

Satyam Computer

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,521	SCS IN
	REUTERS CODE
S&P CNX: 2,901	SATY.BO

20 January 2006

Buy
Rs743
Previous Recommendation: Buy

Equity Shares (m)	325.9
52-Week Range	775/349
1,6,12 Rel. Perf. (%)	2/18/53
M.Cap. (Rs b)	242.3
M.Cap. (US\$ b)	5.5

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	34,824	7,369	23.7	38.1	31.4	7.4	25.4	29.4	6.1	24.3
3/06E	48,328	10,083	31.1	31.5	23.9	6.0	27.9	32.2	4.3	17.6
3/07E	63,713	13,438	40.9	31.2	18.2	3.2	29.7	34.5	3.2	12.6

- Revenue of Rs12.6b was up 9.6% QoQ compared with our expectation of Rs12.7b. The revenue came in on the back of 6.3% higher volumes, led by the enterprise solutions, which grew 9.5% QoQ. Pricing remained stable during the quarter.
- Revenue from GE grew 14.8% QoQ, increasing the share of revenue to 9.4% from 8.95% in 2QFY06. Top 2-5 clients declined 0.7% during the quarter, while top 2-10 clients grew by a mere 0.8%. The non-top clients grew at a healthy 12.8% QoQ, as the client churn continues.
- The company added 35 clients during the quarter, the highest in a single quarter. Net employee addition this quarter, at 950 (690 freshers) staff, was healthy.
- EBITDA margin improved 93bp based on higher utilization and lower SG&A expenses. Forex gains of Rs26m, which boosted other income to Rs330m and the lower tax outgo resulted in net profit growing 13.8% to Rs2.7b. Satyam made a one-time profit of Rs1.6b, due to sale of its stake in Sify. This amounts to an EPS addition of Rs4.9.
- Management has given guidance for full-year revenue of Rs47.80b-Rs47.86b and EPS of 30.31-30.36 (up from Rs29.12-Rs29.23) and 4QFY06 revenue of Rs13.01-Rs13.07b, implying QoQ growth of 2.8%-3.3%. Given management's view that 4Q volume growth would be higher v/s 3QFY06, we believe the guidance is conservative. Consequently, we expect sequential growth of 7% to Rs13.5b. We expect Satyam to record revenue and net profit growth of 38.8% and 36.8% for FY06E and 31.8% and 33.3% for FY07E respectively. On an estimated EPS of Rs40.9 in FY07E, the stock trades at a PE of 18.2x. We maintain **Buy** with a price target of Rs820.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Revenues	7,799	8,621	9,074	9,715	10,587	11,550	12,653	13,538	35,208	48,328
Q-o-Q Change (%)	8.2	10.5	5.3	7.1	9.0	9.1	9.6	7.0	38.5	37.3
Direct Expenses	4,397	4,955	5,269	5,640	6,391	6,779	7,374	7,689	20,261	28,233
Sales, General & Admin. Expenses	1,460	1,538	1,575	1,692	1,789	2,007	2,133	2,371	6,266	8,300
Operating Profit	1,941	2,128	2,230	2,383	2,407	2,764	3,146	3,478	8,682	11,795
Margins (%)	24.9	24.7	24.6	24.5	22.7	23.9	24.9	25.7	24.7	24.4
Other Income	309	240	22	298	234	316	330	394	868	1,273
Depreciation	271	280	282	300	313	347	341	366	1,133	1,367
Interest	25	2	3	1	5	8	27	14	30	42
PBT bef. Extra-ordinary	1,954	2,085	1,968	2,380	2,323	2,725	3,108	3,492	8,387	11,659
Provision for Tax	301	304	289	283	392	333	386	454	1,176	1,547
Rate (%)	15.4	14.6	14.7	11.9	16.9	12.2	12.4	13.0	14.0	13.3
Share of Loss in Associate Companies	16	13	29	36	29	0	0	0	94	29
PAT bef. Extra-ordinary	1,637	1,769	1,649	2,062	1,902	2,392	2,722	3,038	7,117	10,083
Q-o-Q Change (%)	16.3	8.0	-6.8	25.0	-7.7	25.7	13.8	11.6	31.4	41.7

E: MOST Estimates

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Revenue up 9.6% on the back of 6.3% volume growth

Satyam reported revenue of Rs12.6b, up 9.6% QoQ, compared with expectations of Rs 12.7b. This arose on the back of 6.3% growth in volumes, led by its enterprise solutions business, which grew 9.5% QoQ. Engineering solutions grew 6.3%; while infrastructure services grew 15% QoQ. Nipuna, the BPO subsidiary, grew 22% QoQ to Rs220m. Pricing remained stable during the quarter.

