

## Company Flash

18 July 2008 | 9 pages

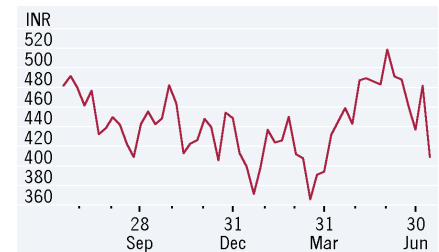
# Satyam Computers Services (SATY.BO)

## Buy: Disappointing quarter on top line; better on profits

- 1Q results below expectations/guidance on top line** — Satyam's 1QFY09 results disappointed on top line. Top-line growth was ~2% in \$ terms (which was lower than management guidance as well). Volumes increased ~3% while pricing was flattish qoq.
- Net profit significantly better than expectations** — Net profit at Rs.5.5bn (despite Rs360m forex loss) was better than our expectation of Rs5.3bn. EBITDA margins improved by ~130bp qoq. Lower-than-expected forex loss and tax rates resulted in net profits of Rs5.5bn (up 17% qoq).
- Nipuna revenues decline sharply** — Nipuna lost animation business (\$8m – as per management) and some voice-based BPO business. Management indicated that this was unexpected, but it was more a quarterly aberration and they expected this to recover going forward.
- 2Q guidance decent; FY09 revenue guidance unchanged** — Satyam guided to ~3.5-4.5% \$-term revenue growth in 2Q – which is decent given the environment. FY09 guidance remained unchanged at 24-26% revenue growth yoy (\$ terms). EPS guidance was revised upwards by ~8% to Rs.31.8-32.3 (32-34% growth yoy) – due primarily to INR depreciation.
- Decent guidance; reasonable valuations** — Satyam's 2Q guidance of 3.5-4.5% growth is decent – given the difficult business environment. Management also indicated that expect margins to improve by ~50bp yoy. Cash on books is ~Rs70 per share (~19% of market cap). Stock trades at ~12x FY09E earnings.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (18 Jul 08)	Rs376.75
Target price	Rs595.00
Expected share price return	57.9%
Expected dividend yield	1.5%
<b>Expected total return</b>	<b>59.4%</b>
Market Cap	Rs253,455M
	US\$5,933M

### Price Performance (RIC: SATY.BO, BB: SCS IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	14,047	20.81	38.0	18.1	4.3	27.9	0.9
2008A	16,879	24.65	18.4	15.3	3.5	26.0	0.9
2009E	22,163	32.37	31.3	11.6	3.0	27.8	2.7
2010E	25,858	37.77	16.7	10.0	2.5	27.2	3.2
2011E	27,693	40.45	7.1	9.3	2.1	24.6	3.2

Source: Powered by dataCentral

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## Key Highlights

- Forex hedge position at the end of June 2008 was \$675m (down from \$1.1bn at the end of previous quarter).
- US revenues increased by ~1.6% qoq, Europe revenues were up ~2% qoq while rest of world revenues increased ~4% qoq.
- BFSI and manufacturing revenues were flat qoq while retail, transportation was up 11% qoq.
- Consulting and Enterprise business solutions increased 1.3% qoq.
- Satyam has moved to industry standards for calculation of utilization; offshore utilization for the quarter was 75% (with new computation) and 84.4% under old computation (85.6% in prior quarter).
- There has been some confusion on the fact that US GAAP revenue growth is ~3.9% while Indian GAAP revenue growth is ~1.7% (in \$ terms). Management indicated this was due to foreign exchange fluctuation out of prevailing US GAAP standards. Due to volatility of INR/USD during the quarter – realized rate (rate at which receivables were converted) was different from accounting rate (spot rate when invoices were raised), were significantly different. Management said that usually this difference is much lower and hence they don't talk about it in their release. There has been no change in the way they have been accounting.

Figure 1. Key Financials

Rs m	1Q08	4Q08	1Q09	QoQ	YoY
<b>Revenue (US\$ m) – US GAAP</b>	<b>452</b>	<b>613</b>	<b>637</b>	<b>3.9%</b>	<b>40.9%</b>
<b>Revenue</b>	<b>18,302</b>	<b>24,160</b>	<b>26,208</b>	<b>8.5%</b>	<b>43.2%</b>
Cost of revenue	11,064	14,706	15,415	4.8%	39.3%
Gross profit	7,238	9,454	10,794	14.2%	49.1%
Gross margin	39.5%	39.1%	41.2%	205bp	164bp
Operating expenses	3,135	3,947	4,471	13.3%	42.6%
<b>EBITDA</b>	<b>4,103</b>	<b>5,507</b>	<b>6,323</b>	<b>14.8%</b>	<b>54.1%</b>
<b>EBITDA margin</b>	<b>22.4%</b>	<b>22.8%</b>	<b>24.1%</b>	<b>133bp</b>	<b>171bp</b>
Dep & amortization	387	435	467	7.3%	20.7%
<b>EBIT</b>	<b>3,716</b>	<b>5,071</b>	<b>5,856</b>	<b>15.5%</b>	<b>57.6%</b>
<b>EBIT margin</b>	<b>20.3%</b>	<b>21.0%</b>	<b>22.3%</b>	<b>135bp</b>	<b>204bp</b>
Other income	632	230	331	44.2%	-47.6%
Profit before tax	4,315	5,255	6,130	16.6%	42.1%
Income tax expense	532	587	653	11.2%	22.7%
Income from operations	3,783	4,669	5,477	17.3%	44.8%
<b>EPS - basic</b>	<b>5.67</b>	<b>6.97</b>	<b>8.16</b>	<b>17.1%</b>	<b>43.9%</b>
<b>EPS - fully diluted</b>	<b>5.53</b>	<b>6.82</b>	<b>8.00</b>	<b>17.3%</b>	<b>44.8%</b>

