Company report

TMT
IT Services
Equity – India

HSBC Global Research

Satyam Computer

FY08 guidance inline despite higher rupee assumptions; introducing FY10e estimates; maintain Overweight

- **Satyam management does not expect any slowdown in IT spending of its clients in the near term, which is inline with comments from other offshore vendors**
- **Better pricing, improved subsidiary performance, higher offshore contribution and scale efficiencies likely to offset margin impact of rupee, wage hike and stock grant in FY08e**
- **Satyam trades at 18x FY08e and 15x FY09e EPS for earnings growth of 23% and 20% respectively. Maintain Overweight and raise target price to INR575 (from INR530 previously)**

Overweight

Target price (INR)	575.00
Share price (INR)	476.35
Potential total return (%)	20.7

Mar	2007a	2008e	2009e
HSBC EPS	21.45	26.40	31.74
HSBC PE	22.2	18.0	15.0

Performance	1M	3M	12M
Absolute (%)	7.0	-2.6	9.3
Relative^ (%)	-2.2	-0.6	-5.3

Note: (V) = volatile (please see disclosure appendix)

23 April 2007

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Issuing office: Mumbai

Overview

Overall: Satyam reported better than expected Mar07 quarter results with its FY08e earnings guidance inline (+18-20% y-o-y) with expectations despite a rupee assumption of 6% y-o-y appreciation. Management expects EBIT margins to be stable in FY08e.

Positive on pricing: As mentioned in our note *Infosys: Pricing assumptions should help FY08 guidance*, dated 13 April 2007, comments from Satyam management also indicate that pricing continues to improve for both new and existing clients – for contracts that are renegotiated and even some not due for renegotiation (+ 2-3% yoy in FY08).

Mar2007 result highlights: Satyam reported strong (+7% q-o-q, +35% y-o-y) revenue growth for the Mar07 quarter. EBITDA margins were impacted by 1.5% rupee appreciation, and restricted stock unit (RSU) cost of INR160m led to flat EBITDA qoq. Higher other income (+144% q-o-q, +590% y-o-y) helped net profits at INR3.93bn (+17% q-o-q, +38% y-o-y). RSU charges were USD5.9m during the quarter and management expects it to be USD20m in FY08e.

Other highlights: Employee attrition declined substantially to 15.7% (LTM basis) and is only 13% in Q4FY07 on an annualised basis. Management plans to add 14,000-16,000 gross employees in FY08e. Any rupee depreciation may be an upside risk.

Financials: We expect revenues and profits to grow 29% and 26% in FY08e. Maintain Overweight and raise target price to INR575 (from INR530) due to estimates revision.

Index^	BOMBAY SE IDX
Index level	13897.41
RIC	SATY.BO
Bloomberg	SCS IN

Source: HSBC

Enterprise value (INRm)	264014
Free float (%)	84.3
Market cap (USDm)	7,552
Market cap (INRm)	315,396

Source: HSBC

HSBC

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	64,851	83,509	105,968	131,251
EBITDA	15,375	19,541	24,501	29,921
Depreciation & amortisation	-1,484	-1,742	-2,064	-2,561
Operating profit/EBIT	13,890	17,799	22,437	27,360
Net interest	1,513	-112	-112	-112
PBT	15,564	19,822	24,884	30,199
HSBC PBT	15,564	19,822	24,884	30,199
Taxation	-1,520	-2,193	-3,262	-6,125
Net profit	14,044	17,629	21,622	24,073
HSBC net profit	14,044	17,629	21,622	24,073
Cash flow summary (INRm)				
Cash flow from operations	12,605	17,591	21,848	28,117
Capex	-4,135	-4,609	-5,065	-6,486
Cash flow from investment	-4,135	-4,609	-5,065	-6,486
Dividends	-1,971	-2,297	-2,636	-2,988
Change in net debt	-8,347	-12,945	-16,771	-17,711
FCF equity	6,866	10,024	13,017	17,198
Balance sheet summary (INRm)				
Tangible fixed assets	8,223	11,091	14,092	18,016
Current assets	60,293	76,630	98,014	121,550
Cash & others	39,916	52,861	69,632	87,343
Total assets	68,953	88,230	112,700	140,259
Operating liabilities	5,745	6,534	8,102	10,029
Gross debt	1,479	1,479	1,479	1,479
Net debt	-38,437	-51,382	-68,153	-85,864
Shareholders funds	57,526	75,191	96,887	121,037
Invested capital	22,855	28,326	34,372	42,194

