

Company Flash

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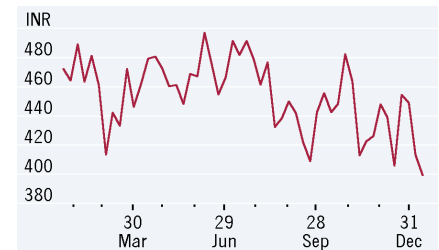
Satyam Computers Services (SATY.BO)

Buy: Strong 3QFY08 Results

- 3QFY08 results above expectations** — Satyam reported revenues of \$557.5m (Indian GAAP), up 10.5% qoq and EBITDA margin of 21.5% (as against 19.8% qoq) – both well above our expectations. Net profit came in at Rs4.35b (against our expectation of Rs4.2b) – up 6% qoq.
- Volumes; pricing continue to surprise positively** — Volume growth for the quarter was 9.4% qoq – significantly above what larger peers have reported. Pricing (both onsite and offshore) was up 2.3-2.4% qoq.
- US does well; BFSI muted** — Americas witnessed a growth of 14% qoq for Satyam, which is well above what peers have reported. BFSI growth was relatively muted at 4% qoq.
- Hiring strong; attrition comes down again** — Satyam had another strong quarter on hiring and added ~3,400 employees in the quarter (in IT Services). In the last four quarters, Satyam has added ~30% to its employee base. Attrition declined for the sixth quarter in a row to one of the lowest in industry - 13.1%.
- Pipeline solid; management confident** — Satyam won 4 large (\$50m+) deals in the quarter and indicated that they have 20 such deals in the pipeline. Management sounded very confident and indicated that deal activity was up ~50% yoy. 4Q guidance looks decent at 5.5-6% growth qoq.
- Satyam remains a top pick** — Satyam continues to outperform the industry and larger peers – in terms of reported numbers as well as employee metrics like hiring and attrition. Satyam has ~16% of its market cap as cash on books. Stock trades at 12x FY09E – remains one of our top picks in the sector.

Buy/Medium Risk	1M
Price (18 Jan 08)	Rs372.60
Target price	Rs565.00
Expected share price return	51.6%
Expected dividend yield	1.9%
Expected total return	53.5%
Market Cap	Rs249,528M US\$6,364M

Price Performance (RIC: SATY.BO, BB: SCS IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	9,979	15.09	36.9	24.7	5.6	26.2	0.9
2007A	14,047	20.81	38.0	17.9	4.3	27.9	0.9
2008E	16,906	24.69	18.6	15.1	3.6	26.7	1.9
2009E	20,410	29.80	20.7	12.5	3.0	27.0	2.7
2010E	22,101	32.27	8.3	11.5	2.6	24.9	3.2

Source: Powered by dataCentral

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Other Highlights

- Client metrics improved on several counts – Number of US\$1m+ clients increased to 220 (from 213 last quarter) while US\$10m+ clients improved to 49 from 40 last quarter.
- Top10 clients grew 9.5% qoq while non-Top10 clients grew 11.4% qoq. Top client contribution has come to 5.4% (lower than that of Infosys and TCS) – this used to be one of the biggest investor concerns some time back.
- For Satyam, package implementation is bigger than ADM revenue now. Also, offshore revenue share is significantly higher than onsite revenue share.
- Company announced that it plans to acquire Bridge Strategy Group (BSG) – US based strategy and management consulting company for US\$35m in all cash deal. Company would be paying US\$19m as upfront and rest would be paid as earn-outs over next 2.5 years. BSG has 36 consultants and has annual revenue of US\$17m.
- Nipuna revenue growth was sluggish at 1.2% qoq (US\$15.3m). Net margin declined further to negative 16% (from negative 8% in q2).
- Company has forex hedge of over US\$1b (accounting for ~75% of their net exposure over next 12 months).
- Company plans to list its existing ADS on NYSE Euro next.

Figure 1. Key Financials

Rs m	3Q07	2Q08	3Q08	QoQ	YoY
Revenue (US\$ m)	376	510	563	10.5%	49.9%
Revenue	16,611	20,317	21,956	8.1%	32.2%
Cost of revenue	9,681	13,034	13,813	6.0%	42.7%
Gross profit	6,930	7,283	8,142	11.8%	17.5%
Gross margin	41.7%	35.8%	37.1%	124bp	-463bp
Operating expenses	2,830	3,256	3,431	5.4%	21.2%
EBITDA	4,100	4,027	4,712	17.0%	14.9%
EBITDA margin	24.7%	19.8%	21.5%	164bp	-322bp
Depreciation and amortization	394	391	423	8.3%	7.5%
EBIT	3,706	3,636	4,289	17.9%	15.7%
EBIT margin	22.3%	17.9%	19.5%	164bp	-278bp
Other income	102	1,105	705	-36.2%	593.1%
Profit before tax	3,776	4,700	4,913	4.5%	30.1%
Income tax expense	403	609	576	-5.4%	42.9%
Net income for shareholders	3,372	4,091	4,336	6.0%	28.6%
EPS - basic	5.15	6.12	6.48	5.9%	25.9%
EPS - fully diluted	5.00	5.97	6.33	6.0%	26.7%

