

Satyam Computer Services Ltd (Q1 FY09)

July 21, 2008

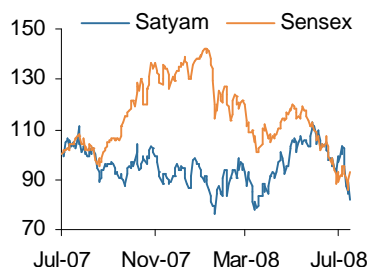
Stock data

Sensex:	13,635
CMP (Rs):	384
Target price (Rs):	445
Upside (%):	16.0
52 Week h/l (Rs):	544/305
Market cap (Rs cr)	25,881
6m Avg vol BSE&NSE ('000 nos):	4,282
No of o/s shares (mn):	675
FV (Rs):	2
Bloomberg code:	SCS IN
Reuters code:	SATY.BO
BSE code:	500376
NSE code:	SATYAMCOMP

Shareholding pattern

March 2008	(%)
Promoters	8.7
FII's	67.7
Indian institutions	13.9
Public & others	9.7

Share price trend



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- ↗ Revenue growth momentum halts; Satyam misses its Q1 FY09 guidance
- ↗ Material improvement in OPM for third consecutive quarter was surprising
- ↗ Net profit jumps 17.3% qoq; far ahead of expectations
- ↗ Q2 FY09 guidance is muted; employee addition remains modest
- ↗ FY09 rupee guidance revised for rupee depreciation but dollar guidance unchanged
- ↗ Multiple negatives already discounted in price; remain positive

Result table

Period	Q4 FY08	Q1 FY09	QoQ	YoY
(Rs mn)	(3)	(3)	(%)	(%)
Net sales	24,160	26,208	8.5	43.2
Total Expenditure	(18,654)	(19,886)	6.6	40.0
Operating Profit	5,507	6,323	14.8	54.1
OPM (%)	22.8	24.1	-	-
Depreciation	(435)	(467)	7.3	20.7
Interest	(46)	(57)	-	-
Other income	230	331	44.2	(47.6)
PBT	5,255	6,130	16.6	42.1
Tax	(587)	(653)	11.2	22.7
Pre-Exceptional PAT	4,669	5,477	17.3	44.8
Number of shares (Mn)	684.7	684.7	-	-
EPS (Rs) - quarterly	6.8	8.0	17.3	41.1

Source: Company, India Infoline Research

Revenue growth momentum halts; Satyam misses its Q1 FY09 guidance

Adjusted Q1 FY09 Revenue performance

Particulars	Q1 FY09	Q1 FY09 Adj	% qoq grth Adj	Guidance	Underperf %
Revenues (Rs mn) - Indian GAAP	26,208	24,690#	2.2	25,000-25,125	1.2-1.7
Revenues (US\$ mn) - US GAAP	637	624*	1.8	631.7-634.8	1.2-1.7
Re/\$	42.46	40.0	-	-	-

Source: Company, India Infoline Research

#Calculated at the guided rate of Rs40/\$

*Subtracted US\$13.5mn worth forex fluctuations arising out of US GAAP standards

Satyam reported a strong 8.5% qoq rupee growth aided by 6.7% rupee depreciation during the quarter. On comparing the actual revenues to the guidance after re-basing at Rs40 (assumed rate for Q1 guidance), it is clear that company has missed the guidance by 1.2-1.7%. Even the US GAAP revenue number adjusted for the forex fluctuation indicates a similar underperformance to the guidance. Further, it has to be noted that about ~US\$7mn (Rs332mn) revenue contribution came from Bridge Strategy Group, a company acquired during the quarter. The poor organic growth was utterly disappointing, as revenue growth expectations were the highest for Satyam.

Revenue growth blip came on the back of loss of animation business in Satyam BPO, which posted a 33% topline de-growth. A particular US-based animation customer abstained from renewing a sizeable contract on completion during the quarter. For the parent company, volume growth was 3% qoq while pricing remained soft.

Growth was broad-based amongst services and driven by TIMES and Retail verticals

Amongst the services, the growth was broad-based with all the four services growing above 8% qoq. TIMES and Retail verticals grew ahead of the company at 11% and 18.8% respectively. Growth in BFSI was at 6.7% qoq. Regionally, Japan grew by 10.6% qoq while US and Europe clocked more than 8% growth.