Ratio, growth and per share analysis

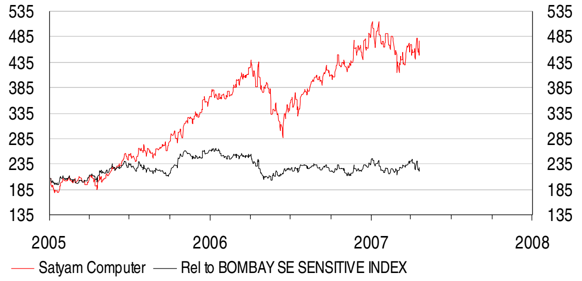
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	35.3	28.8	26.9	23.9
EBITDA	31.8	27.1	25.4	22.1
Operating profit	35.0	28.1	26.1	21.9
PBT	36.5	27.4	25.5	21.4
HSBC EPS	41.5	23.1	20.2	9.2
Ratios (%)				
Revenue/IC (x)	3.4	3.3	3.4	3.4
ROIC	64.8	61.9	62.2	57.0
ROE	27.9	26.6	25.1	22.1
ROA	23.6	22.6	21.6	19.1
EBITDA margin	23.7	23.4	23.1	22.8
Operating profit margin	21.4	21.3	21.2	20.8
Net debt/equity	-66.8	-68.3	-70.3	-70.9
Net debt/EBITDA (x)	-2.5	-2.6	-2.8	-2.9
Per share data (INR)				
EPS reported (fully diluted)	20.98	25.82	31.05	33.89
HSBC EPS (fully diluted)	21.45	26.40	31.74	34.65
DPS	3.50	4.00	4.50	5.00
NAV	87.86	112.59	142.24	174.21

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	4.3	3.2	2.3	1.7
EV/EBITDA	18.0	13.5	10.1	7.7
EV/IC	12.1	9.3	7.2	5.4
PE*	22.2	18.0	15.0	13.7
P/NAV	5.4	4.2	3.3	2.7
FCF yield (%)	2.2	3.2	4.1	5.5
Dividend yield (%)	0.7	0.8	0.9	1.0

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 20 Apr 2007

Disclaimer & Disclosures. This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, that form part of it.

Mar07 result takeaways

- Guidance assumes average exchange rate of INR42.3:USD1 for FY08e. Management expects 2-3% yoy price improvement in FY08 to help margins by 150-180bps
- We believe Satyam can maintain stable EBIT margins in FY08 and expect revenue and profit to grow by 29% and 26% y-o-y

Guidance assumptions

Higher average rupee rate (INR42.3)

Satyam's 18-20% y-o-y earnings growth guidance is inline with our estimates despite a higher rupee appreciation (c6% y-o-y) assumed by the management.

We believe Satyam is likely to report higher revenue growth than guided. Hence, despite its aggressive margin assumptions for FY2008e, we believe the management guidance on a full-year basis is achievable. Moreover, management has assumed an average rupee rate of INR42.3 in its guidance, which we view as conservative and which should provide some further cushion.

Satyam: Guidance for 1QFY08 and FY08e

INRm	Q108	Q208	Q308	Q408	FY08
Revenues	18,100	19,177	20,337	21,568	79,160
Growth (%)	1.7%	6.0%	6.1%	6.1%	22%
EPS	5.98	6.27	6.58	6.90	25.73
Growth (%)	0.0%	4.9%	4.9%	4.9%	20%
USD m	**Q108**	**Q208**	**Q308**	**Q408**	**FY08**
Revenues	434	460	488	517	1,900
Growth (%)	5.5%	6.1%	6.0%	6.0%	30%
EPADS	0.27	0.29	0.30	0.32	1.18
Growth (%)	3.7%	6.0%	6.0%	6.0%	29%

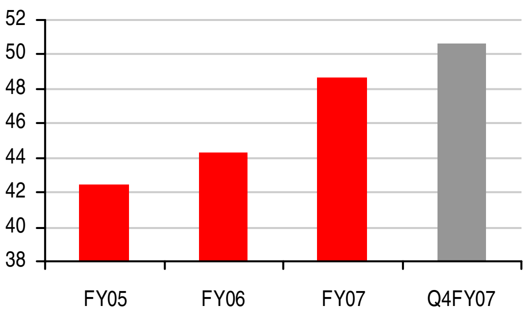
Source: Company, HSBC

Overall, despite assuming 6% rupee appreciation for its guidance, Satyam management guided to revenue and earnings growth of +22% y-o-y and +20% y-o-y respectively in FY08e (+30% y-o-y and +29% y-o-y respectively in USD terms). Management expects full-year margins to be stable compared with FY07.

