. While blended utilization (including trainees) declined to 77.6% in 2QFY06 from 78.5% in the previous quarter due to a dip in utilization rates in the domestic business (from 98% in 1QFY06 to 95%), offshore utilization rates improved to 79.4% from 76.8%.

REVENUE CONTRIBUTION (%)



Source: Company/Motilal Oswal Securities

### Churn in client mix continues

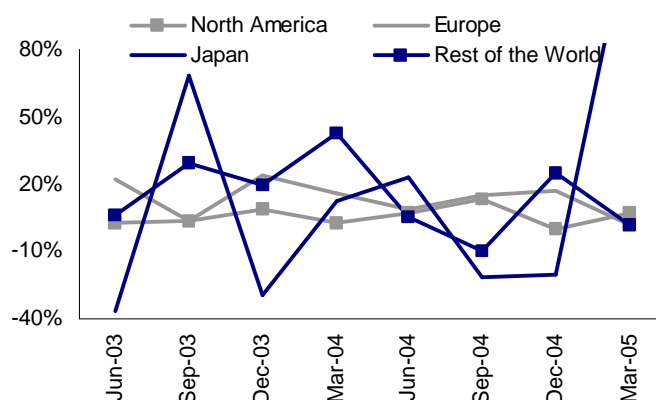
Revenue from the top client (GE) declined 5.6% QoQ, while the top 2-5 clients grew 0.3% QoQ. The top 6-10 clients grew rapidly at 10.8%, followed by the non-top 10 clients, which grew 9.4% QoQ. However, the top 10 clients as a percentage of overall revenue declined to 38.7% during the quarter from 39.4% in 1QFY05, indicating that the non-top 10 clients have grown rapidly during the quarter. The contribution of non-top 10 clients has gone up to 61.3% from 60.6% in the previous quarter.

This is a phenomenon witnessed across the board in the industry, and we believe that non-top 10 clients would continue to ramp up faster, and the client mix would see further churn in the quarters to come.

### BFSI, manufacturing lead growth

Predictably, BFSI, Insurance and Manufacturing performed strongly, growing at 18.7%, 7.3% and 9.5% QoQ, respectively. TIMES grew slower at 6.9% during the quarter after 15%+ growth in the previous two quarters. Retail grew 2.1% QoQ, while Transportation declined 30% QoQ.

REVENUE GROWTH IN REGIONS (%)

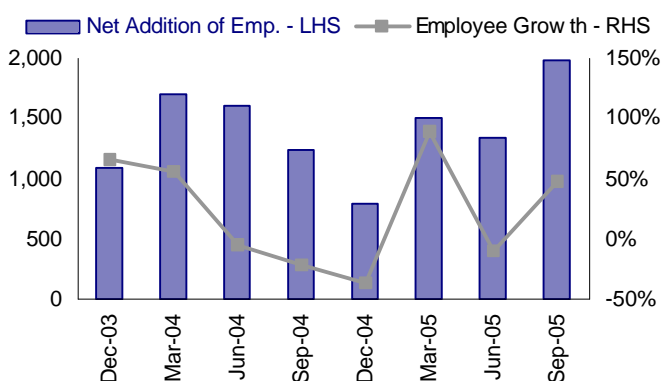


Source: Company/Motilal Oswal Securities

### Net employee addition at historical high

Net employee addition was the highest in the last 12 quarters at 1,977 employees, up 10% QoQ, indicating the robustness of the order pipeline for the second half of the year. The company has raised its employee addition guidance for the full year to 5,000-5,500 employees as against 4,000-4,500 employees guided earlier. This harbors well for the order pipeline in the coming quarters.

NET EMPLOYEE ADDITION



Source: Company/Motilal Oswal Securities

### EBITDA margin up 120bp

Gross margin expanded 170bp to 41.3% due to improvement in offshore utilization rate to 79.4% in 2QFY06 from 76.8% in the previous quarter. The rupee depreciation contributed 20bp to the aforesaid margin improvement. However, SG&A expenses were up 50bp during the quarter, which restricted the net expansion in EBITDA margin to 120bp. While utilization rates at, 79% are difficult to sustain, we believe that margins would continue to improve due to greater volume growth and continued rupee depreciation in the second half of the year.

