

**Satyam Computer Services****Rs480**  
**OUTPERFORMER**

RESULT NOTE

Mkt Cap: Rs332bn; US\$8.2bn

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**Result:** Q1FY08

**Comment:** Volumes better than expected; exhausting operating levers

**Last report:** 4 July 2007 (Price Rs471; Recommendation: Outperformer)

## Key financials (consolidated)

Year to 31 March (Rs m)	Net Sales	yoy change (%)	Net profit	EPS (Rs.)	yoy chg (%)	PER (x)
2005	35,208	37.5	7,116	10.9	33.8	44.1
2006	47,926	36.1	11,427	14.7	35.0	32.7
2007	64,851	35.3	14,047	20.8	41.8	23.0
2008E	81,157	25.1	17,061	24.7	18.5	19.4
2009E	100,655	24.0	20,585	29.0	17.7	16.5

Satyam's Q1FY08 operational performance was strong with revenue growth in \$ terms at 10.6% qoq driven by volume growth of 9.5% qoq and pricing increase of about 1.1% qoq on a blended basis. Satyam's billing rates grew the highest in the last several quarters. But EBITDA margins declined by 60bp, though, in line with our expectation but aided by a huge jump of 520bp in utilization. Its offshore revenue share increased by 140bp to 51.6%, the highest among tier-1 companies. In our view, Satyam has utilized the available levers to near optimum levels, which increases the risk on margins, if the currency were to put further pressure. It raised its revenue (\$) guidance by 4% and EPS (\$) guidance by 0.8% but cut its EPS (Rs) guidance by 4.9%. It's USGAAP (\$) guidance implies a 30bp lower net margin assumption. While Satyam is seeing strong traction in volumes mainly by mining smaller clients (<\$10m), we believe, its margin assumption is still quite aggressive. We are raising our revenue forecast by about 1% for FY08 and leaving all other forecasts unchanged. We are building in higher volumes as we had already assumed pricing increases earlier but lower margins. At 19.4x FY08 and 16.5x FY09 earnings, we maintain Outperformer.

#### □ Revenue growth of 10.6% qoq (in USD terms) – Volume growth ahead of peers

Consolidated revenues grew 2.9% qoq to Rs18.3bn against our expectations of Rs18.14b. Satyam's IT services revenues grew 10.6% qoq in \$ terms and 2.9% qoq in Rupee terms. The growth was mainly led by offshore volume growth of 12.8% qoq and a 7.5% qoq growth in onsite volumes – overall volume growth of 9.5% was far ahead of Infosys, TCS and Wipro. Satyam witnessed significant uptick in prices; +1.46% qoq offshore and +1.31% qoq onsite.

Satyam's offshore revenue share rose to 51.96% , highest amongst peers, up from 50.62% in the previous quarter and 47% a year ago. This is despite the contribution of Consulting and Enterprise solutions practice, rising to 44.2% in Q1FY08 from 42.6% in Q4FY07 and 40.3% a year ago.

Satyam added 2,544 employees in Q1FY08 and about 10,750 people during last four quarters, a rise of 39% yoy in its employee base to 38,386.

### ❑ **EBITDA margins declined by 64bp sequentially**

Satyam's EBITDA margins declined 64bp qoq to 22.4% mainly on account of rupee appreciation (-230bp impact), visa costs (-100bp impact) and ESOP charges (-40bp impact). Subsidiaries reported losses at EBITDA level creating a drag of 31bp on margins. Higher billing rates (+85bp impact), offshorization (+60bp), better utilization (+520bp qoq to 76.54%, +45bp), and other operational improvements (+145bp) were margin levers during the quarter.

EBITDA remained flat qoq at Rs4.1bn, in line with our expectations.

### ❑ **PAT declined 3.9% qoq despite flat EBITDA**

PAT declined 3.9% qoq to Rs3.78bn (we expected Rs4.1bn) on account of lower other income (Rs632m v/s Rs704m in last quarter), marginally higher depreciation (+12bp qoq as a % of revenues) and higher effective tax rate (12.3% against 10.1% in last quarter). The company incurred translation losses of Rs960m while it gained Rs900m from hedging.

### ❑ **Subsidiaries reported losses even at EBITDA level**

Revenues from subsidiaries (combined) increased 1.4% qoq to Rs711m during the quarter, while the subsidiaries (combined impact) reported loss of Rs28m at EBITDA level.

Nipuna reported revenue decline of 3.3% qoq to Rs487m with net loss of Rs83m (highest loss in last 6 quarters) on account of rupee appreciation and salary hike.

Citisoft revenues increased 6.7% qoq to Rs231m and reported net profit of Rs6m (2.5% net margin).

### ❑ **Guided for 5.5-6% qoq growth in \$ terms for Q2FY08 – salary hike to impact Q2 margins**

The company has guided for 5.5-6% qoq revenue growth in \$ terms in Q2FY08 – expect 4.7-5.2% qoq growth in rupee terms with exchange rate of Rs40.5 (0.7% appreciation qoq). EPS is expected to decline 4.6-5.4% in rupee terms to Rs5.36-5.41 during Q2FY08 on account of wage hike.

### ❑ **Rupee terms FY08 EPS guidance cut by 5% - builds in 125bp yoy decline in EBITDA margins**

Satyam increased its \$ terms (US GAAP) FY08 revenue guidance by 4.2% to \$1.958-\$1.98bn (+34-35.5% yoy). However, the company has increased EPADS (\$ terms) by 0.8% to \$1.17-1.19 (+28.3-29.7% yoy) due to 2% equity dilution from ESOPs and an assumed 43bp decline in net margins against the 17bp decline considered earlier. The company now plans to add 15-16k employees (gross) during the year (14-15k additions guided earlier).