Higher contribution from offshore

If Satyam maintains its contribution from offshore at Q4 levels then FY08 may see a +200bps shift towards offshore. A 1% shift towards offshore helps EBIT margins by 30-35bps, we estimate. We expect at least +70-80bps margin cushion from higher offshore contribution in FY08e.

Increasing contribution from Offshore (%)



Source: Company, HSBC

Pricing improvement of 2-3%y-o-y

Pricing improvement should help performance of Indian IT companies overall in FY2008e.

Satyam management expects pricing improvement to continue in FY08e and that this will cushion the negative impact of rupee appreciation on margins. We estimate a 1% pricing improvement should help EBIT margins by c40-50bps for Satyam.

Further, management expects to absorb the impact of offshore wage inflation at 16% y-o-y and onsite wage inflation at 5% y-o-y for FY2008e.

Better performance of subsidiaries

Subsidiaries and JVs accounted for 5.6% of revenues in Q4 for Satyam. Though at the net level they are still a drag on profits, at the EBITDA level subsidiaries had a positive contribution during the quarter.

Trends in subsidiary performance (INRm, %)

Revenues	Q4FY06	Q3FY07	Q4FY07
Nipuna	338	434	503
Citisoft	166	194	216
STI	26	18	11
China	60	103	86
CA Satyam*	31	26	18
Satyam Venture*	168	176	156
Total	**790**	**952**	**991**
% of total revs	*6.0%*	*5.7%*	*5.6%*
PAT	**Q4FY06**	**Q3FY07**	**Q4FY07**
Nipuna	(25)	-57	-10
Citisoft	7	-12	8
STI	2	0	-4
China	(15)	-19	-32
CA Satyam*	3	35	-1
Satyam Venture*	17	14	1
Total	**(11)**	**(38)**	**(38)**
% of total PAT	*-0.4%*	*-1.1%*	*-1.0%*

Source: Company, HSBC; * are JVs; subsd were EBITDA positive in FY07 and mgmt expects them to be net positive in FY08e

Management expects subsidiaries and JVs to contribute positively to net profits in FY08e.

Combined contribution from subsidiaries reported EBITDA of INR80m in FY07 compared with a loss of INR250m in FY06. At the net level, the loss declined from INR440m in FY06 to INR180m in FY07.

Satyam's BPO subsidiary Nipuna is expected by management to deliver revenues of USD61m (+60% y-o-y) in FY08e and turn profitable at the net level.

In FY07, Nipuna reported revenues of USD38m (+91% y-o-y) and was EBITDA positive. However, it made losses at the net level, dragging the company's profitability.

BPO performance: Trends in Nipuna

	FY07	FY08e
Revenues (USDm)	**38**	**61**
Growth	*91%*	*60%*
Profitability	-3.8m	To make net profit

Source: Company, HSBC; *Nipuna was EBITDA positive in FY07

Mar2007 results summary

Mar07 quarter revenues at INR17.8bn (+7% q-o-q, +35% y-o-y) were higher than our estimates. Cost of restricted stock units of INR160m and 1.5% rupee appreciation during the quarter led to EBITDA of INR4.1bn (flat q-o-q, +23% y-o-y).

Consolidated quarterly trends in profit and loss (INRm, %)

Yr to Mar 31	Q4 06	Q3 07	Q4 07
Total Revenues	**13,136**	**16,611**	**17,792**
% chg QoQ	3.8%	3.7%	7.1%
% chg YoY	35.2%	31.3%	35.4%
Total Cost of services	9,791	12,511	13,692
EBITDA	**3,345**	**4,100**	**4,102**
% chg QoQ	6.3%	13.1%	0.1%
% chg YoY	40.4%	30.3%	22.6%
EBITDA Margin (%)	*25.5%*	*24.7%*	*23.1%*
Depreciation	372	394	354
EBIT	**2,973**	**3,706**	**3,748**
% chg QoQ	6.0%	14.0%	1.1%
% chg YoY	42.8%	32.1%	26.1%
EBIT Margin (%)	*22.6%*	*22.3%*	*21.1%*
Finance Expenses	16	32	74
Total Non-op income	289	102	704
PBT	**3,246**	**3,776**	**4,378**
Tax	397	403	442
Effective tax rate (%)	12.2%	10.7%	10.1%
Net Profit	**2,848**	**3,372**	**3,936**
% chg QoQ	4.7%	5.5%	16.7%
% chg YoY	35.8%	23.9%	38.2%
Net Margin (%)	*21.7%*	*20.3%*	*22.1%*

