

## Company Flash

19 January 2007 | 8 pages

# Satyam Computers Services (SATY.BO)

## 3Q07 Results: Below Expectations

- Revenue growth of 7.8% (\$ terms)** — Satyam reported revenue growth of 7.8% qoq which was lower than our and street expectations. Pricing remained broadly stable – unlike peers. In Re terms, growth was 3.7%. Offshore volume growth was the silver lining – 11% growth in offshore volumes was very healthy; however overall volume growth was 7.5% broadly in line with peers.
- Personnel costs decline qoq** — Personnel costs declined 1.5% qoq, which was surprising considering that there was a good headcount increase in the quarter and utilization declined. It could be due to variable component of wages or lower leave encashment charge - we await more clarity on this in the earnings call.
- Margins expand but no RSU costs this quarter** — Margins expanded 200bp which is better than our expectations but partly because restricted stock units (RSU) were deferred to next quarter. As per the company guidance, we had factored in Rs. 180m (~120bp) of RSU related charges in the quarter.
- Forex loss skews reported profits** — Forex loss of ~Rs. 300m skewed reported net profits. Net profit at Rs.3.37b was broadly in line with our expectations adjusting for no RSU charge and forex losses.
- Guidance muted; in line with the past** — Revenue growth guidance of 4.6-5.1% (in \$ terms) is not particularly exciting, but in line with past trends. However, headcount growth was encouraging (9% growth qoq).
- Disappointing; in line with our street-low expectations** — All in all, a bit disappointing but in line with our expectations. Considering the decent run up the stock has had over the last couple of months, stock could see some correction.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (18 Jan 07)	Rs515.20
Target price	Rs510.00
Expected share price return	-1.0%
Expected dividend yield	0.8%
<b>Expected total return</b>	<b>-0.2%</b>
Market Cap	Rs338,685M US\$7,670M

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	7,116	11.02	36.1	46.8	10.0	23.9	0.5
2006A	9,979	15.09	36.9	34.2	7.7	26.2	0.7
2007E	13,878	20.57	36.3	25.0	6.1	28.3	0.8
2008E	16,670	24.72	20.2	20.8	5.0	27.2	1.0
2009E	19,753	29.29	18.5	17.6	4.1	26.2	1.2

Source: Powered by dataCentral

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See page 6 for Analyst Certification and important disclosures.

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Figure 1. Key Financials

	3Q06	2Q07	3Q07	QoQ	YoY
Revenue (US\$ m)	282	352	376	6.7%	33.3%
<b>Revenue</b>	<b>12,653</b>	<b>16,019</b>	<b>16,611</b>	<b>3.7%</b>	<b>31.3%</b>
Cost of revenue	7,381	9,831	9,681	-1.5%	31.2%
Gross profit	5,272	6,188	6,930	12.0%	31.5%
Gross margin	41.7%	38.6%	41.7%	309bp	5bp
Operating expenses	2,126	2,563	2,830	10.4%	33.1%
<b>EBITDA</b>	<b>3,146</b>	<b>3,625</b>	<b>4,100</b>	<b>13.1%</b>	<b>30.3%</b>
<b>EBITDA margin</b>	<b>24.9%</b>	<b>22.6%</b>	<b>24.7%</b>	<b>205bp</b>	<b>-18bp</b>
Depreciation and amortization	341	375	394	5.0%	15.5%
<b>EBIT</b>	<b>2,805</b>	<b>3,250</b>	<b>3,706</b>	<b>14.0%</b>	<b>32.1%</b>
<b>EBIT margin</b>	<b>22.2%</b>	<b>20.3%</b>	<b>22.3%</b>	<b>202bp</b>	<b>14bp</b>
Other income	330	282	102	-64.0%	-69.1%
Profit before tax	3,108	3,505	3,776	7.7%	21.5%
Income tax expense	386	307	403	31.5%	4.4%
Income from operations	2,722	3,198	3,372	5.4%	23.9%
Affiliates/Minority	-24	0	0	n.a.	n.a.
Net income - recurring	2,697	3,198	3,372	5.4%	25.0%
EO gain/(loss)	160	0	0	n.a.	n.a.
<b>Net income for shareholders</b>	<b>2,857</b>	<b>3,198</b>	<b>3,372</b>	<b>5.4%</b>	<b>18.0%</b>
EPS - basic	4.18	4.89	5.15	5.2%	23.1%
EPS - fully diluted	4.03	4.74	5.00	5.4%	24.1%