Source: Company Reports

Figure 2. Performance against Guidance

	Guidance		Actual	vs. guidance	
	Lower	Upper		Lower	Upper
Revenue (Rs m)	21,045	21,145	21,956	4.3%	3.8%
Revenue (\$ m)	538	541	563	4.6%	4.1%
EPS (Rs)	6.18	6.21	6.48	4.9%	4.4%

Source: Company Reports

Figure 3. 4QFY08 Guidance

	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	23,110	23,110	5.3%	5.3%
Revenue (\$ m)	594	597	5.6%	6.1%
EPS (Rs)	7.23	7.23	11.6%	11.6%

Source: Company Reports

Figure 4. FY08 Guidance Revision

	Guidance		Guidance - post 1Q08		Revision		Guidance - post 2Q08		Revision		Guidance - post 2Q08		Revision	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
Revenue (Rs m)	77,930	79,160	78,530	79,420	0.8%	0.3%	81,890	82,200	4.3%	3.5%	83,685	83,795	2.2%	1.9%
Revenue (\$ m)	1,870	1,900	1,958	1,980	4.7%	4.2%	2,068	2,076	5.6%	4.8%	2,119	2,122	2.5%	2.2%
EPS (Rs)	25.32	25.73	24.14	24.46	-4.7%	-4.9%	25.00	25.10	3.6%	2.6%	25.50	25.50	2.0%	1.6%
INR/USD rate		42.30		40.50		-4.3%		39.50		-2.5%		39.30		-0.5%

Source: Company Reports

Figure 5. Key HR and Execution Metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08
Total employee base	29,639	34,105	37,230	38,586	41,380	44,719	48,143
BPO services (Nipuna)	2,005	2,446	2,825	2,916	2,994	3,296	3,296
IT Services - parent only	27,634	31,659	34,405	35,670	38,386	41,423	44,847
Support	1,781	1,829	1,811	1,858	2,030	2,270	2,442
Delivery employees - total	25,853	29,830	32,594	33,812	36,356	39,153	42,405
- Onsite	5,967	6,428	6,551	7,073	7,635	8,949	8,961
- Offshore	18,831	21,835	25,007	25,269	27,600	29,222	32,421
- Domestic	1,055	1,567	1,036	1,470	1,121	982	1,023
Avg. realization (US\$ per hour)							
Onsite	56.07	56.32	56.52	56.87	57.62	58.89	60.28
- change	0.30%	0.45%	0.36%	0.62%	1.31%	2.21%	2.36%
Offshore	23.00	23.05	23.08	23.24	23.58	23.90	24.44
- change	0.18%	0.21%	0.12%	0.72%	1.46%	1.34%	2.27%
Utilization							
Onsite	97.03%	96.99%	96.76%	96.63%	96.19%	97.13%	96.80%
Offshore	79.56%	78.75%	77.60%	78.42%	79.92%	81.54%	83.71%
Offshore with trainees	71.24%	71.11%	68.49%	71.34%	76.54%	76.41%	78.21%
Attrition % (IT services)	19.62%	18.27%	17.62%	15.70%	14.90%	13.89%	13.11%

Source: Company Reports

Figure 6. Revenue Mix

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08
Geography wise							
North America	65.9%	65.9%	64.3%	62.6%	61.7%	58.4%	60.0%
Europe	17.6%	18.0%	19.0%	19.9%	20.1%	21.0%	20.5%
RoW	16.5%	16.1%	16.7%	17.6%	18.2%	20.6%	19.5%
Service line wise							
Development & Maintenance	48.5%	48.0%	47.3%	46.4%	43.7%	43.9%	44.0%
Package implementation	40.3%	40.4%	42.0%	42.6%	44.2%	45.0%	45.0%
Engineering services	6.0%	6.4%	6.8%	7.0%	7.2%	6.5%	6.8%
IMS	5.2%	5.2%	3.9%	4.0%	4.9%	4.5%	4.1%
Vertical wise							
BFSI	29.7%	28.6%	25.6%	24.7%	23.8%	23.8%	22.4%
Manufacturing	27.8%	26.7%	27.1%	27.2%	25.9%	23.7%	23.2%
TIMES	19.1%	20.4%	20.7%	21.8%	22.0%	23.5%	23.1%
Healthcare	6.5%	7.3%	7.6%	8.0%	8.0%	7.9%	8.0%
Retail & Transportation	5.4%	5.2%	6.0%	6.4%	6.9%	7.5%	9.1%
Others	11.5%	11.8%	13.0%	11.9%	13.5%	13.5%	14.2%