Source: Company, HSBC

EBITDA margins were 23.1% (-160bps q-o-q, -240bps y-o-y). Net profit at INR3.9bn (+17% q-o-q, +38% y-o-y) was higher than our estimates and was also driven by higher other income during the quarter.

Though standalone EBITDA saw a sequential decline, better operating performance of subsidiaries and JVs helped cushion the impact of RSU grants to employees. For FY07, subsidiaries and JVs reported positive EBITDA on a consolidated basis and management expects them to contribute to net profits in FY08e. Management expects RSU cost to be USD20m in FY08e and USD13m in FY09e.

Satyam: Standalone profit and loss (INRm, %)

Yr to Mar 31	Q4 06	Q3 07	Q4 07
Total Revenues	**12,600**	**15,949**	**17,090**
% chg QoQ	3.1%	3.7%	7.2%
% chg YoY	32.2%	30.4%	35.6%
Total Cost of services	(9,244)	(11,859)	(13,019)
EBITDA	**3,355**	**4,089**	**4,072**
% chg QoQ	3.4%	14.4%	-0.4%
% chg YoY	37.9%	26.0%	21.4%
EBITDA Margin (%)	*26.6%*	*25.6%*	*23.8%*
Depreciation	(334)	(343)	(305)
% of Revenues	2.6%	2.2%	1.8%
EBIT	**3,022**	**3,746**	**3,767**
% chg QoQ	2.7%	15.4%	0.6%
% chg YoY	39.6%	27.3%	24.7%
EBIT Margin (%)	*24.0%*	*23.5%*	*22.0%*
Finance Expenses	(6)	(14)	(49)
Total Non-op income	276	97	694
PBT	**3,292**	**3,830**	**4,412**
Tax	(392)	(397)	(436)
Effective tax rate (%)	11.9%	10.4%	9.9%
Net Profit	**2,899**	**3,433**	**3,975**
% chg QoQ	1.1%	6.5%	15.8%
% chg YoY	36.0%	19.7%	37.1%
Net Margin (%)	*23.0%*	*21.5%*	*23.3%*

Source: Company, HSBC

Earnings forecast revision

Overall we are raising our profit estimates by 4-7% for FY08e and FY09e. Though we are raising our revenue estimates in USD terms, a higher appreciation of the rupee (-6% y-o-y) leads to marginally lower revenues in rupee terms for FY08-09e.

Management expects to maintain flat EBIT margins in FY08e and also expects the effective tax rate (as percent of PBT) to increase by c200bps each in FY08e and FY09e.

We are also adjusting for 2% dilution in share count due to ESOPS (employee stock options) in Q4FY07. Consequently we raise our earnings estimates by 2-3% for FY08-09e due to better margin assumptions and improved profitability of subsidiaries and JVs.

Earnings forecast revisions (INRm)

Revenues	FY08e	FY09e
Old	85,946	108,655
New	83,509	105,968
Change (%)	-2.8%	-2.5%
PAT	**FY08e**	**FY09e**
Old	17,048	20,239
New	17,707	21,651
Change (%)	3.9%	7.0%
EPS	**FY08e**	**FY09e**
Old	26.09	30.97
New	26.5	31.8
Change (%)	1.6%	2.6%

Source: HSBC

Valuation

We continue to rate Satyam shares Overweight with a new notional price target of INR575 based on a one-year rolling forward PE of 18x. Our target PE is derived from an analysis of the historical trading pattern of the stock and the range of its historical discount to Infosys shares.

Over the last three years, Satyam has traded in a one-year rolling forward PE range of 13-21x. At the current stage of its growth phase, we believe Satyam should trade towards the higher end of its historical trading range, and hence we apply a multiple of 18x to derive our target price. This translates to a 25% discount to our target multiple for Infosys.