### Net profit boosted by exchange gain and lower effective tax rate

Reported net profit was up 24.7% at Rs2.37b, buoyed by higher other income at Rs315.5m and lower effective tax rate. The company had US\$2m in terms of exchange gain during the quarter due to rupee appreciation. The effective tax rate for the quarter declined to 12.2%, down from 16.9% in 1QFY06, due to easing of the guidelines of the fringe benefit tax. The company expects that the effective tax rate for the full year would settle down to the levels seen in FY05 (13.5%).

### Earnings guidance revised 6.5% upwards

Satyam has revised its revenue guidance upwards to Rs47b-47.18b, implying a YoY growth rate of 33.5-34%, as against its earlier guidance of 29-30% growth. It has also revised its earnings guidance upwards to Rs29.12-29.23, implying growth of 30-30.5% from its earlier guidance of 21.5-22.5%.

We estimate that around 2% of the total 6.5% revision would accrue from the continued appreciation of the rupee against major currencies.

### Valuation and view

Satyam's overall performance has been impressive in the last couple of quarters, and the company's initiative in process improvement and relationship management seem to have begun to bear fruit. The 6.5% revision in earnings guidance also speaks volumes for the improved revenue visibility led by robust volume growth. We continue to remain positive on the company and upgrade our estimates for revenue growth to 38.3% and 28% YoY in FY06 and FY07, respectively. We estimate that net profit would grow by 33.7% and 28.2% in FY06E and FY07E, respectively. This would translate into a revision in our EPS estimates from Rs29.8 and Rs37.9 in FY06E and FY07E to Rs31.6 and Rs39.7, respectively. At 14.8x FY07E earnings, the stock appears quite attractive given the growth prospects for the company. We maintain **Buy**.

#### CHANGE IN FORECASTS

	FY06E			FY07E		
	NEW	OLD	VAR	NEW	OLD	VAR
Revenues	48,171	46,760	3.0	61,688	57,603	7.1
Growth (%)	38.3	34.3		28.1	23.2	
EBITDA Margin	25.5	25.9		26.1	26.4	
Net Profit	10,238	9,824	4.2	13,049	12,569	3.8
Growth (%)	33.7	28.3		27.5	27.9	
EPS (Rs)	31.6	29.8	6.3	39.7	37.9	4.6
Growth (%)	33.5	25.6		25.4	27.4	

Source: Motilal Oswal Securities

## Satyam Computer: an investment profile

### Company description

Satyam is the fourth largest Indian IT services company employing more than 19,000 people. It enjoys leadership position in the package implementation services segment and services 144 Fortune Global 500 clients. It services most of the top companies in every industry including GE, Ford, Merrill, DuPont, Cigna and Applied Materials.

### Key investment arguments

- One of the largest beneficiaries of the current preference for offshore vendors by global clients.
- Orbit 5 initiative enabling company to improve processes and efficiency.
- Potential to get re-rated as investors are currently ignoring the qualitative changes in the company.

### Key investment risks

- Frequent comparison with peers on qualitative aspects leads to dissatisfaction.
- Lacks innovation in managing cyclical trends in comparison to peers.
- Valuations are cheap yet expectations are high due to comparison with peers.

### Recent developments

- Signed a multi-million dollar deal with the World Health Organization (WHO) to implement its critical Global Management System with the global roll-out in over 140 country offices.
- Became the first JBoss Certified System Integrator in India, offering application development and subscription support services to enterprises building and deploying solutions on the JBoss Enterprise Middleware System

### Valuation and view

- CAGR of 33% in sales and 31% in net profit over the next two years.
- Valuations at 14.8 FY06E earnings are attractive and deserve a re-rating.
- Buy** with a target price of Rs 675, an upside of 14.8% from current levels.

### Sector view

- Various CIO surveys indicate increasing share of offshore spending in IT budgets.
- Indian offshore vendors gaining market share in competition with MNCs.
- Prefer large companies as they win bulk of volumes while niche players benefit due to lack of competition.

