



## Satyam Computer

STOCK INFO.	BLOOMBERG
BSE Sensex: 18,493	SCS IN
	REUTERS CODE
S&P CNX: 5,474	SATY.BO

23 October 2007

Buy

Previous Recommendation: Buy

Rs462

Equity Shares (m)	668.2
52-Week Range	525/402
1,6,12 Rel. Perf. (%)	3/-37/-38
M.Cap. (Rs b)	308.6
M.Cap. (US\$ b)	7.8

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
3/07A	64,851	14,047	21.5	41.7	21.5	5.3	27.9	30.3	4.2	17.6
3/08E	83,102	17,149	25.7	19.6	18.0	4.3	26.6	30.3	3.1	14.2
3/09E	107,801	21,189	31.5	22.8	14.7	3.5	26.2	30.8	2.3	10.7

\* PAT figures reflects adjusted PAT, FY06 figures adjusted to reflect 1:1 bonus

- 2QFY08 results better than expected; forex gains help boost profits:** Satyam Computer reported dollar revenue growth of 12.4% QoQ to US\$505m in 1QFY08, higher than our estimate of US\$483m. This was driven by volume growth of 9.1% QoQ. Price realizations were up 2.21% QoQ onsite and 1.34% QoQ offshore. EBITDA margins were down 260bp (v/s our estimate of 230bp) due to salary hikes during the quarter. Other income at Rs1.1b was higher than our estimate of Rs782m due to forex gain of Rs422m. Net profit grew 8.1% QoQ to Rs4.1b v/s our estimate of Rs3.74b.
- FY08 EPS guidance upgraded to Rs25.1:** Satyam has upgraded its dollar revenue growth guidance to 41.5-42% from 34-35.5% earlier, and the dollar EPS guidance upwards to 36% from 28.3-29.7%. Corresponding rupee revenue guidance has been revised upwards to 26.3-26.7% from 21.1-22.5%, at underlying rupee assumption of Rs39.5/US\$ v/s Rs40.5/US\$ earlier. The rupee EPS guidance has been increased to Rs25-25.1, a growth of 16.5-17% from 12.5-14% earlier.
- Raising EPS estimate for FY08 by 3.4%; maintain Buy:** FY08 revenue growth guidance of 42% implies the strongest growth over the last 7 years. We have revised our EPS estimates upwards by 3.4% to Rs25.7 for FY08 and 4.6% to Rs31.5 for FY09 to reflect the better than expected performance, despite the higher rupee appreciation. The stock trades at 18x FY08E and 14.7x FY09E earnings. Maintain **Buy**.

### QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
<b>Revenues</b>	<b>14,429</b>	<b>16,019</b>	<b>16,611</b>	<b>17,792</b>	<b>18,302</b>	<b>20,317</b>	<b>21,553</b>	<b>22,929</b>	<b>64,851</b>	<b>83,102</b>
Q-o-Q Change (%)	9.8	11.0	3.7	7.1	2.9	11.0	6.1	6.4	35.3	28.1
Direct Expenses	8,316	9,827	9,674	10,763	11,062	13,028	13,437	13,991	38,579	51,518
Sales, General & Admin. Expenses	2,563	2,567	2,838	2,927	3,137	3,263	3,405	3,577	10,894	13,382
<b>Operating Profit</b>	<b>3,550</b>	<b>3,625</b>	<b>4,100</b>	<b>4,102</b>	<b>4,103</b>	<b>4,027</b>	<b>4,710</b>	<b>5,361</b>	<b>15,377</b>	<b>18,202</b>
Margins (%)	24.6	22.6	24.7	23.1	22.4	19.8	21.9	23.4	23.7	21.9
Other Income	745	282	102	704	632	1,105	774	778	1,833	3,289
Depreciation	362	375	394	354	387	391	431	447	1,484	1,656
Interest	26	27	32	74	33	42	43	46	159	164
<b>PBT bef. Extra-ordinary</b>	<b>3,908</b>	<b>3,505</b>	<b>3,776</b>	<b>4,378</b>	<b>4,315</b>	<b>4,699</b>	<b>5,011</b>	<b>5,647</b>	<b>15,566</b>	<b>19,671</b>
Provision for Tax	368	307	403	442	532	609	649	732	1,520	2,522
Rate (%)	9.4	8.8	10.7	10.1	12.3	13.0	13.0	13.0	9.8	12.8
Share of (P)/L in Associate Companies	0	0	0	0	0	0	0	0	0	0
Minority Interest	-1	0	0	0	0	0	0	0	-1	0
<b>PAT bef. Extra-ordinary</b>	<b>3,541</b>	<b>3,198</b>	<b>3,372</b>	<b>3,936</b>	<b>3,783</b>	<b>4,090</b>	<b>4,361</b>	<b>4,915</b>	<b>14,047</b>	<b>17,149</b>
Q-o-Q Change (%)	24.4	-9.7	5.4	16.7	-3.9	8.1	6.6	12.7	43.0	22.1