Risks

These are the key risk factors that may prevent Satyam stock from achieving our target price:

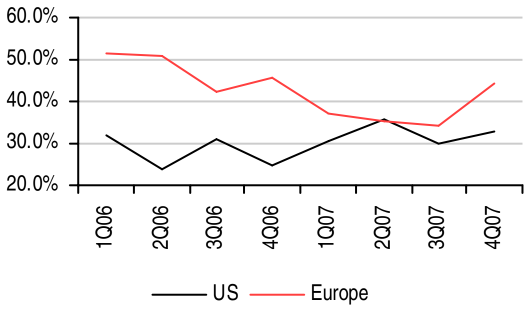
1) Any slowdown/uncertainty in IT spend in the US, which is the largest market for Indian IT services companies.

2) Any significant appreciation of the rupee vis-à-vis the dollar would be detrimental to margins of IT services companies.

3) Country risks, terrorist attacks and geopolitical risks may delay travel plans leading to disruption in flow of volumes.

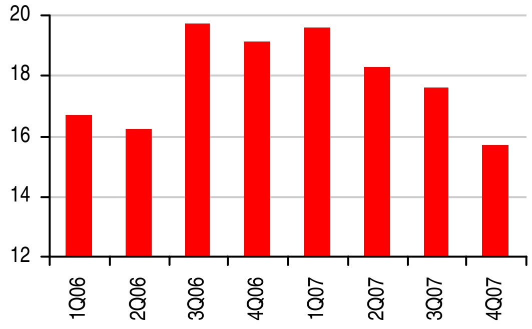
4) Any change in government policies on tax for offshore vendors could materially impact profitability.

Revenues: Trends in y-o-y growth in US and Europe



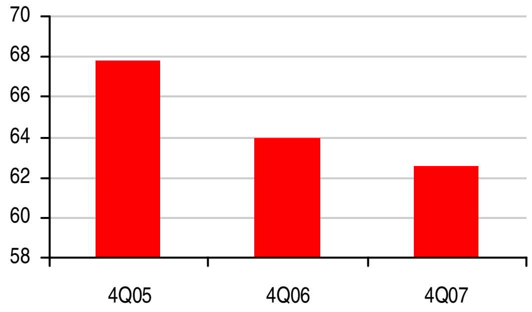
Source: Company, HSBC

Satyam: Trends in employee attrition (%)



Source: Company

Satyam: Declining contribution to revenue from US (%)



Source: Company

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the views expressed herein accurately reflect their personal view(s) about the subject security(ies) and issuer(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Vipin Khare

Important disclosures

Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

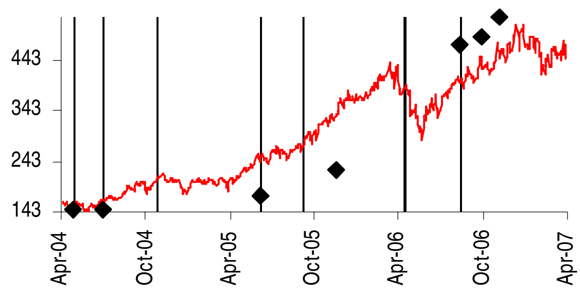
Rating distribution for long-term investment opportunities

As of 23 April 2007, the distribution of all ratings published is as follows:

Overweight (Buy)	44%	(15% of these provided with Investment Banking Services)
Neutral (Hold)	35%	(16% of these provided with Investment Banking Services)
Underweight (Sell)	21%	(12% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Satyam Computer Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Sell	Hold	17 May 2004
Hold	Reduce	22 July 2004
Reduce	N/R	15 November 2004
N/R	Overweight	30 June 2005
Overweight	Neutral	28 September 2005
Neutral	N/A	05 May 2006
N/A	Overweight	04 September 2006
Target Price	**Value**	**Date**
Price 1	145.00	17 May 2004
Price 2	145.00	22 July 2004
Price 3	N/R	15 November 2004
Price 4	175.00	30 June 2005
Price 5	225.00	07 December 2005
Price 6	475.00	04 September 2006
Price 7	490.00	20 October 2006
Price 8	530.00	29 November 2006

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
SATYAM COMPUTER	SATY.NS	476.35	20-Apr-2007	4

Source: HSBC

1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
3 At the time of publication of this report, HSBC is a market maker in securities issued by this company.
4 As of 31 March 2007 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
5 As of 28 February 2007, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
6 As of 28 February 2007, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking-securities related services.
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MICA (P) 137/08/2006

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