#### COMPARATIVE VALUATIONS

		SATYAM	WIPRO	TCS
P/E (x)	FY06E	18.6	27.0	24.9
	FY07E	14.8	21.1	20.5
P/B (x)	FY06E	4.7	6.8	12.0
	FY07E	3.9	5.1	8.2
EV/Sales (x)	FY06E	3.3	4.5	5.6
	FY07E	2.5	3.4	4.4
EV/EBITDA (x)	FY06E	12.8	19.5	19.2
	FY07E	9.4	14.0	15.5

#### SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	14.4	15.2	16.2
Domestic Institutions	5.5	5.4	10.7
FII's/FDIs	74.8	75.0	66.0
Others	5.3	4.4	7.1

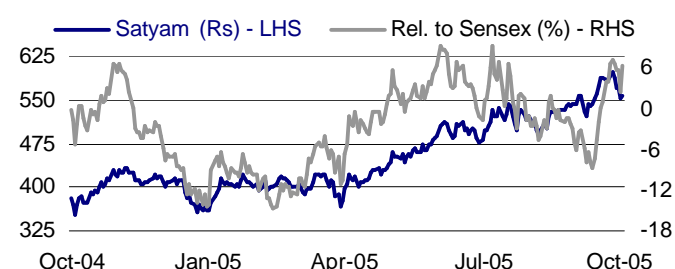
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VIATION (%)
FY06	31.6	28.4	11.5
FY07	39.7	34.5	15.1

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
588	675	14.8	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
<b>Sales</b>	<b>20,237</b>	<b>25,415</b>	<b>34,824</b>	<b>48,171</b>	<b>61,688</b>
Change (%)	16.8	25.6	37.0	38.3	28.1
Cost of Goods Sold	12,374	16,249	23,239	32,160	40,709
SG&A	1,676	2,241	2,511	3,749	4,906
<b>EBITDA</b>	<b>6,186</b>	<b>6,926</b>	<b>9,073</b>	<b>12,262</b>	<b>16,073</b>
% of Net Sales	30.6	27.3	26.1	25.5	26.1
Depreciation	1,242	1,116	1,070	1,519	2,068
Interest	6	7	6	22	12
Other Income	279	678	826	1,205	1,450
<b>PBT</b>	<b>5,217</b>	<b>6,480</b>	<b>8,822</b>	<b>11,925</b>	<b>15,443</b>
Tax	616	1,062	1,167	1,688	2,394
Rate (%)	11.8	16.4	13.2	14.2	15.5
PAT	4,601	5,418	7,654	10,238	13,049
Change (%)	-6.1	17.8	41.3	33.7	27.5
Extra Ordinary Items	-1,517	140	0	0	0
<b>Net Income</b>	<b>3,084</b>	<b>5,558</b>	<b>7,654</b>	<b>10,238</b>	<b>13,049</b>

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	629	633	639	639	639
Share Premium	7,879	8,251	8,922	8,922	8,922
Other Reserves	12,840	16,926	22,614	30,600	40,627
<b>Net Worth</b>	<b>21,349</b>	<b>25,810</b>	<b>32,175</b>	<b>40,160</b>	<b>50,188</b>
Loans	184	73	99	0	0
<b>Capital Employed</b>	<b>21,532</b>	<b>25,882</b>	<b>32,273</b>	<b>40,160</b>	<b>50,188</b>
Gross Block	7,759	8,472	9,377	15,377	22,377
Less : Depreciation	4,836	5,978	6,854	8,373	10,442
<b>Net Block</b>	<b>2,923</b>	<b>2,494</b>	<b>2,523</b>	<b>7,004</b>	<b>11,935</b>
CWIP	270	222	647	300	300
Investments	576	748	785	1,566	1,566
<b>Curr. Assets</b>	<b>21,638</b>	<b>25,955</b>	<b>32,835</b>	<b>40,563</b>	<b>48,406</b>
Debtors	4,799	5,928	7,652	9,898	12,169
Cash & Bank Balance	15,418	18,154	23,633	29,226	34,511
Loans & Advances	1,386	906	1,199	1,439	1,726
<b>Current Liab. &amp; Provisions</b>	<b>3,875</b>	<b>3,536</b>	<b>4,516</b>	<b>9,273</b>	<b>12,020</b>
Creditors	1,845	1,508	1,889	4,230	5,374
Other Liabilities	345	437	740	851	933
Provisions	1,684	1,591	1,887	4,192	5,714
<b>Net Current Assets</b>	<b>17,763</b>	<b>22,419</b>	<b>28,319</b>	<b>31,290</b>	<b>36,386</b>
<b>Application of Funds</b>	<b>21,532</b>	<b>25,882</b>	<b>32,274</b>	<b>40,160</b>	<b>50,188</b>