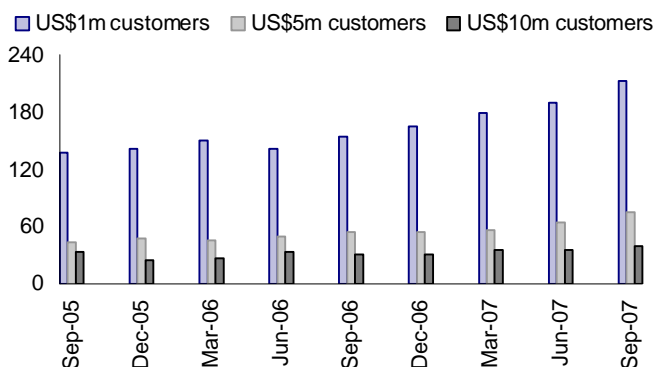
E: MOST Estimates

**2QFY08 results better than expected; forex gains help boost profits**

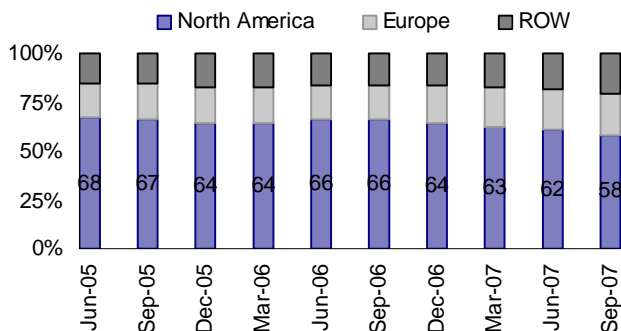
Satyam Computer reported dollar revenue growth of 12.4% QoQ to US\$505m in 1QFY08, higher than our estimate of US\$483m. This was driven by volume growth of 9.1% QoQ v/s our estimate of 7.2% growth. Price realizations were up 2.21% QoQ onsite and 1.34% QoQ offshore. This was boosted by higher revenue contribution from enterprise services (45% v/s 44.2% in 1QFY08) and continued price increases across service lines.

EBITDA margins were down 260bp (v/s our estimate of 230bp) due to salary hikes during the quarter. Salary hikes of 5% onsite and 16% offshore impacted revenue by 450bp. Higher onsite contribution (49.6% v/s 48% in 1QFY08) impacted margins by 70bp. Rupee appreciation had lesser impact at 30bp. Overall margin erosion was contained at 260bp by higher price realizations (120bp), SG&A leverage (110bp) and efficiency measures (60bp). Other income at Rs1.1b was higher than our estimate of Rs782m due to forex gain of Rs422m. Net profit grew 8.1% QoQ to Rs4.1b v/s our estimate of Rs3.74b.

