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Stock Rating
**Overweight**

Industry View
**Attractive**

# Satyam Computer Services

## Highlights from the Analyst Day

**Quick Comment:** Satyam held its Analyst Day (themed *The Next Orbit*) in Mumbai earlier today. Two key points struck us from the various presentations. The impact of a potential US slowdown on demand is a key issue at this point of time - the management seems comfortable with the demand environment, mixed US economic data-points notwithstanding. Any significant increase in average pricing can be a powerful consensus earnings and stock price driver – while we do not see concrete signs of that happening yet, we sensed that the management was a bit more optimistic of this happening than before.

**What's New:** Management sounded confident of the demand environment in various service lines, industry verticals and geographies. The pipeline of large deals is 4x a year-ago level. Cost-side issues appear to be as indicated previously and the management seems very comfortable with its full-year guidance.

**Implications:** The Analyst Day left us comfortable with our Overweight call on the stock and our Attractive view on the sector. Demand is strong, the cost issues are well understood in our view and Satyam seems comfortably poised to meet consensus full-year estimates. The stock trades at a 28% discount to Infosys on 12-month forward P/E and 15-20% discount is apt, in our view.

Details from the various presentations are noted in the following pages.

### Key Ratios and Statistics

**Reuters: SATY.BO  Bloomberg: SCS IN**
**India Software**

| | |
|---|---|
| Shr price, close (Sep 8, 2006) | Rs797.40 |
| Mkt cap, curr (mn) | US$5,642 |
| 52-Week Range | Rs890.00-515.25 |

**Overview**
As Satyam enters its next phase of evolution, it is focusing on strengthening domain competencies, relationship management (with increased global talent), operational excellence (through its internal platform named STARTRAC) and enhancing leadership skills within the organization.

Demand: Even as US economic datapoints are mixed, Satyam's sense from its large customers is that IT budgets will continue to rise at 3-5% annual rates similar to the past few years. Management is comfortable with this year's guidance and optimistic on offshore demand - it sees broader acceptance of global delivery from customers.

Pricing: There is potential for price improvements as prices have been stable for many years and customers appear willing to pay for value.

Margins: Levers to offset wage inflation include operational efficiency (utilization, higher proportion of fixed-price projects) associate mix (more entry-level employees), higher offshore proportion, further reduction in SG&A as a proportion of revenue, pricing (renegotiations and ramp-up in new customers) and performance of subsidiaries (it expects its BPO subsidiary Nipuna to be EBITDA positive in F07).

MNC Competition: The management appears less wary of competition from MNCs as it believes that the latter's average cost of delivery is much higher and offshore is still a small proportion of the total for them. On the flip side, it believes that Indian companies need to demonstrate the same industry depth as the MNCs.

**On Large Deals**
Satyam has a dedicated Strategic Deals Group which tracks opportunities, manages margins, formulates negotiation strategies and HR strategies for people transfer, and has multi-national regulatory knowledge. This group is headed by Hetzel Folden who has a 30+ year career and who was previously a lead negotiator at CSC.

The total contracted value of large deals each year has remained nearly the same from 2000-2005 but the number of deals have increased from 200 a year to over 300 (Source: TPI) and the contract period has reduced to 3-7 years from 10 years. Satyam sees large deals being broken down and offshore service providers playing a larger role. TPI estimates 400 deals @ 100 bn to be negotiated between June 2006 and May 2008. 80% may go back to incumbent vendors but offshore companies may compete in the remainder 20%.

Satyam has seen a 4x increase in pipeline of large deals in the last 12 months.

Satyam is cautious about margins for these large deals and is careful while taking over people and assets. It also believes that fixed-price projects offer opportunity to improve margins.

**SAP**
Satyam's management does not see a risk from the high proportion of enterprise solutions business (package implementation) as it feels that customers will increasingly use packages as functionality gets richer and package providers consolidate.

Customers are now focusing on business solutions and new technology/platforms such as NetWeaver and SOA. Satyam has been rapidly building capabilities in these areas. It estimates the addressable services market to be US$30 bn in 2004 and expects it to grow to US$70 bn in 2010.