Despite increase in \$ terms revenue guidance the rupee terms revenue guidance for FY08 has been broadly maintained at earlier level (Rs78.53-79.42bn, a 21.1-22.5% yoy) as the exchange rate assumptions has been revised to Rs40.5/\$ from Rs42.3/\$ earlier, a 4.3% rupee appreciation assumed.

However, EPS guidance for FY08 in rupee terms has been cut by 4.9% to Rs24.14-24.46 (+12.5-14% yoy), as the new guidance builds in 111bp yoy decline in net margins (26bp decline assumed earlier) and 1.4% equity dilution.

Company has mentioned that it has built in 125bp yoy decline in EBITDA margins in FY08 guidance compared to earlier guidance of flat margins yoy on account of rupee appreciation (4.3% rupee appreciation). The company will witness margin headwinds of about 700-800bp on account of salary hike (16% offshore and 5% onsite with -350bp impact on margins), rupee appreciation (-300bp impact) and RSU charges. The company is confident of partly offsetting the adverse impact by way of productivity improvement, better utilization, offshorization, pricing increase and other operational levers.

## Revision in FY08 guidance (analysis of upper end of guidance)

	Old	New	Change
INR/US\$	42.30	40.50	(4.3)
<b>Rupee terms</b>			
Revenue (Rs m)	79,160	79,420	0.3
EPS (Rs)	25.73	24.46	(4.9)
Basic shares (m)	658	667	1.4
PAT (Rs m)	16,942	16,325	(3.6)
PAT margins (%)	21.4	20.6	(85bp)
yoy change (bp)	(26)	(111)	
<b>\$ terms</b>			
Revenue (\$ m)	1,900	1,980	4.2
EPS (\$)	1.18	1.19	0.8
Basic ADS (m)	326	333	2.0
PAT (\$ m)	385	396	2.8
PAT margins (%)	20.3	20.0	(27bp)
yoy change (bp)	(17)	(43)	

Source: Company, SSKI Research

## OTHER HIGHLIGHTS

- Net addition of 2,716 employees (3,978 gross adds of which 1,300 are freshers), taking the total headcount to 38,386. Attrition declined to 14.9% as against 15.7% in Q4FY07 and 19.62% in Q1FY07 (on TTM basis).
- In the quarter, 29 new customers were added, taking the number of active customers to 551.
- Onsite utilization remained broadly flat at 96.19%, while offshore utilization increased to 79.92% from 78.42% in last quarter. Offshore utilization with trainees increased by 520bp to 76.54%.
- Hedges increased to \$750m from \$460m at end of last quarter.
- Receivable days increased from 87 in the previous quarter to 90 in the quarter under review.

### □ Valuation and view

Satyam's Q1FY08 operational performance was very strong with highest volume growth in the sector and pricing increase of 1% qoq. Its volume growth of 9.7% qoq and pricing increase of 0.96% qoq was the highest in the last 9 quarters. In our view, Satyam is mining its smaller clients (<\$10m) and getting more offshore business. We believe, the EPS (Rs) guidance cut came as a negative surprise to the street as Satyam was expected to make up the impact of the currency through higher forex gains due to its relatively higher forward cover. Satyam has lowered its USGAAP (\$) net margin assumption by 30bp in its guidance. It has aggressively utilized most of its operating levers to limit the impact of the currency pressure. We are raising our revenue forecast marginally up to account for the volume surprise but maintaining our earnings forecast due to lower margin assumption. At 19.4x FY08E and 16.5x FY09E earnings, we maintain Outperformer.

## Earnings model (Indian GAAP Consolidated)

Year to 31 March (Rs m)	Q1FY07	Q2FY07	Q3FY07	Q4FY07	Q1FY08	FY07	FY08E
<b>Revenue</b>	<b>14,429</b>	<b>16,019</b>	<b>16,611</b>	<b>17,792</b>	<b>18,302</b>	<b>64,851</b>	<b>81,157</b>
Personnel expenses	8,323	9,827	9,674	10,763	11,062	38,586	50,520
Operating & admin exp	2,556	2,567	2,838	2,927	3,137	10,888	12,793
<b>EBITDA</b>	<b>3,550</b>	<b>3,625</b>	<b>4,100</b>	<b>4,102</b>	<b>4,103</b>	<b>15,377</b>	<b>17,844</b>
Interest	26	27	32	74	33	159.2	68.2
Other income	745	282	102	704	632	1,833	3,142
Depreciation	362	375	394	354	387	1,484	1,766
PBT	3,908	3,505	3,776	4,378	4,315	15,566	19,151
Provision for taxation	368	307	403	442	532	1,520	2,090
<b>PAT</b>	<b>3,540</b>	<b>3,198</b>	<b>3,372</b>	<b>3,936</b>	<b>3,783</b>	<b>14,046</b>	<b>17,061</b>
<b>yoy growth (%)</b>							
Revenues	36.3	38.7	31.3	35.4	26.8	35.3	25.1
EBIDTA	47.5	31.2	30.3	22.6	15.6	31.9	16.0
Profits	83.3	33.7	23.9	38.2	6.9	42.0	21.5
<b>qoq growth (%)</b>							
Revenues	9.8	11.0	3.7	7.1	2.9		
EBIDTA	6.1	2.1	13.1	0.1	0.0		
Profits	24.3	-9.7	5.4	16.7	-3.9		
<b>Margins (%)</b>							
EBITDA margin	24.6	22.6	24.7	23.1	22.4	23.7	22.0
Net margin	24.5	20.0	20.3	22.1	20.7	21.7	21.0

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2. Neutral: Within 0-10% to Index
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