E: MOST Estimates

RATIOS					
Y/E MARCH	2003	2004	2005	2006E	2007E
<b>Basic (Rs)</b>					
<b>EPS*</b>	<b>14.6</b>	<b>17.2</b>	<b>23.7</b>	<b>31.6</b>	<b>39.7</b>
Cash EPS*	18.6	20.7	27.3	36.3	46.0
Book Value	67.9	81.7	100.7	124.1	152.6
DPS	3.0	4.0	5.3	7.0	9.2
Payout %(Incl.Div.Taxes)	20.5	23.4	22.0	22.0	23.2
<b>Valuation</b>					
P/E	40.2	34.3	24.8	18.6	14.8
Cash P/E	31.6	28.4	21.5	16.2	12.8
EV/EBITDA	27.8	24.4	18.1	12.8	9.4
EV/Sales	8.5	6.7	4.7	3.3	2.5
Price/Book Value	8.7	7.2	5.8	4.7	3.9
Dividend Yield (%)	0.5	0.7	0.9	12	16
<b>Profitability Ratios (%)</b>					
RoE	22.6	23.0	26.4	28.3	28.9
RoCE	25.5	27.3	30.3	32.9	34.2
<b>Turnover Ratios</b>					
Debtors (Days)	87	85	75	75	72
Asset Turnover (x)	2.6	3.0	3.7	3.1	2.8
<b>Leverage Ratio</b>					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Cash Flow from Operations	5,843	6,438	8,576	11,756	15,117
Cash for Working Capital	-637	1,691	714	-2,383	98
<b>Net Operating CF</b>	<b>6,480</b>	<b>4,748</b>	<b>7,862</b>	<b>14,139</b>	<b>15,019</b>
Net Purchase of FA	-256	-815	-1,330	-5,653	-7,000
Net Purchase of Invest.	-975	-32	28	-640	288
<b>Net Cash from Invest.</b>	<b>-1,230</b>	<b>-846</b>	<b>-1,303</b>	<b>-6,293</b>	<b>-6,712</b>
Proceeds from Pvt. Plac	3	325	677	0	0
Proceeds from LTB/STB	125	-111	-73	0	0
Dividend Payments	-944	-1,381	-1,684	-2,252	-3,022
<b>Net CF from Finan.</b>	<b>-816</b>	<b>-1,166</b>	<b>-1,080</b>	<b>-2,252</b>	<b>-3,022</b>
Free Cash Flow	6,225	4,429	6,680	8,486	8,019
<b>Net Cash Flow</b>	<b>4,434</b>	<b>2,736</b>	<b>5,479</b>	<b>5,593</b>	<b>5,285</b>
<b>Opening Cash Bal.</b>	<b>10,983</b>	<b>15,418</b>	<b>18,154</b>	<b>23,633</b>	<b>29,226</b>
Add: Net Cash	4,434	2,736	5,479	5,593	5,285
<b>Closing Cash Bal.</b>	<b>15,418</b>	<b>18,154</b>	<b>23,633</b>	<b>29,226</b>	<b>34,511</b>

E: MOST Estimates

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**Disclosure of Interest Statement****Satyam Computer**

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|--|----|
| 1. Analyst ownership of the stock            | No |
| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

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