**IMPRESSIVE CLIENT MINING**

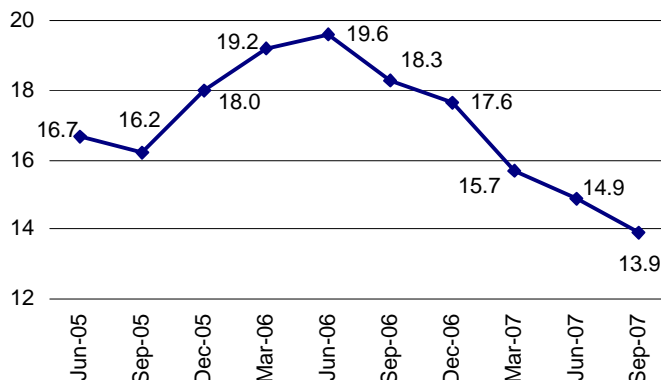


**REDUCING DEPENDENCE ON THE US – ONCE A HIGH RISK FOR SATYAM**



Source: Company/Motilal Oswal Securities

**ATTRITION DECLINES FOR THE 5<sup>TH</sup> SUCCESSIVE QUARTER**



Source: Company/Motilal Oswal Securities

**FY08 EPS guidance upgraded to Rs25.1**

Satyam has upgraded its dollar revenue growth guidance to 41.5-42% from 34-35.5% earlier, and the dollar EPS guidance upwards to 36% from 28.3-29.7%. Corresponding rupee revenue guidance has been revised upwards to 26.3-26.7% from 21.1-22.5%, at underlying rupee assumption of Rs39.5/US\$ v/s Rs40.5/US\$ earlier. The rupee EPS guidance has been increased to Rs25-25.1, a growth of 16.5-17% from 12.5-14% earlier, but still lower than its initial guidance of 18-20%.

The new EPS guidance of Rs25-25.1 factors in margin erosion of 175bp v/s 125bp decline assumed earlier. This is due to higher than expected rupee appreciation implied in the guidance (Rs39.5/US\$ v/s Rs40.5/US\$). The guidance also factors in 4% increase in pricing YoY over strong pricing improvements in 1HFY08. Our current estimates factor in margin decline of 180bp in FY08 (v/s our earlier assumption of 170bp decline).

**Raising EPS estimate for FY08 by 3.4%; maintain Buy**

FY08 revenue growth guidance of 42% implies the strongest growth over the last 7 years. We are impressed by the quality of growth – diversification into non-ERP based service offerings, emphasis on large deals and greater growth from Europe & Asia-Pacific, which have reduced the risk perception for Satyam and increased revenue

visibility. The company has started gaining momentum in areas such as Infrastructure Management and Engineering Services, wherein it was a relatively late entrant. On the supply side, the company's efforts to reduce attrition seem to be yielding results – attrition has declined for the 5<sup>th</sup> successive quarter.

We have revised our EPS estimates upwards by 3.4% to Rs25.7 for FY08 and 4.6% to Rs31.5 for FY09 to reflect the better than expected performance, despite the higher rupee appreciation. The stock trades at 18x FY08E and 14.7x FY09E earnings. Maintain **Buy**.

## Satyam Computer: an investment profile

### Company description

Satyam is the fourth largest Indian IT services company employing more than 39,000 people in its IT services operations. It enjoys leadership position in the package implementation services segment and services over 575 clients including Fortune 500 clients. It services 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.
- Leadership in the enterprise applications space would help Satyam tap strong demand environment.

### Key investment risks

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

### Recent developments

- Acquired UK-based Nitor Global Solutions, a niche infrastructure management services firm, for a consideration upto GBP2.76m.
- Changing the name of BPO subsidiary to Satyam BPO Limited from Nipuna Services Ltd as a consequence of buyout of external stakeholders.

### Valuation and view

- CAGR of 28.9% in sales and 22.8% in net profit over the next two years.
- Valuations at 18x FY08E and 14.7x FY09E offer room for upside.
- Maintain **Buy** with a target price of Rs565.

### Sector view

- CY08 IT budgets could be cautious due to perceived slowdown in the US economy.
- Sharp rupee appreciation continues to be cause for concern over the near term.
- We prefer large companies, as they are better placed to contain margin erosion due to rising rupee.