Source: Company Reports

Figure 2. Satyam 4Q07 guidance

4Q07 Guidance	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	17,280	17,360	4.0%	4.5%
Revenue (\$ m)	393	395	4.6%	5.1%
EPS (Rs)	5.42	5.42	5.3%	5.3%

Source: Company Reports

Figure 3. Satyam FY07 guidance

FY07 Guidance	Revised guidance		Guidance revision	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	64,340	64,420	-0.3%	-0.5%
Revenue (\$ m)	1,443	1,445	0.6%	0.3%
EPS (Rs)	20.90	20.90	-49.6%	-49.8%
INR/USD assumption		44.30		-2.2%

Source: Company Reports

Figure 4. Key HR and Execution Metrics

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Total employee base	22,117	24,155	25,071	28,276	29,639	34,105	37,230
BPO services (Nipuna)	1,612	1,673	1,639	1,765	2,005	2,446	2,825
IT Services - parent only	20,505	22,482	23,432	26,511	27,634	31,659	34,405
Support	1,482	1,592	1,642	1,710	1,781	1,829	1,811
Delivery employees - total	19,023	20,890	21,790	24,801	25,853	29,830	32,594
- Onsite	4,933	5,276	5,517	5,829	5,967	6,428	6,551
- Offshore	13,294	14,673	15,201	17,444	18,831	21,835	25,007
- Domestic	796	941	1,072	1,528	1,055	1,567	1,036
<b>Avg. realization (US\$ per hour)</b>							
Onsite	55.75	55.82	55.86	55.90	56.07	56.32	56.52
- change	0.13%	0.13%	0.07%	0.07%	0.30%	0.45%	0.36%
Offshore	22.89	22.92	22.93	22.96	23.00	23.05	23.08
- change	0.22%	0.16%	0.03%	0.13%	0.18%	0.21%	0.12%
Domestic	13.26	13.32	13.93	13.96	13.74	14.02	14.09
- change	1.38%	0.45%	4.58%	0.22%	-1.58%	2.04%	0.50%
<b>Utilization</b>							
Onsite	97.14%	96.98%	97.60%	97.77%	97.03%	96.99%	96.76%
Offshore	76.80%	79.43%	79.67%	79.91%	79.56%	78.75%	77.60%
Offshore with trainees	74.21%	74.70%	74.28%	72.19%	71.24%	71.11%	68.49%
<b>Attrition % (IT services)</b>	<b>16.68%</b>	<b>16.21%</b>	<b>17.98%</b>	<b>19.17%</b>	<b>19.62%</b>	<b>18.27%</b>	<b>17.62%</b>

Source: Company Reports

Figure 5. Revenue Mix

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
<b>Geography wise</b>							
North America	67.8%	66.8%	64.4%	63.9%	65.9%	65.9%	64.3%
Japan	1.5%	1.2%	1.2%	1.9%	1.1%	1.7%	1.7%
Europe	17.2%	18.3%	18.5%	18.6%	17.6%	18.0%	19.0%
RoW	13.6%	13.7%	15.9%	15.6%	15.4%	14.5%	15.1%
<b>Service line wise</b>							
Development & Maintenance	51.3%	50.1%	50.1%	50.7%	48.5%	48.0%	47.3%
Package implementation	37.4%	39.4%	39.4%	39.3%	40.3%	40.4%	42.0%
Engineering services	7.2%	6.6%	6.4%	6.4%	6.0%	6.4%	6.8%
IMS	4.2%	3.9%	4.1%	3.7%	5.2%	5.2%	3.9%
<b>Vertical wise</b>							
Manufacturing	28.8%	29.2%	27.6%	28.9%	27.8%	26.7%	27.1%
TIMES	19.4%	19.2%	18.5%	18.3%	19.1%	20.4%	20.7%
Healthcare	6.0%	5.6%	7.2%	6.2%	6.5%	7.3%	7.6%
Retail & Transportation	6.4%	5.4%	6.3%	5.1%	5.4%	5.2%	6.0%
Others	12.5%	11.9%	12.3%	12.7%	11.5%	11.8%	13.0%

