

Satyam delivered a much improved Q4 FY07 performance post the disappointing previous quarter. Sequential revenue growth was strong at 7.1% despite Rupee appreciation led by a mix of material volume growth and pricing improvements. Operating margin declined by more than expected 160 bps qoq impacted by RSU charge and Rupee appreciation. However, sequentially higher other income and lower depreciation led to a robust net profit growth of 16.7%. Company has guided for a muted Q1 FY08 and below expected FY08 revenues and earnings but has reiterated strength in business environment as its larger peers.

Key highlights of the quarter

Financials

Period	Growth			Growth			Growth			
	03/07	12/06	(%)	03/06	(%)	03/07	03/06	(%)	03/08E	(%)
(Rs mn)	(3)	(3)	qoq	(3)	yoy	(12)	(12)	yoy	(12)	(12)
Sales	17,792	16,611	7.1	13,136	35.4	64,851	47,926	35.3	82,826	27.7
Operating Profit	4,102	4,100	0.1	3,345	22.6	15,377	11,662	31.9	19,206	24.9
OPM (%)	23.1	24.7	-	25.5	-	23.7	24.3	-	23.2	-
Net Profit	3,936	3,372	16.7	2,847	38.3	14,047	9,819	43.1	17,506	24.6
NPM (%)	22.1	20.3	-	21.7	-	21.7	20.5	-	21.1	-
Equity	1,311	1,311	-	641	-	1,311	641	-	1,337	-
Annualized EPS (Rs)	24.0	20.6	16.7	17.4	38.3	21.4	15.0	43.1	26.2	22.2
P/E (x) at CMP Rs475	19.8	-	-	-	-	22.2	-	-	18.1	-

- ✓ In Dollar terms qoq revenue growth stood strong at 8.8% comprising 8.1% volume growth and 0.7% pricing growth. As the Rupee appreciation impacted Dollar topline growth by 1.7%, the Rupee based revenue growth was 7.1% qoq. Despite Rupee impact, company surpassed its guidance of 4-4.5% growth by a wide margin. In full year FY07, company recorded revenue growth of 35.3% led by 31% volume growth.
- ✓ Company witnessed strong pricing improvements on sequential basis at 0.7% offshore and 0.6% onsite. For the year, it witnessed pricing improvements of 1.2% onsite and 0.7% offshore. In the H2 FY07, company was able to fetch 3-5% improved pricing from new clients as well some improvements on many of the contracts that came up for renewal.
- ✓ The shift towards offshore further strengthened in the quarter making it the seventh successive one. Offshore contribution increased by 170 bps qoq to 50.6%, greater than onsite contribution for the first time. Offshore shift was driven by robust 10.9% growth in offshore revenues. Since Q1 FY06, offshore revenue share has increased by more than 600bps.
- ✓ In terms of service offerings non-ADM services viz Extended Engineering Solutions (7% of revenues), Consulting & Enterprise Business Solutions (42.6% of revenues) and Infrastructure Management (4% of revenues) grew faster than the company 10.7%, 8.6% and 9% respectively on sequential basis.
- ✓ The verticals of TIMES (21.8% of revenues), Health & Pharma (8% of revenues) and Retail (6.4% of revenues) recorded far above company growth rates of 12.8%, 13.2% and 14.6% respectively on sequential basis. BFSI qoq growth was low at 3.5% similar to that witnessed by some larger peers. Europe and ROW led sequential growth with 12% and 14.5% respectively while US registered a slow growth of 4.3% qoq.
- ✓ Growth in the quarter was driven by all the key large clients except the Top client. Top 5 and Top 10 client brackets grew by 10% and 13.6% respectively on qoq basis while the Top client revenues grew by just 3.5% qoq. Existing business grew by strong 10.8% sequentially.
- ✓ OPM declined by more than expected 160bps to 23.1% impacted 80-90 bps by a RSU charge of Rs160mn and 50-60 bps by Rupee appreciation. As a result, there was no growth in operating profit. For FY07, OPM was lower 60 bps yoy at 23.7%.

- ✓ Other income jumped significantly from Rs102mn to Rs704mn on sequential basis on account of positive forex gains of ~Rs40mn in the quarter against forex losses of ~Rs350mn in the previous quarter. Depreciation was lower 10.1% qoq at Rs354mn.
- ✓ Driven by higher other income and lower depreciation, net profit grew 16.7% on sequential basis. In FY07, net profit grew by 43.1%.
- ✓ In Q4 FY07, parent company added net 1,265 people and in FY07 it added 9,159 people, 34.5% of FY06 ending workforce. The attrition rate declined significantly yoy from 19.8% in FY06 to 15.7% in FY07. Annualized attrition rate for the quarter stood low at ~13%.
- ✓ Nipuna delivered strong performance growing revenues by 16% qoq and reducing net losses by 81% qoq. For FY07, it exceeded guidance of US\$37mn revenues by recording US\$38.3mn.
- ✓ In Q1 FY08, company expects 1.2-1.7% growth in revenues to Rs18.01-18.10bn and a flattish growth of -0.8-0% in EPS to Rs5.93-5.98. Management expects some margin improvement with salary hikes (planned 16% offshore & 5% onsite) being implemented only from July 1st 2007.
- ✓ For full year FY08, company expects 20-22% growth in revenues to Rs77.93-79.16bn and a relatively lower growth of 18-20% in EPS to Rs25.32-25.73. Management anticipates Rupee topline growth being impacted by ~6% lower Rupee rate realization while expects its negative impact on margin along with salary hike to be offset by higher pricing (~2% higher yoy), offshore shift, SG&A leverage, better subsidiary performance, employee mix changes, etc. The EPS guidance factors ~2% equity dilution on account of exercise of outstanding ESOPs. Company plans 14,000-15,000 gross additions in the year.

Outlook

Post factoring better than expected Q4 FY07 numbers and company's expectations about FY08, we revise our FY08 EPS estimate upwards by 1.6% to Rs26.2. We maintain 'Market Performer' rating on Satyam with a one-year price target of Rs576, representing 21.3% upside from current levels. The potential price upside is in line or lower than larger peers.

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