Material improvement in OPM for third consecutive quarter was surprising

OPM improved by 133bps qoq against our expectation of a flat margin. Over the past three quarters, OPM has improved by 423bps. The significant improvement in OPM in Q1 FY09 was despite a huge operating loss at Satyam BPO. The OPM of the parent company improved 210bps qoq aided by rupee depreciation, utilization improvement and cost optimization initiatives. Higher visa cost and soft pricing were the negatives.

Net profit jumps 17.3% qoq; far ahead of expectations

Other income was surprisingly higher 44% qoq due to lower than expected forex loss of Rs363mn reported by the company. This, along with marginally lower tax provision, led to a net profit jump of 17.3% qoq.

Employee addition remained modest; attrition drops again

Satyam added net 651 people during Q1 FY09 making it the second consecutive quarter of weak employee additions. Over the last two quarters, company added 1,773 employees, just 4% of its Q3 FY08 base. Though it reflects company's conscious efforts to improve utilization (up 470 bps from Q3 FY08) in part, it also indicates lower business volume in the near term. Satyam has done a tremendous job with respect to attrition over the last two years. It stood at 12.6% in Q1 FY09; significantly lower than 19.6% in Q1 FY07.

Q2 FY09 guidance is muted

Guidance for Q2 FY09

Particulars	Q2 FY09E	% qoq grth
Indian GAAP		
Revenues (Rs mn)	27430-27690	4.7-5.7
EPS (Rs) – Basic	7.7-7.8	(4.7-5.5)
US GAAP		
Revenues (US\$ mn)	645.6-651.9	3.5-4.5*
ADS (US\$)	0.35	(7.9)
Re/\$	42.88	1.0

Source: Company

*After adjusting Q1 FY09 revenues for US\$13.5mn worth forex fluctuations

For Q2 FY09, company has guided for ~3.7-4.7% qoq growth under Indian GAAP adjusted for the Re/\$ assumption, which is materially lower than expectations and that guided by Infosys. The EPS is expected to significantly decline qoq with material contraction in OPM. Effective 1st July 2008, company has implemented 12-14% offshore and 3-4% onsite salary hike.

FY09 rupee guidance revised for rupee depreciation but dollar guidance unchanged

Guidance for FY09

Particulars	New	% yoy grth	Old	Revision %
Indian GAAP				
Revenues (Rs bn)	111.8-113.6	32.0-34.1	105.0-106.7	6.5
EPS (Rs)	31.8-32.4	26.1-28.2	29.5-30.0	8.0
US GAAP				
Revenues (US\$ bn)	2.65-2.69	24.0-26.0	2.65-2.69	-
ADS (US\$)	1.45-1.48	16.0-18.4	1.44-1.47	-
Re/\$	42.78	-	40.00	7.0

Source: Company, India Infoline Research

As expected, post Infosys' results, Satyam did not revise its dollar guidance. The loss of animation business in the BPO in Q1 FY09 may have clipped any room for upward revision. Assuming that Satyam achieved the mid-point of its revenue and earnings guidance in Q2 FY09, the required Q3-Q4 FY09 CQGR are modest at 4.5% and 3% for revenues and earnings respectively. We believe that given the strong margin performance in Q1 FY09, there could be upsides to company's expectation of ~50bps higher OPM yoy. In FY09, Satyam plans to add 14,000-15,000 people on gross basis.

Multiple negatives already discounted in price; remain positive

We believe that at CMP Rs383 ie near 10x FY10 P/E, all the company-specific negatives and near term macro uncertainties are more than factored in. Given the management's confidence and modest required growth rates, we expect Satyam to meet the FY09 guidance without too much difficulty. Even in a conservative scenario in FY10, we expect company to deliver at least 10% earnings growth, which takes valuations near 10x P/E. Further, the stock has corrected the most since Infosys' results (by 20%). Remain positive (relative to the sector) on Satyam with a one-year target price of Rs445.

Projected financials

y/e Mar (Rs mm)	FY07	FY08	FY09E	FY10E
Revenues	64,851	84,735	112,622	134,731
yoy growth (%)	35.3	30.7	32.9	19.6
Operating Profit	15,377	18,348	25,946	29,574
OPM (%)	23.7	21.7	23.0	22.0
Pre-exceptional PAT	14,046	16,879	22,420	25,428
yoy growth (%)	43.0	20.2	32.8	13.4
EPS (Rs)	21.1	24.7	32.7	37.1
P/E (x)	18.2	15.6	11.7	10.3
P/BV (x)	4.4	3.7	2.9	2.3
EV/EBITDA (x)	15.3	12.3	9.2	7.2
ROE (%)	27.9	26.1	27.5	24.9
ROCE (%)	30.6	30.0	29.6	29.1

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