Source: Company Reports

Figure 2. Q1FY09 Performance vs. Guidance

	Guidance		Actual	Vs. Guidance	
	Lower	Upper		Lower	Upper
Revenue (Rs m)	25,000	25,125	26,208	4.8%	4.3%
Revenue (\$ m)	632	635	637	0.9%	0.4%
EPS (Rs)	7.64	7.68	8.16	6.8%	6.2%

Source: Company Reports

Figure 3. FY09 Guidance

	Guidance		Guidance - post 1Q		Guidance revision	
	Lower	Upper	Lower	Upper	Lower	Upper
Revenue (Rs m)	105,000	106,700	111,810	113,630	6.5%	6.5%
Revenue (\$ m)	2,652	2,694	2,652	2,694	0.0%	0.0%
EPS (Rs)	29.54	30.04	31.83	32.35	7.8%	7.7%
INR/USD assumption		40.00		42.78		

Source: Company Reports

Figure 4. Q2FY09 Guidance

	Guidance		Implied Lower	growth Upper
	Lower	Upper		
Revenue (Rs m)	27,430	27,690	4.7%	5.7%
Revenue (\$ m)	646	652	1.3%	2.3%
EPS (Rs)	7.71	7.78	-5.5%	-4.6%

Source: Company Reports

Figure 5. Key HR and Execution Metrics

	1Q08	2Q08	3Q08	4Q08	1Q09
Total employee base	41,380	44,719	48,098	49,966	46,620
IT Services - parent only	38,386	41,423	44,847	45,969	46,620
Support	2,030	2,270	2,442	2,690	2,753
Delivery employees - total	36,356	39,153	42,405	43,279	43,867
- Onsite	7,635	8,949	8,961	9,391	9,497
- Offshore	27,600	29,222	32,421	32,767	32,776
- Domestic	1,121	982	1,023	1,121	1,594
<b>Avg. realization (US\$/hour)</b>					
Onsite	57.6	58.9	60.3	60.7	60.6
- change	1.3%	2.2%	2.4%	0.6%	-0.2%
Offshore	23.6	23.9	24.4	24.6	24.5
- change	1.5%	1.3%	2.3%	0.5%	-0.2%
<b>Utilization</b>					
Onsite	96.2%	97.1%	96.8%	97.3%	96.5%
Offshore	79.9%	81.5%	83.7%	85.6%	75.0%
Offshore with trainees	76.5%	76.4%	78.2%	81.8%	73.7%
<b>Attrition % (IT services)</b>	14.9%	13.9%	13.1%	13.1%	12.6%

Source: Company Reports

Figure 6. Revenue Mix

	1Q08	2Q08	3Q08	4Q08	1Q09
<b>Geography wise</b>					
North America	61.7%	58.4%	60.0%	60.6%	60.3%
Europe	20.1%	21.0%	20.5%	20.7%	20.7%
RoW	18.2%	20.6%	19.5%	18.7%	19.0%
<b>Service line wise</b>					
Development & Maintenance	43.7%	43.9%	44.0%	44.4%	44.6%
Package implementation	44.2%	45.0%	45.0%	45.1%	44.7%
Engineering services	7.2%	6.5%	6.8%	6.7%	6.8%
IMS	4.9%	4.5%	4.1%	3.9%	3.9%
<b>Vertical wise</b>					
BFSI	23.8%	23.8%	22.4%	21.8%	21.4%
Manufacturing	25.9%	23.7%	23.2%	23.5%	23.1%
TIMES	22.0%	23.5%	23.1%	21.5%	21.9%
Healthcare	8.0%	7.9%	8.0%	7.1%	7.1%
Retail & Transportation	6.9%	7.5%	9.1%	9.6%	10.5%
Others	13.5%	13.5%	14.2%	16.5%	16.1%

