

Satyam Computer Services Ltd.

₹74

**KRChoksey**  
 wealth enhancement solutions


Disappointment at all fronts

REDUCE

Relatively lower billing rate seems to be key reason for disappointment at revenue front: - Satyam Computer Services's (Satyam) revenue in Q2FY11 was ₹1242.4 crore, which is significantly lower than consensus estimates. We believe, the primary reason for disappointment at revenue front is lower than expected billing rate (taking into account number of employees has remained almost constant at around 28,000 and utilization rate of 71% is more or less in line with peers). The management believes that disclosure of financial numbers will enable it to participate in bidding of the deals, which till date acted as a big hindrance in vendor qualification process since revelation of financial scam. They expect the company's ability to bid will drive future growth. However, we believe over the span of last 24 months the company has lost its competitive strength in its focus area of ERP and product engineering services to its domestic rivals and this will limit its outperformance compared to peer sets, going forward.

Significant dip in operating margin in Q2FY11: - The operating margin was 5.9% in Q2FY11 as against consensus estimates of around mid-teens. The key factor that impacted margins was increase in SG&A expenses (despite of significant decline in rental) cost as percentage of sales to 20.5% in Q2FY11 as compared to 17.2% in FY10 because of aggressive selling and marketing activities by the company. Beside increase in SG&A expenses as percentage of sales, we believe the company's policy of hiring mainly laterals as compared to campus recruitment over the span of last two years has adversely impacted its operating margin. We expect, the company's focus on maintaining its bench strength in focus areas will constraint its ability to cross double-digit operating profit margin in H2FY11.

Beside lower operating margin; sharp shoot-up in tax rate and foreign exchange loss led 76% QoQ decline in net profit in Q2FY11: - The tax rate shoot up to 53% in Q2FY11 from 21% in Q1FY11. Further, there was a forex loss of ₹9.1 crore in Q2FY11 as against forex gain of ₹33.6 crore in Q1FY11. Dip in operating profit margin by 381 bps QoQ, increase in tax rate and forex loss resulted in decline in net profit by 76.1% QoQ in Q2FY11.

**Valuation and view:** Considering, challenges Satyam faces in capturing back its market share and regain its competitive position in its core areas such as ERP and product engineering, we believe there is low probability of the company outperforming its peer sets in terms of volume growth in H2FY11E and FY12E. Taking the same into account, we expect the company to trade at similar valuation at which tier II IT companies trade. We prefer EV/EBITDA valuation methodology in case of Satyam because of the lack of data of likely tax rate in H2FY11E and FY12E. We give multiple of 8 times to its FY12E EBITDA and arrive at a target price of ₹75 per share and assign "REDUCE" rating to the stock.

## Exhibit 1 : Key Financials

(₹ Crore)

Particulars	FY09	FY10	FY11E	FY12E
Sales	8,812.6	5,481.0	5,021.2	5,950.0
EBITDA	301.7	456.9	389.4	684.1
PAT	(8,176.8)	(124.6)	282.9	519.0
*EPS	-	-	2.4	4.4
OPM	3.4%	8.3%	7.8%	11.5%
NPM	-92.8%	-2.3%	5.6%	8.7%
P/E	-	-	31	17
*P/BV (adjusted)	25	3	3	2
*EV/EBITDA	19	13	15	8

Source: Company Data, KRChoksey Research \*Note-As per the latest outstanding equity shares

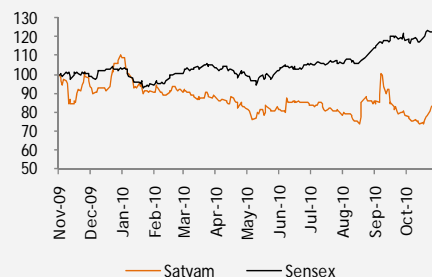
Price target ₹75

Market Data	November 16, 2010
Shares outs (Cr)	117.6
Equity Cap (₹. Cr)	235.2
Mkt Cap (₹. Cr)	8,752
52 Wk H/L (₹)	121/73
Avg Vol (1yr avg)	234,784
Face Value (₹)	2
Bloomberg Code	SCS IN