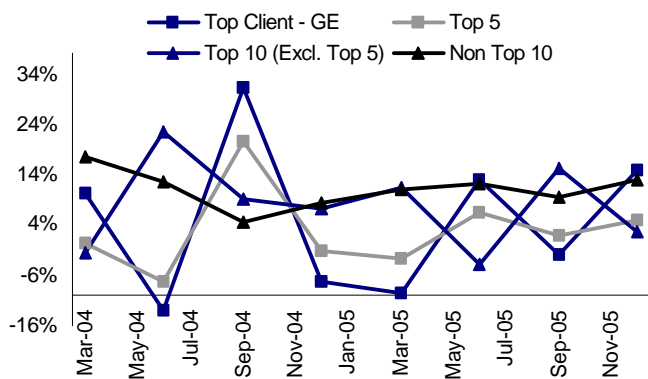
REVENUE COMPOSITION (RS M)

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Software develop.& mainten.	4,773	5,069	5,307	5,601	6,124
QoQ (%)	4.5	6.2	4.7	5.5	9.3
Consultng. & Enterp. busin.	3,146	3,402	3,866	4,403	4,822
QoQ (%)	4.7	8.1	13.6	13.9	9.5
Extended engineering solutn.	629	680	742	734	780
QoQ (%)	14.8	8.0	9.1	-1.0	6.3
Infrastructure mngmt.	365	382	430	435	500
QoQ (%)	0.4	4.9	12.6	1.0	15.1

Source: Company/Motilal Oswal Securities

Revenue from GE grew 14.8% QoQ, increasing the proportion of revenue to 9.4% from 8.95% in 2QFY06. Management has affirmed that GE would continue to form a significant proportion of revenue going forward. Top 2-5 clients declined 0.7% during the quarter, while top 2-10 clients grew by a mere 0.8%. The non top clients grew faster than the company average at 12.8% QoQ. We expect that the slow down in top clients would result in faster client churn in the coming quarters. The company added 35 clients during the quarter — highest in a single quarter.

REVENUE GROWTH FROM THE CLIENT



Source: Company/Motilal Oswal Securities

CLIENT CHURN (NOS)

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Gross Clients Added	28	28	31	31	35
Client Churning	13	10	11	12	12
Net Clients Added	15	18	20	19	23

Source: Company/Motilal Oswal Securities

Revenue from North America grew slower at 5.5% QoQ v/s rest of the world. Europe grew 10.3% QoQ, while Japan grew 11.3% QoQ and ROW grew 27.1% QoQ during the quarter. Going forward, we expect higher growth rates in Europe and ROW as compared to North America, in line with the company’s strategy of higher growth outside North America.

REVENUE BY GEOGRAPHY

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
North America	6,023	6,462	7,010	7,463	7,877
QoQ (%)	-0.3	7.3	8.5	6.5	5.5
Europe	1,588	1,611	1,779	2,049	2,259
QoQ (%)	17.0	1.4	10.4	15.2	10.3
Japan	98	231	152	134	149
QoQ (%)	-20.8	135.3	-34.1	-11.8	11.3
ROW	1,203	1,230	1,403	1,526	1,940
QoQ (%)	25.1	2.2	14.1	8.8	27.1

Source: Company/Motilal Oswal Securities

Margins up 93bp aided by higher offshore composition, lower SG&A

EBITDA margin improved 93bp due to higher offshore composition, greater utilization and lower SG&A expenses. Offshore composition of revenue went up to 45% from 44.2% in 2QFY06. Utilization levels were also marginally higher with 97.6% onsite utilization and 79.7% offshore utilization during the quarter, compared with 97% and 79.4% in 3QFY06. However, higher attrition at 18% lowered the expansion in gross margins and consequently, the margin expansion was lower than our expectation of 150bp.

MARGIN EXPANSION

	(BP)
Employee Costs	41
Traveling Expenses	-76
Other Development Exp	65
Marketing Expenses	2
Other Admin Expenses	61
Total Margin Expansion	93

Source: Company/Motilal Oswal Securities

Rs26m forex gain boosts other income

Satyam had forex gains of Rs26m during the quarter, which boosted other income to Rs330m. Tax outgo was also lower than expected at 12.4%, thereby improving net margin by 80bp and resulting in net profit of Rs2.7b 9as against expectation of Rs2.6b, up 13.8%QoQ. The company also had one-time profit due to sale of stake in Sify to the tune of Rs1.6b, which amounts to an EPS addition of Rs4.9.