Source: Company Reports

Figure 6. Key Client Metrics

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
<b>Client relationship</b>							
Total active clients	410	429	452	469	489	504	523
New clients added	31	32	35	22	34	35	34
1+ mn USD Clients	134	137	142	150	142	154	164
5+ mn USD Clients	38	43	49	46	51	54	54
10+ mn USD Clients	21	22	25	27	33	32	32
<b>Client concentration</b>							
Top client	9.9%	9.0%	9.4%	8.0%	7.1%	6.7%	6.3%
Top 5 clients	27.2%	25.7%	24.6%	24.3%	22.7%	22.3%	21.6%
Top 10 clients	39.4%	38.7%	36.8%	35.9%	34.4%	33.9%	34.2%
Revenue from existing business	91.9%	92.4%	92.1%	91.4%	87.7%	86.1%	85.7%

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 over 500 clients across the globe and employs over 34,000 professionals across IT and BPO services. Satyam was an early entrant into IT consulting/package implantation work. As of 2Q07, ~40% of its revenue comes from this service line. It has domain competencies in verticals such as Manufacturing, Banking & Financial Service and Insurance among others.

### Investment thesis

We rate Satyam Buy/Medium Risk (1M) with a target price of Rs510. 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 last several quarters, volume growth has trended at over 5% qoq.

With revenue over US\$1 billion, Satyam becomes a strong contender for winning large deals looking at leveraging offshore. It has won at least three large deals over the last four quarters. We expect gradual margin decline (rather than steep), as wage inflation should be partially offset by positive leverage from better onsite-offshore mix, fresher hiring and improved utilization. Overall, we forecast 31.8% revenue CAGR and 24.1% EPS CAGR over FY06-09E.

### Valuation

Our 12-month target is Rs510 based on 21x FY08E earnings. We value Satyam on a P/E basis relative to its medium-term growth potential and also on its valuation relative to peer Infosys, which is the industry benchmark. Given that we expect Satyam's earnings to grow at a 24% CAGR over the next three years - with upside risk to estimates given strong industry growth - we believe the stock could 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 lower growth rates. Our forward P/E is based on a ~25% discount to our target multiple of 28x for Infosys. Our Rs510 target price equates to a FY08E Price/Sales of 4x, which is within the historical trading range of 2-5x.

## Risk

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 sharp slowdown in the US economy; (6) A slowdown in the banking, financial services and insurance (BFSI) sector; and (7) limited H1B visa quotas.

## Infosys (INFY.BO - Rs2,219.75; 1L)

### Valuation

Our target price of Rs2,660 is based on a P/E of 28x on average FY08E-09E EPS. We forecast 34% earnings growth and upside potential from pricing improvement. The 28x multiple was also derived from a P/E band analysis of Infosys' trading pattern. During slowdowns in tech and offshore IT services, Infosys has traded at an average one-year rolling P/E of 25.1x with a low of 13x. Retrospectively, the average trading multiple of 25.1x is much lower because Infosys's earnings have consistently seen consensus upgrades on greater visibility and revisions in management guidance. At this stage of the growth cycle, we believe Infosys should trade in a band of 25-30x 12-month forward given the strong outlook for offshore IT services. Infosys has historically grown faster than the broader market (BSE Sensex) and traded at a premium of 40-135% (average of 84%) to the market. Our estimates continue to assume a P/E premium of 80% to the market; this is justified, in our view, given the strong FCF, ROIC and growth rates for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys's profitable track record and high earnings visibility.

### Risks

We rate Infosys shares as Low Risk, which is consistent with our quantitative risk-rating system that tracks historical share price volatility. The key downside risks to the shares reaching our target price include (1) any significant appreciation of the rupee against the US dollar/euro/pound; (2) pressure on billing rates (as Infosys continues to enjoy a 10-15% premium in its billing rates); (3) a sharp slowdown in the US economy; and (4) limited H1B visa quotas.