## Market Info:

SENSEX	19865
NIFTY	5989

## Price Performance



## Share Holding pattern (%)

Particulars	Mar-10	Sep-10	Chg (%)
Promoters	42.7	42.7	0.0
Institutions	4.6	3.3	-1.3
FII's	9.1	9.9	0.8
Public & Others	43.6	44.1	0.5
Total	100	100	

Source: BSE

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## Other key highlights

- The number of employees at the end of Q2FY11 was 28,068 as compared to around 27,000 at the end of FY10.
- The attrition rate is around 25% (on annualizing quarterly rate), which is more or less in line with peer sets.
- Onsite and offshore revenue mix is 58:42 in Q2FY11.
- Geography wise revenue breakup is 58% North America, 26% Europe and 16% Rest of the World.
- The number of clients came down to 217 (contributing more than USD250,000 per annum) in Q2FY11 from 315 at the time Tech Mahindra took over the management of Satyam in FY10.
- Top 100 customers contribute around 91% of total revenue.
- Witnessing traction in manufacturing, telecom, media and entertainment; whereas healthcare is registering slower growth.
- Service line wise ERP and IMS growing faster than the company's average and traditional services growing at relatively slower rate.

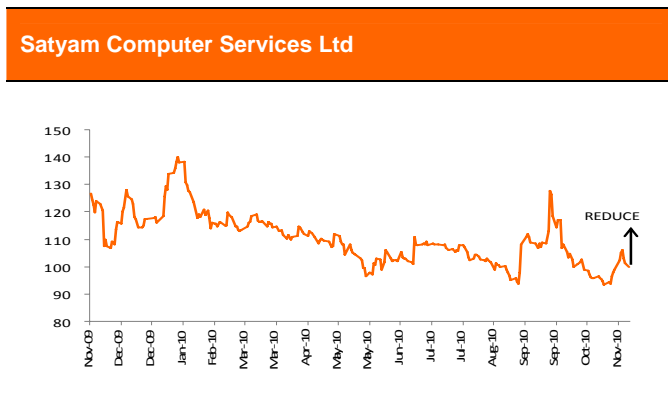
## Exhibit 2 : Q2FY11 Result

(₹ In Crore)

Particulars	Q2FY11	Q1FY11	Q-o-Q	Comment
Revenues	1,242.4	1,248.0	-0.4%	Increase in competition has adversely impacted revenue growth.
Employee cost	913.6	867.7	5.3%	Increase in number of employees and average wage hike of around 11% w.e.f July led increase in employee cost despite decline in revenue
Other operating expenses	255.3	258.9	-1.4%	
Operating profit	73.5	121.4	-39.5%	
Operating profit margin	5.9%	9.7%	-3.81%	Decrease in revenue and increase in employee cost led decline in operating profit margin
Depreciation	42.9	59.4	-27.8%	
Other income	31.3	73.2	-57.2%	Forex loss as compared to forex gain in Q1FY11 result in decrease in other income
Interest and financing charges	2.5	2.5	0.0%	
Exceptional items	8.4	7.9	6.3%	
Profit before tax	51.0	124.8	-59.1%	
Taxes	27.0	26.4	2.3%	
Profit after tax	24.0	98.4	-75.6%	
Minority interest	0.7	0.9	-22.2%	
Net profit	23.3	97.5	-76.1%	
Net profit margin	1.9%	7.8%	-5.9%	Decline in operating profit margin and other income and increase in tax rate led sharp fall in net profit margin

Source : Company data, KRChoksey Research

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Rating Legend	
<b>Our Rating</b>	<b>Upside</b>
Buy	More than 15%
Hold	5% - 15%
Reduce	Nil - 5%
Sell	Less than 0%

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