EPS guidance revised to Rs30.31-Rs30.36

Management has given guidance for full year revenue of Rs47.80b-Rs47.86b from the earlier guidance of Rs47b-Rs47.18b. The corresponding EPS guidance has been revised to Rs30.31-Rs30.36 from Rs29.12-Rs29.23. The revenue guidance for 4QFY06 revenue is Rs13.01b-Rs13.07b, implying QoQ growth of 2.8%-3.3%.

Outlook and view

While 3QFY06 results were slightly below expectations in terms of revenue growth and margin expansion, operationally, the company has performed well with healthy client and employee additions. Given that management is on record that volume growth in 4QFY06 would be greater

than that in 3QFY06, we believe the guidance for 4QFY06 is conservative. We also believe that the margin expansion is sustainable as the company id still left with options for expansion such as onsite composition, utilization rates and SG&A expenses. Additionally, performance of subsidiaries and JV are expected to improve, which would have a beneficial impact on margins. For instance, Nipuna, which has losses of Rs98m during the quarter, is expected to achieve cash breakeven in 4QFY06.

The company has seen good business traction over the past few quarters, growing at over 9% sequentially for 3 successive quarters. Management is confident about the business momentum given that Satyam has been winning more and more contracts against big MNC players. Consulting & enterprise solutions, where the company has established itself as a dominant player, is also witnessing good traction and is expected to drive growth ahead. Consequently, we expect sequential growth of 7% to Rs13.5b. We expect Satyam to record revenue and net profit growth of 38.8% and 36.8% for FY06E and 31.8% and 33.3% for FY07E respectively. On an estimated EPS of Rs40.9 in FY07E, the stock trades at a PE of 18.2x. We maintain **Buy** with a price target of Rs820.

Satyam Computer: an investment profile

Company description

Satyam is the fourth largest Indian IT services company employing more than 19,000 people. It enjoys leadership position in the package implementation services segment and services 144 Fortune Global 500 clients. It services most of the top companies in every industry including GE, Ford, Merrill, DuPont, Cigna and Applied Materials.

Key investment arguments

- ✍ One of the largest beneficiaries of the current preference for offshore vendors by global clients.
- ✍ Orbit 5 initiative enabling company to improve processes and efficiency.
- ✍ Potential to get re-rated as investors are currently ignoring the qualitative changes in the company.

Key investment risks

- ✍ Frequent comparison with peers on qualitative aspects leads to dissatisfaction.
- ✍ Lacks innovation in managing cyclical trends in comparison to peers.
- ✍ Valuations are cheap yet expectations are high due to comparison with peers.

Recent developments

- ✍ Formed strategic alliance with eBaoTech to jointly promote new generation insurance package software solutions, which would add to its expertise in insurance package solutions in the Life and Non-Life sector
- ✍ Rated by Forrester Research as a leader among vendors in the consulting market

Valuation and view

- ✍ CAGR of 35% in sales and 34% in net profit over the next two years.
- ✍ Valuations at 18.2x FY07E offer room for upside
- ✍ **Buy** with a target price of Rs820, an upside of 10% from current levels.

Sector view

- ✍ Various CIO surveys indicate increasing share of offshore spending in IT budgets.
- ✍ Indian offshore vendors gaining market share in competition with MNCs.
- ✍ Prefer large companies as they win bulk of volumes while niche players benefit due to lack of competition.

COMPARATIVE VALUATIONS

		SATYAM	HCLT	PATNI
P/E (x)	FY06E	23.9	25.2	20.0
	FY07E	18.2	20.1	14.7
P/BV (x)	FY06E	6.0	4.8	3.8
	FY07E	4.8	4.6	3.1
EV/Sales (x)	FY06E	4.3	3.7	2.5
	FY07E	3.2	2.9	1.9
EV/EBITDA (x)	FY06E	17.6	16.8	12.7
	FY07E	12.6	13.0	9.0

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	14.1	14.4	15.7
Domestic Institutions	7.5	5.5	9.6
FII's/FDIs	73.6	74.8	68.5
Others	4.8	5.3	6.2