## Analyst Certification Appendix A-1

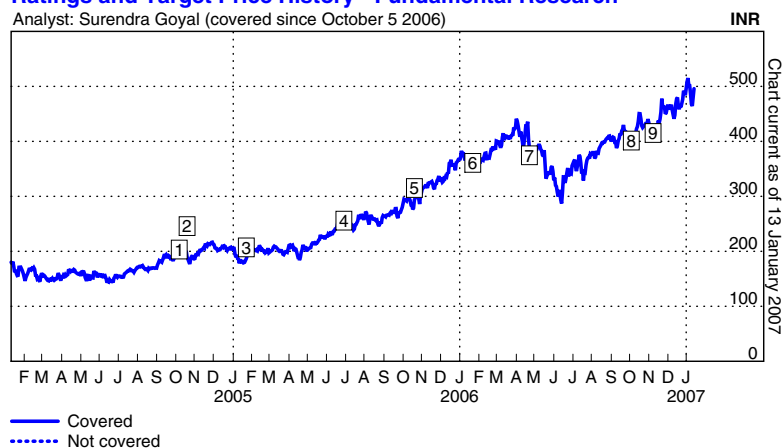
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#### Satyam Computers Services Ltd (SATY.BO)

##### Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)



#	Date	Rating	Target Price	Closing Price
1:	7 Oct 04	1M	*237.50	196.77
2:	20 Oct 04	1M	*242.50	189.77
3:	24 Jan 05	1M	*230.00	186.80
4:	29 Jun 05	1M	*300.00	244.48
5:	20 Oct 05	1M	*350.00	293.75
6:	22 Jan 06	1M	*450.00	363.13
7:	23 Apr 06	*1L	*465.00	386.73
8:	4 Oct 06	*2M	*475.00	401.42
9:	8 Nov 06	*1M	*510.00	415.20

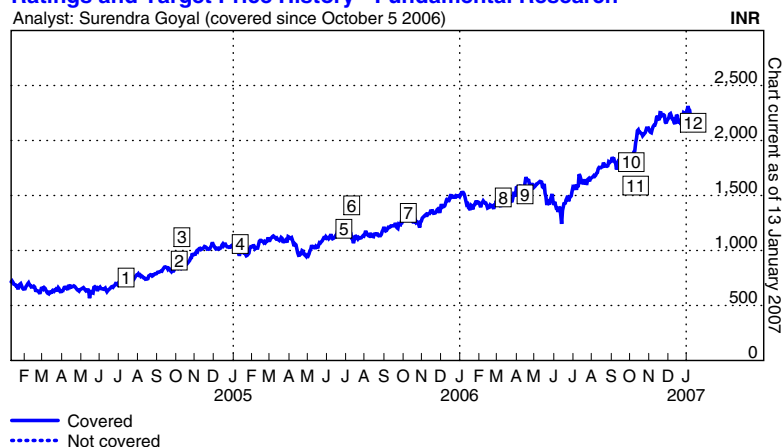
\*Indicates change.

Chart current as of 13 January 2007

#### Infosys Technologies Ltd (INFY.BO)

##### Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)



#	Date	Rating	Target Price	Closing Price
1:	14 Jul 04	*1M	*1,762.00	710.30
2:	7 Oct 04	1M	*2,050.00	852.42
3:	12 Oct 04	1M	*2,200.00	856.13
4:	13 Jan 05	1M	*2,400.00	982.70
5:	29 Jun 05	1M	*2,800.00	1,162.05
6:	12 Jul 05	1M	*2,700.00	1,109.97
7:	11 Oct 05	1M	*3,140.00	1,341.95
8:	12 Mar 06	*1L	*3,270.00	1,466.70
9:	16 Apr 06	1L	*3,475.00	1,615.15
10:	4 Oct 06	1L	*2,165.00	1,803.20
11:	11 Oct 06	1L	*2,340.00	1,981.35
12:	11 Jan 07	1L	*2,660.00	2,183.00

\*Indicates change.

Chart current as of 13 January 2007

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*Data current as of 31 December 2006*

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<i>% of companies in each rating category that are investment banking clients</i>	48%	50%	39%

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