Source: Company Reports

Figure 7. Key Client Metrics

	1Q08	2Q08	3Q08	4Q08	1Q09
<b>Client relationship</b>					
Total active clients	551	577	598	617	631
New clients added	29	37	32	32	34
US\$1+ mn clients	190	213	220	230	237
US\$5+ mn clients	65	75	79	85	93
US\$10+ mn clients	36	40	49	50	52
<b>Client concentration</b>					
Top client	5.7%	5.8%	5.4%	4.5%	4.5%
Top 5 clients	21.1%	20.8%	20.7%	19.0%	19.1%
Top 10 clients	34.4%	33.9%	33.5%	30.9%	30.6%
Existing clients	89.5%	93.1%	93.2%	93.4%	93.0%

Source: Company Reports

## Satyam Computers Services

### Company description

Satyam is the fourth-largest IT solutions provider from India and is one of the pioneers of offshore IT services delivery. The company has more than 570 clients across the globe and employs more than 50,000 professionals across IT and BPO services. Satyam was an early entrant into IT consulting/package implementation work. Around 45% of its revenue came from this service line. It has domain competencies in verticals such as Manufacturing, Banking & Financial Service and Insurance, among others.

### Investment strategy

We rate Satyam Buy/Medium Risk (1M). We believe offshore IT outsourcing is now a mainstream option and Satyam, which has achieved meaningful scale with its top-five position in India, appears well positioned to benefit from growing business volumes. Over the past several quarters, volume growth has

trended at over 8% QoQ. With revenues over US\$2bn, Satyam becomes a strong contender for winning large deals. It has won at least three large deals over the past four quarters. We expect a gradual margin decline (rather than steep), as wage inflation should be partly offset by positive leverage from a better onsite-offshore mix, hiring strategies and improved utilization. Overall, we forecast 27.6% revenue CAGR and 21.8% EPS CAGR over FY07-10E.

## Valuation

Our 12-month target is Rs595, based on 17x average of FY09-10E EPS. We value Satyam at a 15% discount to Infosys historic trading range. We ascribe a 15% discount to Infosys due to Satyam's smaller size, lesser diversification, lower pricing and lower margins. Given that we expect Satyam's earnings to grow at a 21.8% CAGR over the next three years, we believe the stock should trade toward the mid point of its historical three-year trading range of 12-21x 12-month forward earnings. Satyam has traded at a 10-40% discount to Infosys in the past two years due to its slower growth rates. We believe P/E remains the most appropriate valuation measure given Satyam's past profitability and future earnings visibility.

## Risks

Although our quantitative risk-rating system suggests Low Risk for Satyam, we rate Satyam as Medium Risk given the similar risk ratings for other similar-sized IT peer-group companies in our coverage universe. The key downside risks that could impede the shares from reaching our target price include: 1) a slowdown in enterprise software license revenues; 2) the supply side situation becoming more difficult; 3) risks to earnings from a sharp US slowdown; 4) any significant appreciation of the rupee against the USD/Euro/GBP; 5) a slowdown in the banking, financial services and insurance (BFSI) sector; and 6) limited H1B visa quotas.

# Appendix A-1

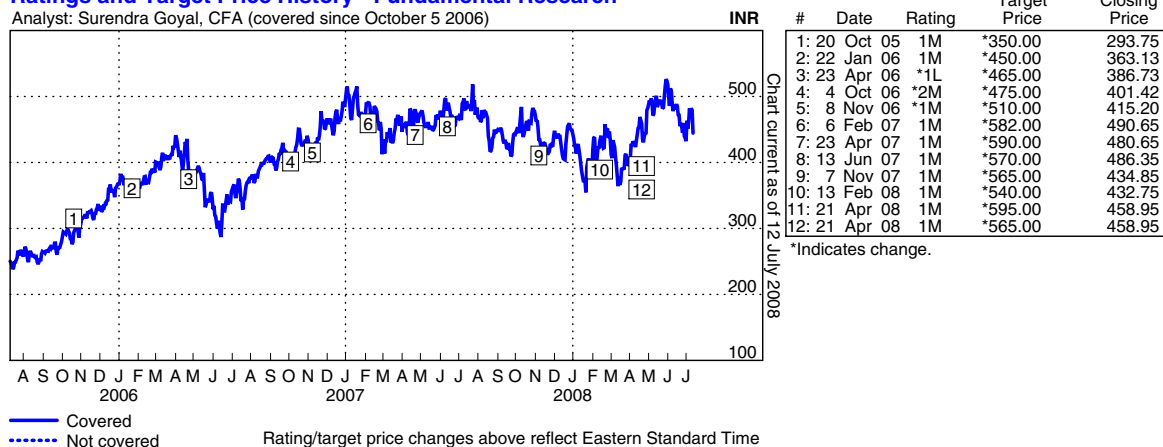
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Analyst: Surendra Goyal, CFA (covered since October 5 2006)



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