#### COMPARATIVE VALUATIONS

		SATYAM	HCLT	PATNI
P/E (x)	FY08E	18.0	15.9	14.7
	FY09E	14.7	13.1	13.1
P/BV (x)	FY08E	4.3	3.6	2.4
	FY09E	3.5	3.2	2.1
EV/Sales (x)	FY08E	3.1	2.3	1.7
	FY09E	2.3	1.7	1.3
EV/EBITDA (x)	FY08E	14.2	10.5	9.6
	FY09E	10.7	8.1	7.4

#### SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	8.8	8.8	9.2
Domestic Inst	12.1	11.6	12.0
Foreign	68.7	68.0	67.1
Others	10.4	11.6	11.7

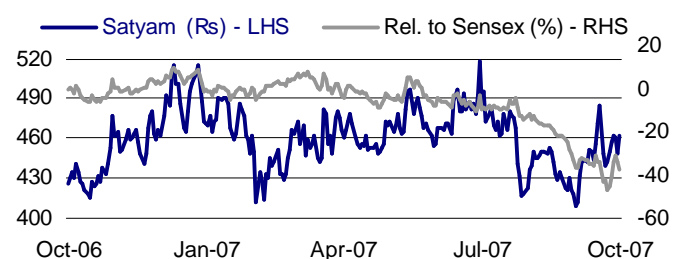
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	25.7	25.0	2.7
FY09	31.5	30.1	4.5

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
462	565	22.3	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
<b>Sales</b>	<b>35,208</b>	<b>47,926</b>	<b>64,851</b>	<b>83,102</b>	<b>107,801</b>
Change (%)	37.5	36.1	35.3	28.1	29.7
Cost of Goods Sold	23,821	32,738	45,062	59,250	78,023
SG&A	2,705	3,526	4,412	5,650	6,750
<b>EBITDA</b>	<b>8,682</b>	<b>11,662</b>	<b>15,377</b>	<b>18,202</b>	<b>23,027</b>
% of Net Sales	24.7	24.3	23.7	21.9	21.4
Depreciation	1,133	1,373	1,484	1,656	1,950
Interest	9	55	159	164	189
Other Income	847	1,168	1,833	3,289	3,607
<b>PBT</b>	<b>8,387</b>	<b>11,402</b>	<b>15,566</b>	<b>19,671</b>	<b>24,496</b>
Tax	1,176	1,508	1,520	2,522	3,307
Rate (%)	14.0	13.2	9.8	12.8	13.5
<b>PAT</b>	<b>7,116</b>	<b>9,820</b>	<b>14,047</b>	<b>17,149</b>	<b>21,189</b>
Change (%)	37.0	38.0	43.0	22.1	23.6
Extra Ordinary Items	0	1,598	0	0	0
<b>Net Income</b>	<b>7,116</b>	<b>11,418</b>	<b>14,047</b>	<b>17,149</b>	<b>21,189</b>

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Share Capital	639	649	1,334	1,337	1,346
Preference Share Capital	910	910	455	455	455
Share Premium	8,917	10,292	13,216	13,553	14,624
Other Reserves	22,515	31,322	42,521	56,291	73,384
<b>Net Worth</b>	<b>32,981</b>	<b>43,173</b>	<b>57,526</b>	<b>71,636</b>	<b>89,809</b>
Minority Interest	0	42	0	0	0
Loans	189	1,027	1,479	1,000	750
Deferred Tax	-107	-46	-437	-1,367	-2,543
<b>Capital Employed</b>	<b>33,063</b>	<b>44,195</b>	<b>58,568</b>	<b>71,269</b>	<b>88,016</b>
Gross Block	10,142	13,172	15,054	18,554	22,554
Less : Depreciation	7,057	8,402	9,848	11,504	13,454
<b>Net Block</b>	<b>3,086</b>	<b>4,770</b>	<b>5,207</b>	<b>7,051</b>	<b>9,101</b>
CWIP	693	803	3,017	1,000	1,000
Investments	763	0	0	0	0
<b>Curr. Assets</b>	<b>32,900</b>	<b>45,752</b>	<b>60,292</b>	<b>76,352</b>	<b>95,933</b>
Debtors	7,805	11,684	17,432	20,362	26,893
Cash & Bank Balance	23,701	31,117	39,914	51,289	63,392
Loans & Advances	1,148	1,843	2,296	3,022	4,092
Other Current Assets	247	1,108	649	1,678	1,556
<b>Current Liab. &amp; Prov</b>	<b>4,379</b>	<b>7,130</b>	<b>9,947</b>	<b>13,133</b>	<b>18,018</b>
Creditors	1,720	3,323	4,174	4,477	6,746
Other Liabilities	763	1,047	1,571	1,753	2,559
Provisions	1,896	2,760	4,201	6,903	8,713
<b>Net Current Assets</b>	<b>28,522</b>	<b>38,622</b>	<b>50,345</b>	<b>63,218</b>	<b>77,915</b>
<b>Application of Funds</b>	<b>33,063</b>	<b>44,195</b>	<b>58,568</b>	<b>71,269</b>	<b>88,016</b>