Source: Company Reports

Figure 7. Client Metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08
Client relationship							
Total active clients	489	504	523	538	551	577	598
New clients added	34	35	34	35	29	37	32
1+ mn USD Clients	142	154	164	180	190	213	220
5+ mn USD Clients	51	54	54	57	65	75	79
10+ mn USD Clients	33	32	32	35	36	40	49
Client concentration							
Top client	7.1%	6.7%	6.3%	6.1%	5.7%	5.8%	5.4%
Top 5 clients	22.7%	22.3%	21.6%	22.2%	21.1%	20.8%	20.7%
Top 10 clients	34.4%	33.9%	34.2%	36.3%	34.4%	33.9%	33.5%
Revenue from existing business	87.7%	86.1%	85.7%	88.7%	89.5%	93.1%	93.2%

Source: Company Reports

Satyam Computers Services

Company description

Satyam is the fourth-largest IT solutions provider from India and is one of the pioneers of offshore IT services delivery. The company has more than 570 clients across the globe and employs over 45,500 professionals across IT and BPO services. Satyam was an early entrant into IT consulting/package implantation work. As of 2Q FY08, ~45% of its revenue came from this service line. It has domain competencies in verticals such as Manufacturing, Banking & Financial Service and Insurance, among others.

Investment strategy

We rate Satyam as Buy/Medium Risk (1M). We believe offshore IT outsourcing is now a mainstream option and Satyam, which has achieved meaningful scale with its top-five position in India, appears well positioned to benefit from growing business volumes. Over the past several quarters, volume growth has

trended at over 9% qoq. With revenue of over US\$1.5bn, Satyam becomes a strong contender for winning large deals. It has won at least three large deals over the past four quarters. We expect a gradual margin decline (rather than steep), as wage inflation should be partly offset by positive leverage from a better onsite-offshore mix, hiring strategies and improved utilization. Overall, we forecast 24.6% revenue CAGR and 15.7% EPS CAGR over FY07-10E.

Valuation

Our 12-month target is Rs565, based on 19x FY09E earnings. We value Satyam on a historical P/E basis relative to its medium-term growth potential and cross-check its valuation relative to peer Infosys, which is the industry benchmark. Given that we expect Satyam's earnings to grow at a 16% CAGR over the next three years, we believe the stock should trade toward the upper end of its historical three-year trading range of 12-21x 12-month forward earnings. Satyam has traded at a 10-40% discount to Infosys in the past two years due to its slower growth rates. Our forward P/E equates to a ~17% discount to our target multiple for Infosys.

Risks

Although our quantitative risk-rating system suggests Low Risk for Satyam, we rate Satyam as Medium Risk given the similar risk ratings for other mid-sized IT peer-group companies in our coverage universe. The key downside risks that could impede the shares from reaching our target price include: (1) a slowdown in enterprise software license revenues; (2) the supply side situation becoming more difficult; (3) risks to earnings from a sharp US slowdown; (4) any significant appreciation of the rupee against the US Dollar/Euro/GBP; (5) a slowdown in the banking, financial services and insurance (BFSI) sector; and (6) limited H1B visa quotas.

Appendix A-1

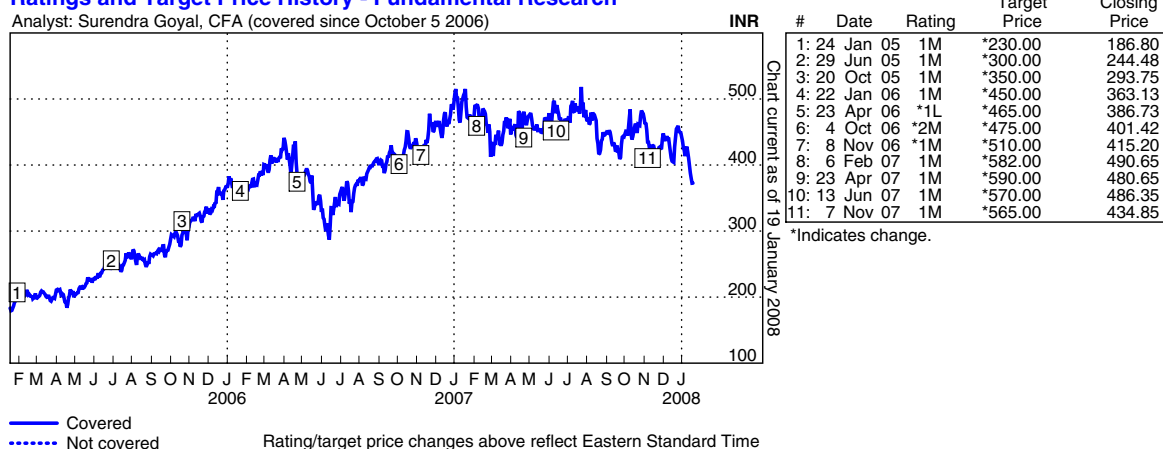
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Analyst: Surendra Goyal, CFA (covered since October 5 2006)



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