Satyam has arranged its SAP practice along industry verticals. It also has a large geographical footprint and can cater to a customer in several countries. For example, it serves a leading chemical manufacturer in 31 countries and a global hi-tech leader in 18 countries.

It hires a mix of fresh engineers, business users, industry experts and experienced professionals. It builds skills using its SAP Academy, Center of Excellence and Satyam Learning Center. It currently has 3,000 people in its SAP practice with over 1,000 in NetWeaver.

**Engineering Services**
A recent NASSCOM-Booz Allen Hamilton study has estimated global demand for such services at US$1.1 trillion by 2020 with 14-20% being outsourced and a potential market for Indian companies of US$40 bn. The main verticals are automotive & high-tech/telecom.

Satyam has 3,000 people in this practice and obtains 7% of total revenue. Key industries that it focuses on are consumer products, automotive, telecom, and semi-conductors.

Differences between engineering services and other IT services include a high level of initial knowledge transfer, high exit costs for the customer (due to upfront investments), and high capex due to setting up of labs. 30-35% of the work needs to be done onsite at the beginning of a project but 80% of the project can be executed offshore eventually. Bill rates are similar to those for IT services.

MNC captive centers constitute key competition. These comprised 20% of the offshore industry 3 years back and comprise 40% now. However, Satyam's management is of the view that these may be unable to scale up and they may start outsourcing themselves after they reach a certain size.

Employee retention rates are high (90%) due to the nature of work.

**HR:**
Satyam continues to see improvement in its attrition levels. It has over 93% retention among key performers and leaders, and the associate delight index has gone up from 3.60 in Jul-05 to 4.28 in Jul-06.

Mid-level availability of talent and junior-level attrition are the main pressure points for Satyam.

As per the management, 50% of graduating engineers are deployable by the industry and a further 20% can be used after suitable training. Satyam is also looking at non-engineering graduates for some of its service lines. It is exploring alternate geographies for talent in a limited way - these geographies include China, Malaysia, Vietnam, Hungary and Brazil.

**Company Description**

Satyam Computer Services Ltd. is a leading player in the offshore IT services industry and has gained strong positioning in the enterprise solutions area (package implementation). It offers a wide array of IT services and offers BPO services through Nipuna, a separate subsidiary.

**Industry View: Attractive**

**MSCI Country: India**

Asia Strategist's Recommended Weight: 2.0%
MSCI Asia/Pac All Country Ex Jp Weight: 6.5%

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ModelWare[SM]

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| | Coverage Universe | | Investment Banking Clients (IBC) | | |
|---|---|---|---|---|---|
| Stock Rating Category | Count | % of Total | Count | % of Total IBC | % of Rating Category |
| **Overweight/Buy** | **784** | **39%** | **294** | **44%** | **38%** |
| **Equal-weight/Hold** | **888** | **44%** | **297** | **45%** | **33%** |
| **Underweight/Sell** | **332** | **17%** | **74** | **11%** | **22%** |
| **Total** | **2,004** | | **665** | | |

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## Industry Coverage:India Software

| Company (Ticker) | Rating (as of) | Price (09/08/2006) |
|---|---|---|
| **Anantha Narayan** | | |
| HCL Technologies (HCLT.BO) | E (01/30/2004) | Rs562.40 |
| Hexaware Technologies Limited (HEXT.BO) | O (06/22/2006) | Rs155.35 |
| Infosys Technologies (INFY.BO) | O (04/17/2006) | Rs1794.70 |
| MphasiS BFL Group (MBFL.BO) | E (03/15/2004) | Rs185.80 |
| Patni Computer Systems (PTNI.BO) | O (08/08/2005) | Rs392.65 |
| Polaris Software Lab Ltd. (POLS.BO) | U (08/08/2005) | Rs121.10 |
| Satyam Computer Services (SATY.BO) | O (03/18/2002) | Rs797.40 |
| Tata Consultancy Services (TCS.BO) | O (09/29/2004) | Rs993.10 |
| Wipro Ltd. (WIPR.BO) | E (03/22/2002) | Rs509.90 |
| i-flex Solutions Ltd. (IFLX.BO) | E (10/31/2005) | Rs1440.75 |

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