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>11.1</b>	<b>15.1</b>	<b>21.5</b>	<b>25.7</b>	<b>31.5</b>
Cash EPS*	12.9	17.2	23.7	28.1	34.4
Book Value	516	66.5	87.8	107.1	133.5
DPS	2.5	3.5	3.5	4.2	5.2
Payout %(Incl.Div.Taxes)	22.4	23.3	16.5	16.5	16.5
<b>Valuation (x)</b>					
P/E		30.5	21.5	18.0	14.7
Cash P/E		26.8	19.5	16.4	13.4
EV/EBITDA		23.9	17.6	14.2	10.7
EV/Sales		5.8	4.2	3.1	2.3
Price/Book Value		6.9	5.3	4.3	3.5
Dividend Yield (%)		0.8	0.8	0.9	1.1
<b>Profitability Ratios (%)</b>					
RoE	23.9	25.8	27.9	26.6	26.2
RoCE	28.1	29.5	30.3	30.3	30.8
<b>Turnover Ratios</b>					
Debtors (Days)	81	75	72	72	72
Asset Turnover (x)	3.5	3.6	4.3	4.5	4.8
<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	2005	2006	2007	2008E	2009E
Cash Flow from Operations	7,350	10,128	15,704	14,749	18,545
Cash for Working Capital	-1,336	-2,605	-5,649	-1,768	-3,108
<b>Net Operating CF</b>	<b>6,015</b>	<b>7,523</b>	<b>10,054</b>	<b>12,981</b>	<b>15,436</b>
Net Purchase of FA	-1,854	-3,034	-4,089	-1,483	-4,000
Net Purchase of Invest.	1,797	2,584	2,130	3,289	3,607
<b>Net Cash from Invest.</b>	<b>-57</b>	<b>-451</b>	<b>-1,959</b>	<b>1,806</b>	<b>-393</b>
Equity and related items	1,122	1,399	3,016	341	1,080
Proceeds from LTB/STB	107	838	452	-479	-250
Dividend Payments	-1,732	-1,893	-2,766	-3,274	-3,772
<b>Net CF from Finan.</b>	<b>-502</b>	<b>343</b>	<b>702</b>	<b>-3,412</b>	<b>-2,942</b>
Free Cash Flow	4,161	4,489	5,966	11,498	11,436
<b>Net Cash Flow</b>	<b>5,455</b>	<b>7,416</b>	<b>8,797</b>	<b>11,375</b>	<b>12,102</b>
<b>Opening Cash Bal.</b>	<b>18,246</b>	<b>23,701</b>	<b>31,117</b>	<b>39,914</b>	<b>51,290</b>
Add: Net Cash	5,455	7,416	8,797	11,375	12,102
<b>Closing Cash Bal.</b>	<b>23,701</b>	<b>31,117</b>	<b>39,914</b>	<b>51,290</b>	<b>63,391</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 |
| 4. Investment Banking relationship with company covered | No |

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