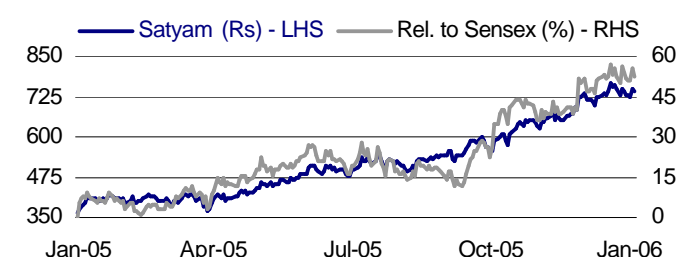
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	31.1	30.0	3.7
FY07	40.9	37.6	8.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
743	820	10.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Sales	25,415	34,824	48,328	63,713	80,912
Change (%)	25.6	37.0	38.8	318	27.0
Cost of Goods Sold	16,249	23,524	32,787	42,583	53,747
SG&A	2,241	2,511	3,746	5,060	6,346
EBITDA	6,926	8,788	11,795	16,070	20,819
% of Net Sales	27.3	25.2	24.4	25.2	25.7
Depreciation	1,116	1,070	1,367	1,784	2,266
Interest	7	6	53	32	16
Other Income	678	826	1,273	1,372	1,549
PBT	6,480	8,537	11,648	15,626	20,086
Tax	1,062	1,167	1,565	2,188	2,912
Rate (%)	16.4	13.7	13.4	14.0	14.5
PAT	5,418	7,369	10,083	13,438	17,174
Change (%)	17.8	36.0	36.8	33.3	27.8
Extra Ordinary Items	140	94	0	0	0
Net Income	5,558	7,464	10,083	13,438	17,174

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	633	639	639	639	639
Share Premium	8,251	8,922	8,922	8,922	8,922
Other Reserves	16,926	22,614	30,479	40,896	54,545
Net Worth	25,810	32,175	40,040	50,456	64,105
Loans	73	99	0	0	0
Capital Employed	25,882	32,273	40,040	50,456	64,105
Gross Block	8,472	9,377	16,377	22,377	29,377
Less : Depreciation	5,978	6,854	8,221	10,005	12,270
Net Block	2,494	2,523	7,156	12,372	17,107
CWIP	222	647	300	300	300
Investments	748	785	1,566	1,566	1,566
Curr. Assets	25,955	32,835	40,207	48,271	60,037
Debtors	5,928	7,652	9,930	12,568	15,961
Cash & Bank Balance	18,154	23,633	28,838	33,976	42,005
Loans & Advances	906	1,199	1,439	1,726	2,072
Current Liab. & Pro	3,536	4,516	9,190	12,053	14,904
Creditors	1,508	1,889	4,304	5,613	7,080
Other Liabilities	437	740	851	933	1,034
Provisions	1,591	1,887	4,035	5,508	6,791
Net Current Assets	22,419	28,319	31,017	36,218	45,133
Application of Funds	25,882	32,274	40,040	50,456	64,105

E: M O S t Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS*	17.2	23.7	31.1	40.9	51.4
Cash EPS*	20.7	26.4	35.4	46.3	58.2
Book Value	81.7	100.7	123.7	153.4	191.8
DPS	4.0	5.1	6.9	9.2	10.5
Payout %(Incl.Div.Taxes)	23.4	22.0	22.0	22.5	20.5
Valuation (x)					
P/E		31.4	23.9	18.2	14.5
Cash P/E		28.2	21.0	16.1	12.8
EV/EBITDA		24.3	17.6	12.6	9.3
EV/Sales		6.1	4.3	3.2	2.4
Price/Book Value		7.4	6.0	4.8	3.9
Dividend Yield (%)		0.7	0.9	12	14
Profitability Ratios (%)					
RoE	23.0	25.4	27.9	29.7	30.0
RoCE	27.3	29.4	32.2	34.5	35.1
Turnover Ratios					
Debtors (Days)	85	75	75	72	72
Asset Turnover (x)	3.0	3.7	3.1	2.8	2.8
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Cash Flow from Operatio	6,438	8,291	11,449	15,222	19,439
Cash for Working Capital	1,691	714	-2,268	350	1,232
Net Operating CF	4,748	7,577	13,717	14,872	18,207
Net Purchase of FA	-815	-1,330	-5,653	-7,000	-7,000
Net Purchase of Invest.	-32	28	-640	288	346
Net Cash from Inves	-846	-1,303	-6,293	-6,712	-6,655
Proceeds from Pvt. Plac	325	677	0	0	0
Proceeds from LTB/STB	-111	-73	0	0	0
Dividend Payments	-1,381	-1,399	-2,218	-3,022	-3,524
Net CF from Finan.	-1,166	-795	-2,218	-3,022	-3,524
Free Cash Flow	4,429	6,395	8,064	7,872	11,207
Net Cash Flow	2,736	5,479	5,205	5,138	8,028
Opening Cash Bal.	15,418	18,154	23,633	28,838	33,976
Add: Net Cash	2,736	5,479	5,205	5,138	8,028
Closing Cash Bal.	18,154	23,633	28,838	33,977	42,005

E: M O S t Estimates



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Satyam Computer

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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